A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, February 11, 1964, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Bopp
Mr. Clay
Mr. Daane
Mr. Irons
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Scanlon
Mr. Shepardson
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Hickman, Wayne, and Shuford, Alternate Members of the Federal Open Market Committee

Messrs. Ellis, Bryan, and Deming, Presidents of the Federal Reserve Banks of Boston, Atlanta, and Minneapolis, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hexter, Assistant General Counsel
Mr. Noyes, Economist
Messrs. Baughman, Brill, Eastburn, Garvy, Green, Holland, Koch, and Tow, Associate Economists
Mr. Stone, Manager, System Open Market Account

Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Fauver, Assistant to the Board of Governors
Mr. Broida, Assistant Secretary, Board of Governors
Mr. Wood, Associate Adviser, Division of International Finance, Board of Governors
Mr. Axilrod, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Mr. Hemmings, First Vice President, Federal Reserve Bank of San Francisco
Messrs. Sanford, Mann, Ratchford, Jones, and Parsons, Vice Presidents of the Federal Reserve Banks of New York, Cleveland, Richmond, St. Louis, and Minneapolis, respectively
Mr. Sternlight, Assistant Vice President, Federal Reserve Bank of New York
Mr. Brandt, Assistant Vice President, Federal Reserve Bank of Atlanta
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Runyon, Economist, Federal Reserve Bank of San Francisco

Before this meeting there had been distributed to the members of the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period January 28 through February 5, 1964, and a supplementary report covering the period February 6 through February 10, 1964. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Sanford commented that gold sales of at least $52 million were expected over the rest of the month, and with only $48 million in the Stabilization Fund, the Treasury was transferring $50 million from the gold stock to the Fund today. The Russians remained out of the gold market and private demand in the London gold market, while unspectacular, had until the last two days been large enough to absorb all new production coming onto the market. The United States received $23.4 million as a distribution from the gold pool.

On Thursday, the day when the gold stock reduction would be released to the press, the Treasury would be making the anticipated first drawing on the International Monetary Fund under the $500 million standby arrangement announced last July as part of President Kennedy's balance of payments package. The drawing would total $125 million, and it would be publicly announced.

As the Committee would recall, Mr. Sanford continued, the standby arrangement was made to meet the problem that arises when the Fund cannot accept dollars in repayment of foreign countries' repurchase obligations (because its dollar holdings would exceed 75 per cent of the U. S. quota). By drawing foreign currencies from the fund and selling them to those members making repayments to the Fund, the chance was reduced of their coming to the U. S. for gold to effect such repurchases. The $125 million of foreign currencies that the U. S. would be drawing was expected to be sufficient to match foreign countries' repayments to the Fund through the end of April. The largest repurchase now scheduled was one of $60 million equivalent by Canada, which would be announced at about the same time as the U. S. drawing.

Except for the German mark at the end of last week, Mr. Sanford observed, the foreign exchange markets had been fairly quiet during the past two weeks, with no particular pressure on the dollar. For almost two weeks until last Wednesday the strength of the German mark had temporarily abated, reflecting mainly the calming effects of the German Federal Bank's announcement on January 23 that it was not contemplating any new measures to deal with the German payments surplus. Last Thursday and Friday, however, the demand for marks again increased to the point where the German Federal Bank had to intervene. So far, the German authorities had felt able to hold for their own account the dollars they had picked up in the market, having in mind the reduction in their dollar holdings early in January when the German commercial banks had reversed their year-end window dressing operations. Nevertheless, with the possibility of a revival of speculation on mark revaluation and the prospect of a seasonal tightening of the German money market in March, the System might have to face the necessity of making fresh drawings on its mark swap to mop up part of Germany's dollar intake.

The Swiss franc market had retained the moderate ease it developed following the Swiss Government's announcements of proposed measures to curb the inflow of funds from abroad and to restrain the Swiss boom. However, the Swiss franc had not yet moved very far from the ceiling but with some further easing the System might be able to acquire some francs for the purpose of starting to repay its Swiss franc commitments. Today the Swiss franc was quoted at 4.323 to the dollar, as compared with the effective ceiling of 4.3150.

The liquidation of the System's guilder swap drawing had slowed down in this period, as the decline in the guilder rate and the Netherlands Bank's sales of dollars in the market came to a halt. The Account had been able to purchase only $4 million of guilders from the Netherlands Bank over and above the amount reported at the last meeting, and using

$1 million of its guilder balances, it reduced the swap drawing to $45 million from $50 million.

The Italian lira continued under pressure. During January the Bank of Italy had lost about $250 million, mainly reflecting large repayments of foreign indebtedness by Italian commercial banks. Italy's reserve decline was being cushioned by the second $50 million drawing on the System swap (mentioned at the last meeting) and by the purchase by the System of another $50 million lire which the System had sold forward to the Treasury. The Italians might be expected to need further assistance before too long, as the Bank of Italy had cashed in one-half of the U. S. Government certificates from the last drawing. The recently-formed Italian Government could ill afford the development of even a semblance of a speculative crisis, in view of the delicate political situation. Meanwhile, they were proceeding to reduce bank liquidity, both at home and abroad.

Sterling still had not shown the strength it usually exhibited at this time of the year. The discount on forward sterling, moreover, had widened slightly. The possibility that the markets might be beginning to react to the forthcoming British elections seemed to be getting stronger. The British Treasury bill rate had edged up in the last two weeks, but the widening of the discount on sterling had more than offset this increase. The covered arbitrage differential in terms of Treasury bills was now about 1/4 of 1 per cent in favor of New York. The differential in terms of other instruments--such as finance paper--remained slightly in favor of London, but selected banks reported that no funds were moving.

At the request of the Chairman, Mr. Sanford summarized Open Market Account operations in foreign currencies during the period January 28 through February 10. Operations which had been for value within this particular period, he said, were as follows: (1) the Bank of Italy drew $50 million under the $250 million swap arrangement with the System, thus making its outstanding drawings $100 million, (2) the Federal Reserve bought from the Bank of Italy a second $50 million of lire and immediately sold the lire for three-month forward delivery to the U. S. Treasury, bringing the total for this type of operation to $100 million; (3) the Bank of Italy had renewed for another three months its maturing $50 million swap drawing from the System, this being the first renewal; (4) the System reduced its swap drawing from the Netherlands Bank by $5 million to $45 million, using $4 million of guilders bought from the Netherlands Bank and $1 million from its balances; (5) the System paid off at maturity the remaining $5.5 million of outstanding drawings on the Bank of France, by use of francs previously bought forward, and the swap arrangement with the Bank of France was now completely on a standby basis; (6) a maturing $30 million swap drawing on the Swiss National Bank was rolled over for three months, this being the first renewal of that drawing; and (7) the swap arrangements with the Bank of Japan of $150 million, with the Bank of France of $100 million, and with the German Federal Bank of $250 million were all extended for three months.

Mr. Robertson asked whether the transaction in which the Account had acquired lire and sold them forward to the Treasury was undertaken at the Treasury's request, and Mr. Sanford replied that the transaction was made in cooperation with the Treasury. The lire would be used ultimately to repay the Treasury's outstanding lira-denominated bonds.

In response to questions by Mr. Mitchell, Mr. Sanford reported that Italy held about $200 million equivalent in lira-denominated U. S. Treasury bonds, and that the System had sold forward to the Treasury $100 million equivalent of lira. The Italians had drawn $100 million on the swap with the System, of which they had disbursed all but $25 million.

Mr. Daane asked what public announcements were planned of the prospective U. S. drawing from the IMF and what reaction to the drawing might be expected.

Mr. Sanford replied that a press release on Thursday of this week would explain that the drawing was a technical matter related to the announcement last July of the $500 million standby arrangement. The Canadians would be announcing the repayment of their debt to the Fund at about the same time. He would expect the foreign reaction to be favorable, as it was last July.

Mr. Mills asked whether the purpose of the debt to the Fund that the United States was assuming was to accommodate Canada and the Fund, and Mr. Sanford replied that in his judgment its purpose was to accommodate the U. S. In the alternative, a country desiring to make a repayment to the Fund might buy gold from this country, and the object was to avoid such gold losses.

Mr. Mills then asked whether it oversimplified the matter to say that countries that would otherwise be obliged to draw on the U. S gold stock in order to make payments in gold to the Fund were in a surplus position in dollars, so that the U. S. was accommodating both them and itself. Would that lead to a tendency among foreign countries to reduce their holdings of dollars by compelling the U. S. to draw increasingly on the Fund in this kind of arrangement?

In response, Mr. Sanford said that while it would appear to be to our advantage to draw in order to avoid gold losses, such drawings would be well within our control. Mr. Daane added that the arrangement was linked to debt repayments; countries could not arbitrarily pay sums into the Fund when they had no debt to the Fund.

Chairman Martin emphasized that all aspects of the proposed U. S. drawing from the Fund were confidential, and should be so treated by persons in the room.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period from January 28 through February 10, 1964, were approved, ratified, and confirmed.

Mr. Sanford stated that he had no recommendations to place before the Committee for consideration at this meeting.

Chairman Martin observed that what probably were the most important financial negotiations of the current period were now being conducted by deputies of the "Group of Ten," who had been meeting periodically since the Bank and Fund meetings in Washington last autumn. He noted that Mr. Daane had participated in these discussions at their outset as a representative of the Treasury Department, and was continuing to participate as a representative of the Federal Reserve. Central banks of the other countries also were represented. The Chairman invited Mr. Daane to comment on the status of the discussions.

Mr. Daane said that the most recent meeting of the group was held in Paris on January 24, 25, and 27. This meeting, like the earlier ones on which he had reported to the Committee in December, was exploratory, and was marked by frank expressions of individual views. In one session, led by Mr. Polak, there was extensive discussion of papers that had been submitted by the Fund on (1) the role of the Fund in the provision of international liquidity, (2) drawings on the gold tranche, and (3) the role of gold. In another session two papers presented by the OECD were considered, on the need for reserves and for international credit arrangements, and on the contribution of the long-term capital markets to the adjustment process.

A third session, Mr. Daane continued, was concerned with three papers by the BIS, which Mr. Gilbert presented. One of these was an interesting paper on the Euro-dollar market which was quite favorable to that market. It concluded with the following statement:

> The Euro-dollar market is today a substantial source of international credit. It brings many lenders and borrowers together on more favorable terms to both, and therefore more

> efficiently, than would otherwise be the case. Moreover, the impetus towards equalization of money rates which it has given has been useful, not only to individual lenders and borrowers, but in the broader context of international monetary equilibrium. Some observers have stressed certain adverse consequences which the market may have and it would seem that these observations have their element of truth. From the standpoint of official policy, however, it does not seem that the possible dangers of Euro-currency credit are of a different order from those of other movements of short-term funds. Maybe, because of its efficiency, the Euro-currency market has an exceptional potential for expansion which may create a special problem for monetary authorities in the future; but so far this does not seem to have been the case and on the whole it appears clear that the market has served a useful purpose.

Mr. Daane said that he and one or two others had challenged the favorable flavor of these conclusions. The second paper was largely descriptive, and concerned short-term arrangements between central banks and monetary authorities. The third paper dealt with laws and government regulations covering monetary reserves and private uses of gold. One questionable aspect of this paper was an interpretation that the System would be unable to acquire an adequate stock of foreign currencies because of the requirement for a 25 per cent gold cover on Federal Reserve liabilities. One-half of a day also was taken for discussion of proposals for a composite reserve unit. The French views were elaborated further, but there was some change in focus by the French representatives, who now clearly placed schemes of this sort in a more futuristic context, rather than describing them as something for today or tomorrow.

Another meeting of the same exploratory type would be held at the end of February, Mr. Daane continued, to discuss (1) papers that the participating countries had been invited to submit on the issues that in their judgment should be covered in the report to be presented to the Fund; (2) a joint United States-United Kingdom paper on the role of reserve currencies and the consequences for the international payments system of partial or total displacement of reserve currencies; and (3) a wide-ranging paper by Dr. Emminger of the German Federal Bank on the various radical reform proposals that had been advanced.

A 10-day negotiating session was to be held in Washington during April, in preparation for which the U. S. would have to determine its position. This would be a Government position, to be developed by an intra-Governmental group--the so-called "Long-Range International Payments Committee"--on which representatives of both the Board and the New York Bank sat in technical advisory capacities. The final U. S. Government position would be cleared at the top level of Government, in discussions at which the System presumably would be represented by the Chairman. There would be another session, possibly in May, to translate the April negotiations into a preliminary report to the June meeting of Ministers. The final report, Mr. Daane said, was to be made at the Tokyo meeting of the Fund in September.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering open market operations in U. S. Government securities and bankers' acceptances for the period January 28 through February 10, 1964. A copy of this report has been placed in the files of the Committee.

In supplementation of the written report, Mr. Stone commented as follows:

We have faced some rather interesting problems in conducting open market operations recently. During the past few weeks there has occurred the customary seasonal reduction in credit use that is the other side of the seasonal rise in December. The sharp seasonal increase in credit use in December of course upset the rough relationship that emerged earlier between free reserves of around $100 million on the one hand and the market tone and feel sought by the Committee on the other. Given the seasonal spurt in credit use, that tone and feel, and that free reserve level, could not occur together; they were no longer compatible. Since we could not maintain both the same feel and the same free reserve figures as earlier, we interpreted the directive as instructing us to maintain a steady feel. This meant permitting the free reserve figure to ride up to some extent while the use of credit was rising and was at its peak. Conducting operations with precise symmetry during the past few weeks of seasonal decline in credit use would have involved permitting the free reserve figure to ride down as far as necessary in order to maintain the kind of market conditions that prevailed in December and earlier. The difficulty with that approach, however, is that, in my view, it might very well have involved the publication of negative free reserve figures in one, or perhaps two, recent statement weeks. The Treasury, of course, has been in the market almost continuously for the past five weeks, and to have published a net borrowed reserve figure at any time during that period would have done injury to one or both of the major financing operations in which the Treasury was engaged. Such a result would hardly have been consistent with the maintenance of an even keel. We therefore frequently found ourselves on a tightrope during the recent period. A few more reserves might on occasion have produced significantly easier market conditions; at the same time, however, had somewhat fewer reserves been injected, we might have found ourselves publishing net borrowed reserves. The end result of our tightrope walking has been a money market that was rather steadily firm but with a smaller margin of unsatisfied demands for reserves that had to be met at the discount window. Thus, while the Federal funds rate was 3-1/2 per cent each day, member bank borrowings have recently averaged around $150 to $250 million, rather than the general $300-$400 million range that had prevailed earlier. The free reserve figures, meanwhile, have been subject to rather sizable retroactive upward revisions.

> During the past few days a closer relationship between the market atmosphere and the reserve statistics appears to have been reasserted--as one would expect to happen as the seasonal decline in credit use approaches an end.
>
> Turning briefly to the market, the Treasury's February refunding operation, announced two days after the last meeting, was given a favorable but quite uneventful reception by the market. Perhaps the most noteworthy feature of the financing was the $1.8 billion of subscriptions the Treasury received for the reopened 4 per cent notes of 1966. That issue was priced at par to yield 4 per cent--only 4 basis points above the yield on the 3-7/8 per cent notes, which mature a year earlier. By providing investors the alternative of the 1966 issue, the Treasury obtained some very inexpensive debt extension.
>
> The refunding took place against the background of a Treasury bond market that was moving up in price, partly in reflection of Treasury comments concerning long rates over the rest of the year. There also appears to have been some diversion of funds from corporate to Treasury bonds in view of the relatively narrow spread that has developed between yields on these obligations. The market is not altogether confident of current price levels, however; and yesterday, when a market letter discussed the possibility of some move in monetary policy over the next few weeks, there were signs of restiveness on the part of some dealers with sizable holdings of bonds acquired in the recent advance refunding.

Following this statement, Mr. Stone indicated that current reserve projections suggested that it might be appropriate to return the limitation on changes in the aggregate amount of U. S. Government securities held in the System Open Market Account between meetings of the Committee to $1 billion from the $1.5 billion that had recently prevailed.

Mr. Mills said he would like to direct a broad question not so much to Mr. Stone as to the Committee. Mr. Stone's discussion had brought out the fact that an even keel policy devoted to giving background assistance to Treasury financing had been followed recently, as was customary in similar situations. The presumption was that, if it had not been for the Treasury financing, free reserves would have been permitted to fall to a much lower level--in fact, to a negative position--despite the fact that the short-term rate structure had not changed appreciably. The question in his mind was whether the loyalty of the Committee and the System to the Treasury should outrank the allegiance owed to the general market, where over a protracted period there had been a level of positive free reserves of quite substantial size. If, when the Treasury's need for assistance had passed, the Committee should proceed to shrink the level of reserves rather materially, it would be going in the face of what the market could reasonably have expected to have been the trend in policy. If that should be the future course of events, it was possible that the market would develop a cynicism and skepticism about the good faith of the System that, instead of benefiting the Treasury, might harm their future financing programs.

Mr. Stone commented that, as he had indicated in his statement, there had appeared to be a closer relationship over the past three or four days between the market atmosphere, on the one hand, and the reserve statistics on the other. This was to be expected as the end of the seasonal decline in credit use approached. During the latter part of January, in particular, there had been a substantial decline in bank credit. As bank loans were repaid, banks in turn repaid discounts and made their excess reserves available in the Federal funds market, and the market generally had an easier tone.

Mr. Daane observed that there had been substantial upward revisions in preliminary free reserve figures in recent weeks, and Mr. Stone noted that such revisions had occurred in every week since the first of the year.

Mr. Mitchell commented that at the previous meeting of the Committee there had been a discussion of the desirability of letting signals come through from the market, but he noted that there had been only a 3-point fluctuation in the bill rate since then.

In response, Mr. Stone said that in the discussion at the previous meeting he had tried to indicate the variety of reasons for the recent narrow range of movements in the bill rate. One was that the market had been conditioned to narrower movements. Beyond that, and perhaps as important collectively, were recent structural changes in the market. For these reasons the bill rate no longer provided the kind of signals it previously gave, and fluctuations probably would continue to be smaller than in the past.

However, Mr. Stone said, the Desk was not without sensitive signals, of which the performance of the Federal funds market was perhaps the most sensitive. Recently, the Federal funds rate had stayed at or close to the discount rate. But over the past year and a half, the Desk had developed a new network of contacts that disclosed what was happening with respect to the volume of flows behind the relatively fixed Federal funds rate. Through the course of each day the Desk had information on the depth of bidding for Federal funds, and on the size of the supply of excess reserves available to the funds market; and it got confirmation of the impressions obtained from this information after the close each day from figures on funds transactions in the New York market that day. Figures on member bank borrowing which became accessible the next morning provided additional confirmation. The dealer lending rates posted by New York and out-of-town banks, and evidence on the ease or difficulty encountered by dealers in their efforts to get credit, also provided useful clues to market conditions. The indicators on which the Desk relied were more subtle than previously, but nevertheless were sensitive and useful.

Mr. Mitchell commented that such information might be very useful to the Desk, but the problem remained of how the Desk could tell what objectives the Committee wanted it to pursue. Mr. Stone had implied that his instructions were to keep the Federal funds rate at the discount rate, to keep the money market firm, and to keep free reserves at about $100 million. But these instructions were inconsistent by his own test, and he had to choose among them. The Committee, Mr. Mitchell said, should state what it wanted the Desk to do, and should not tell the Account Manager to make decisions for the Committee. Nor should the Desk use standards and guides that the Committee was not posted on.

Mr. Stone replied that the implication he had intended in his comment was that the market atmosphere and the free reserve figures prevailing before December were not compatible during December and January when there were sharp changes in the rate at which reserves were being utilized, but that the earlier relationship was now being re-established.

In his judgment, the Committee had made clear where it wanted the Desk to put the emphasis; the directive called for "maintaining about the same conditions in the money market as have prevailed in recent weeks." This instruction referred to market atmosphere.

Mr. Mitchell said that in following the criterion of market stability--and he agreed with Mr. Stone that that was about what the Committee had voted to instruct the Desk to do--the Desk in effect had given the Committee a small fluctuation in rate. If, because of structural changes in the market, small fluctuations should be expected to persist, it seemed to him that the Committee needed current intelligence on some of the measures available to the Desk.

Mr. Daane commented that the measures in question, specifically, the rates on and flows of Federal funds, were reported every morning in the 11 o'clock call. He personally decried interest rate rigidity, Mr. Daane continued, but since the last meeting he had talked with some leading dealers and had read Mr. Stone's statements in the minutes of that meeting. He thought Mr. Stone's analysis was correct. A major factor holding the bill rate within a narrow range was the development of the certificate of deposit market, and as long as that market functioned as at present, the bill rate probably would fluctuate within narrower limits.

In another comment, Mr. Daane said he thought it incorrect to pose the choice facing the Committee as between formulating policy in terms of a rigid bill rate or in terms of a reserve target. Both were wrong; it was necessary for the Desk to have some flexibility in trying to translate the feel of the Committee's wishes. The Desk had done that in a difficult period over the past two weeks.

Mr. Bopp observed that Mr. Stone got a general notion of the Committee's desires out of discussion around the table. The Committee members could not act as technicians, he said. The Account Manager had to have a degree of flexibility, and the Committee had to trust in the Account Manager's judgment.

To Mr. Robertson's question of whether the Federal funds rate was more sensitive than the bill rate, Mr. Stone replied that both were relatively fixed. When these rates were moving, the rapidity of their movements was a useful indicator; but when they were not moving, the volume of flows, the depth of demand, and the supplies of Federal funds constituted highly useful indicators. He added that the Desk was still learning how best to use information of these types.

Mr. Balderston asked what the Desk would do if the Committee came to the conclusion that the bill rate should fluctuate more than it had recently, and Mr. Stone replied that it would be extremely difficult to achieve that result. He noted that in the week before the last the Account had bought over $1/2 billion of bills in the market, and the rate had moved down only 1 or 2 basis points. About the only way the System could get the bill rate to move significantly--even by 5 or 10 basis points--would be to take some action indicating to the market that System policy was changing, such as raising the discount rate or publishing zero or net borrowed reserve figures for two or three weeks in a row. Such actions would change the level of rates, but would not necessarily result in a larger amplitude of fluctuation. He would not want to state categorically that gradual movements in rates were no longer possible, but it was true that large fluctuations were not likely.

Mr. Daane commented that, as he interpreted Mr. Stone's position, bill rate fluctuations were likely to be narrower than they had been in earlier periods, but could be wider than they had been during the past several weeks.

Chairman Martin observed that he thought the problem under discussion reflected the Committee's decision to deal in all sectors of the market, thus departing from the so-called "bills only" policy. The Committee had decided to change its policy in this regard for the sake of the advantages it thought would result. The Committee had discussed the matter for a long time, and had been aware of the likely consequences of its decision. In his judgment no purpose would be served by retracing those steps.

Mr. Stone said he would like to reiterate a point he had made at the last meeting: the bill market was not faltering; it was a broad, active, strong market. In a recent go-around in which the Desk had solicited offers of Treasury bills, dealers had offered a total of $1,083 million of bills at existing market quotations. There had been structural changes in the whole network of markets that had had the effect of reducing the amplitude of rate changes, but the bill market itself was an excellent one. That was why it had been able to accommodate the pressures for structural charges that had been impinging upon it.

Mr. Hickman commented that in the recent period free reserve figures had fluctuated erratically, and the bill rate had been sticky because of the structural changes Mr. Stone had mentioned. But figures on borrowed reserves had worked pretty well as an indicator in the past month and a half; when they were high, there was a tight feeling in the market. These figures might not always work as well as they had in this period, but perhaps their usefulness was worth further study.

Chairman Martin commented that there were various aspects to the idea of "depth, breadth, and resiliency." There was no doubt in his mind but that a "bills only" policy produced more depth, breadth, and resiliency in the market, particularly for longer term issues. But he also thought it would not be possible, under a "bills only" policy, to get results as effectively and efficiently in terms of managing the money market as were obtainable under the Committee's present method of operation.

Mr. Deming observed that free reserve figures were a less perfect guide in January and December than at other times of the year. This was partly because of imperfect seasonals, and partly because there was more churning in the market at that time. This fact, coupled with the Treasury financings this year, and with the series of upward revisions in the free reserve figures, had made free reserves a virtually useless primary guide recently.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period January 28 through February 10, 1964, were approved, ratified, and confirmed.

Chairman Martin then called for the staff economic and financial reports, supplementing the written reports that had been distributed prior to the meeting, copies of which have been placed in the files of the Committee.

Mr. Noyes commented on economic conditions as follows:

Early agreement on the tax bill now seems a virtual certainty. The Treasury has successfully completed its current financing program. We have in hand the results of the new McGraw-Hill plant and equipment expenditure survey. A basic reappraisal of the appropriateness of the current posture of monetary policy in the light of these developments would seem to be indicated.

With this in mind, I have reviewed the economic developments of recent weeks as carefully as I could to see if I could find in them any clues which would help evaluate the current posture of policy, or suggest that either greater or lesser ease would help contribute to the achievement of the broad goals of economic policy. My conclusion is that it is hard to fault monetary policy or the performance of the economy in either direction.

It is still true, as we are constantly reminded, that unemployment remains in the unacceptably high 5-1/2 per cent range. But we did get a gain in seasonally adjusted employment in January. In fact, most of the data that have become available seem to have moved in the "right" direction. That is, figures that seemed unreasonably high or low have changed down and up, respectively. December retail sales are an example, on one hand, and capital expenditure plans on the other. Industrial production, which has lagged since the middle of last year, appears to be picking up a little. Bank credit expansion, to borrow an example from the financial area, moderated in January after a period of rather vigorous growth. In these few weeks, at any rate, most of the movements have not only been in the direction, but very nearly of the magnitude that one might have hoped, had he specified his wishes in advance.

Perhaps a further word about the 9 per cent increase in plant and equipment spending in 1964 reported in the McGraw-Hill survey is in order in this connection. In my judgment, this is not an alarmingly high figure, but one more nearly in line with other observed developments in the economy and estimates of the future. Sensibly interpreted, it should not result in any higher estimates of business borrowing than were already contemplated. It is just about consistent with the Council of Economic Advisers GNP projection for the year, and with the forecasts of many business economists and financial analysts. Financial markets seem to have interpreted it in this way.

I find the subject of price developments most difficult, primarily because I have very little confidence in my own judgment in this area. I can plead in my defense, I think, that recent developments have been without precedent in the post-war period and may well be unique in this century. We are about to enter the fourth year of rather vigorous recovery and expansion with wholesale prices still at about the same levels that prevailed in the preceding recession. Beyond this, profit margins, far from being squeezed, seem to have improved a little, if anything. Thus, we find ourselves in a situation in which the experience of this generation, at least, is not of much help to us. There are some good reasons why we might expect upward price pressures in the year ahead, but they are not very different from the reasons why we might have expected such price developments in 1961, 1962, or 1963. It is hard to conclude that price movements of the last year, taken as a whole, or of recent weeks, can be fairly characterized as inflationary, nor is there a basis for forecasting, with any more certainty than one might have felt a year ago or two years ago, that a truly inflationary situation will emerge in the period ahead. Conventional cyclical analysis would have called for rising unit costs, impingement on profit margins and upward pressures on prices, in all but the very early stages of the recovery. Recent experience has not conformed to this pattern.

The big difference this year is that the economy will receive the additional stimulus of a large reduction in Federal taxes. This may provide just the additional stimulus needed to achieve a somewhat higher level of resource utilization without generating inflationary pressures; or it may create an excess of aggregate demand, putting prices under strong upward pressure; or finally, it conceivably could fail in its intended purpose and add very little to either consumer purchases or business spending.

In the absence of the uncertainties surrounding the impact of the tax cut, one could make a very strong case, I think, that the present posture of monetary policy is appropriate to the needs of the domestic economy. In the light of these uncertainties, one can only conclude that it may not be, but that the nature and degree of change needed, if any, depends heavily on one's guess as to the timing and magnitude of the impact of the tax cut on aggregate demand. It takes more confidence than I have in our measurement of multipliers and accelerators to predict that impact with assurance.

In the discussion following Mr. Noyes' statement, it was brought out that the latest McGraw-Hill survey indicated a gradual upward movement in plant and equipment expenditures over the successive quarters of 1964.

Mr. Holland made the following statement with regard to the financial situation:

The developments that have occurred since the last meeting of this Committee confirm the calmer financial performance that has followed the sharp year-end bulges in activity. Even the stock market, in advancing to new highs, has done so by means of fairly orderly and moderate moves, considering the rapidly improving likelihood of an early tax cut. Long-term debt markets have been firmer, with most rates declining slightly on balance. Short-term rates have moved narrowly around the levels reached late in December.

Our latest figures show that bank loans and investments declined by about one-half billion dollars more than usual in January, in sharp contrast to much stronger than seasonal increases in the last two months of 1963. Most loan categories showed only moderate January increases, seasonally adjusted, apart from a bulge in securities loans associated chiefly with Treasury financings. To make room for such loan expansion, banks returned to the position of being large net sellers of Government securities, chiefly shorter terms. Meanwhile, the average money supply has been boosted by a large year-end runup that has not yet been fully reversed; and by dint of aggressive merchandising efforts, especially in CDs, banks have increased their time deposit totals sharply.

Other savings institutions also indicate sizable recent net inflows, seasonally adjusted, most of which are quickly reinvested in longer term earning assets. The result has been an extension of the trend characteristic of most of this cyclical upswing--private liquidity growing moderately faster than the growth in real GNP, combined with decreasing liquidity of the intermediary financial institutions. Studying this development in retrospect, I think the recent growth in the liquidity of the nonfinancial sector should not appear either surprising or unnatural, when one considers such influences as the affluence of most of our society, the relative attractiveness of liquid financial investment compared with other outlets for funds, and the mounting totals of indebtedness to be serviced. But there is no gainsaying the fact that the larger liquid asset holdings in private hands provide the wherewithal for substantial step-ups in spending if that inclination should develop. On the other hand, since most of this liquidity is in nonmoney form it must be converted into demand deposits and currency to be spent and the banks will have to come to the Federal Reserve to cover the reserve needs thus generated. Furthermore, our financial institutions have moved into a position in which they seem quite vulnerable to a significant tightening in reserve availability, and thus are likely to be a good deal speedier and sharper transmitters of monetary pressure to both private borrowers and investors. In effect, we have sharper tools in hand, but a bigger job may be in prospect.

The question is often asked, "How much has the Federal Reserve contributed to this development?" The catalytic role of the increase in Regulation Q ceilings is, I think, clearly recognized. Less clear is the part that has been played by System actions to add to the reserve base. Partly, I am sure, this is because of the variety of reserve measures at hand and the often counterbalancing movements among them. I suppose at no time has this been more evident than over the six months or so since the last change in policy in July. Over this span, System open market operations have added net to nonborrowed reserves at only a 1.9 per cent annual rate, less than half the rate of the preceding half-year. Banks have borrowed a bit more in reserves from the discount window, however, so total reserves over this period are up at a 2.3 per cent rate. Loan demands and investment opportunities have been such as to lead banks to make more than proportionate use of these reserves, and therefore required reserves have moved up at a 3.2 annual rate. But two further factors have greatly helped banks to economize on their use of reserves to supply private credit and liquidity. One has been a large net transfer of deposits out of Government hands and into private hands, in amount sufficient to free the equivalent of a 3.3 per cent annual rate of accretion in reserves behind private demand deposits. The second has been the continued large public appetite for time deposits. With the low applicable reserve requirement on these deposits, even the 17.5 per cent annual rate of increase in reserves needed to back time deposits since July absorbed only about half the total available reserve funds. As a result, total reserves required behind private time and demand deposits combined showed an increase of 7.0 per cent annual rate after July 31. Accompanying the deposit expansion, total bank credit has grown by an 8.6 per cent annual rate.

Some observers may regard the rates of expansion of bank credit and private deposits over the past six months as greater than are likely to be desirable if long continued. But indications over the past four weeks suggest that market forces themselves are eliciting a less vigorous bank expansion. Signs of this can be seen in the more moderate bank loan demand, the return to substantial bank divestment of securities, and the January see-saw in money supply totals.

The chief exception to this rule appears to lie in heavy January bank sales of CDs. These sales have been large, and may even become larger for a time if banks endeavor to deal with greater reserve pressures by trying to buy liabilities rather than liquidate assets. Such a problem could be knotty, but it may lend itself more to treatment by means of a selective adjustment of the limitations of Regulation Q rather than the flexing of general monetary policy.

However the general thrust of policy is determined over the next few weeks and months, the question of operating instructions to the Desk is obviously a matter of continuing concern. I am led to observe that System efforts to loosen money market rigidities would probably have to involve a toleration of larger swings in the "feel" of the market and in bank borrowing, as well as larger ranges of permitted fluctuation in free reserves and in money market interest rates. In essence, this would mean System open market operations conducted with a view to offsetting somewhat less of the daily, weekly, and monthly reserve and money market fluctuations than has been usual.

Mr. Daane asked whether Mr. Holland, by his final observation, meant to suggest a redefinition of "even keel," since an even keel period had been and still was in effect and probably would extend beyond the February 17 payment date for the Treasury's refunding. Mr. Holland replied that he was abstracting from periods of Treasury financings. Mr. Ellis commented that this would imply that the difference in amplitudes of fluctuation in market statistics between periods of even keel and other periods would be increased. Mr. Noyes remarked that if the market were accustomed to wider movements, there could be larger fluctuations during even keel periods; bill rates had moved up and down by 5-10 basis points in such periods in the past, although the movements had not been predominantly in one direction. Chairman Martin observed that the nature of policy after the even keel period also was a factor.

Mr. Wood then read the following report, which had been prepared by Mr. Furth, on international developments and the U. S. balance of payments:

> The past two weeks have seen no substantial change in the trend of the international economy. Tentative weekly data indicate a deficit in U. S. international payments for the first five weeks of the year of only \$125 million, a rate slightly lower than that for the second half of 1963.
>
> Abroad, economic expansion continues, still combined with a payments surplus in most countries of continental Europe. The payments difficulties of Italy appear to have been eased; in January, its deficit, adjusted for the repayment of bank debts incurred last year, has hardly exceeded the normal seasonal range.
>
> In 1963, the Common Market countries had an aggregate payments surplus of \$1-1/2 billion. Robert Marjolin, a Vice President of the Common Market Commission, has predicted that these countries would have an aggregate deficit in 1964. But this widely publicized statement should be interpreted as nothing more than an attempt at defending the negative European policies under attack by U. S. critics--refusal to abandon agricultural protectionism; to grant adequate tariff concessions in the imminent "Kennedy round" of trade negotiations; to bear a more equitable share of defense and aid burdens; and to modify traditional anti-inflationary monetary policies that tend to increase the inflow of foreign capital into Europe. It is heartening, however, to find that Germany has taken the first modest steps toward reducing its interest-rate level, by offering bonds at 5-5/8 per cent rather than the usual 6 per cent yield.

At home, data that became available last week show both the composition of the U. S. payments deficit for 1963 and the way in which it was financed. These data make it possible to analyze the impact of recent improvements in the U. S. payments balance on the international liquidity position and thus on the international financial strength of the United States.

The conventional calculation of the U. S. balance is asymmetrical in that it regards an increase of liquid claims of foreigners against U. S. residents as increasing the deficit but does not regard an increase of liquid claims of U. S. residents against foreigners as reducing the deficit. For some analytical purposes it seems possible to take the position that--while there is in many cases a difference in the degree of liquidity--there is no difference in principle between a Canadian deposit with a U. S. bank and a U. S. deposit with a Canadian bank; between a German bank loan to a U. S. customer and a U. S. bank loan to a German customer; between Belgian acquisition of U. S. bonds and U. S. acquisition of Belgian bonds; and between the grant of U. S. assistance to a foreign nation and the receipt of repayments from the assisted country. There may be good reasons for differentiating between these payments and receipts for the purpose of calculating changes in primary liquidity but there seem to be no good reasons for doing so in calculating changes in the equally important secondary liquidity position of the United States.

If the U. S. payments deficit in recent years is adjusted in accordance with that view, the deficits for 1958, 1959, 1960, and 1962 remain disturbingly high. The deficit for 1961 is greatly reduced and the deficit for 1963 virtually disappears, being reduced to $200 million.

This computation is presented not to deprecate further measures to eliminate the "conventional" deficit but to assess the European complaints which assert that the United States has been financing extravagant expenditures by forcing dollar claims on unwilling foreign holders. The data show that the size of the deficit as conventionally calculated need not be interpreted as reflecting U. S. debts incurred to finance U. S. military and economic aid to foreigners and the acquisition of equities abroad by U. S. investors; rather, it may be interpreted as arising mainly because foreigners borrowed U. S. dollars, i.e., gave the United States claims on them, to the tune of $2-1/4 billion, taking in return half a billion in gold and roughly $2 billion in claims on the United States. Last year, in contrast to most previous years, the net borrower was not the United States; it was the rest of the world.

The weakness of the argument that the United States has been forcing dollar balances on unwilling holders may be demonstrated in another way. The deficit for last year, conventionally calculated, was $3 billion. Foreign authorities made debt prepayments of half a billion, took another half a billion in gold, as just mentioned, and an additional half a billion in nonmarketable securities denominated in foreign currencies. This left $1-1/2 billion to be financed by an increase in foreign dollar holdings. International institutions reduced their dollar holdings by $200 million, but foreign authorities increased theirs by $900 million, and foreign private bankers, merchants, and investors by $800 million. About half of the $900 million increase in official dollar holdings accrued to less developed countries, which presumably were willing recipients of these assets. Similarly, the net increase of $800 million in foreign private dollar holdings was voluntary; the attitude of the international market toward the dollar is shown by the fact that private foreigners reduced holdings of "covered" dollars by $200 million and increased holdings of "uncovered" dollars by $1 billion. Thus, if there was any involuntary increase in foreign dollar holdings; it must have been confined to the increased in dollar holdings of the "Group of Ten," other than the United States, amounting to less than half a billion dollars. Clearly, the conversion of that amount into gold would have been tolerable, and might have been a small price to pay for putting a stop to the complaints of some members of the Group about the sacrifices they are making in supporting the allegedly weak dollar and permitting it temporarily to remain an international reserve asset.

If the tentative deficit figures of January and early February are confirmed by the final reports, these complaints may soon be replaced by demands for larger outflows of dollars. In the meantime, the forthcoming U. S. drawing on the IMF might well have adverse psychological repercussions. It therefore is particularly important at this time to improve understanding of monetary reality among public as well as private members of the international financial community by pointing out those recent developments in the U. S. payments deficit and its financing which seem to have escaped their, and perhaps our own, attention.

Chairman Martin then called for the usual go-around of comments and views on economic and monetary policy beginning with Mr. Treiber, who commented as follows:

This month marks three full years of business expansion. The business situation continues to be good, and business sentiment is buoyant. The economy's present momentum, the absence of speculative inventory accumulation, and the stimulus of a prospective tax cut support the expectation of another year of business expansion.

Since the last meeting of the Committee there have been no significant changes with respect to employment or prices. The leveling off of bank credit expansion in January in contrast to large increases in preceding months does not necessarily indicate any significant change in the underlying trend of loan demand. But it does indicate the possibility of a slowdown in the rate of bank credit expansion. There has been little change in bank liquidity ratios. Broadly speaking, there is plenty of bank liquidity and nonbank liquidity.

Over the last three years we have had relatively stable prices. More recently, however, price developments have been mixed and industrial materials prices have risen moderately. Continuation of a reasonable degree of price stability cannot be taken for granted. Further gains in business activity will tend to reduce excess manufacturing capacity and make the economy more vulnerable to demand pressures. The trucking industry and the teamsters' union have agreed on a nationwide contract, with wage increases and fringe benefits costing about 4 per cent a year over the next three years. There are indications that other labor unions, such as the United Auto Workers, will press for substantial wage increases, citing large increases in productivity and large profits in their particular industries. While large wage increases in industries that have had above average increases in productivity may be absorbed without increases in prices in those industries, the large wage increases are likely to foster corresponding wage increases elsewhere and to push up wages generally faster than the increase in over-all productivity. The consequence could be a cost-push on prices.

Prospects for further general price stability depend on such underlying elements as world market trends in primary products, and movements in the rate of capacity utilization, in productivity, and in wages and salaries. Price stability is required not only to protect the domestic purchasing power of the dollar but also to strengthen the international competitiveness of the United States and thus improve our balance of payments.

The most recent balance of payments figures are encouraging. Favorable factors in January included the absence of any new foreign security issues, a relatively small build up in liabilities to foreign branches of U. S. banks and to the foreign offices of

Canadian bank agencies, and the after effects on payments of the December jump in our export surplus. But one or two swallows don't make a summer. It remains to be seen to what extent the current favorable situation will continue. Part of the improvement probably reflects a continuing gain in our international competitive position. Part reflects additional exports financed by the U. S. Government in one way or another. Can we keep down or reduce our unit costs at home? We can't rely on further price increases abroad to improve our competitive position. Some European countries recently have undertaken steps to curtail their domestic price rises. Such steps also could attract capital outflows from the United States. Regardless of the effect of monetary action taken by foreign countries, we know that foreign security issues in the United States are going to rise in the next few months. The balance of payments must continue to have high priority in our thinking.

The current situation calls for caution. We have a domestic situation which may well call for less ease in view of the better business prospects; we have possible dangers ahead if there are further rapid increases in bank credit and liquidity; we have signs of some upward movement in prices; and we have continuing uncertainty on the international side. But, in my opinion, these factors do not call for a change in policy today.

The lack of immediate inflationary pressures, some indication of a slowdown in the rate of credit expansion, the encouraging signs with respect to our balance of payments, and the attention being given by the Congress to legislation in the economic area, particularly taxes, counsel no change in Federal Reserve policy at this time.

I do think, however, that it would be entirely consistent with the current directive to have a slightly firmer tone in the money market than we have had in the last couple of weeks. I am glad to see that somewhat firmer conditions have in fact emerged in the last few days.

I think there should be no change in the discount rate and that there should be no substantial change in the directive. The reference in the directive to an imminent Treasury refunding should be deleted.

Mr. Ellis said that the New England economy was satisfactory but not up to its full potential. Manufacturing output had risen a little more than seasonally in December. The purchasing agents survey suggested strengthening of output in January--there were more frequent reports of increased orders to manufacturers in the region. The December employment record was not good; there was a November to December decline in employment in nondurable manufacturing industries which pulled total manufacturing employment down. Both groups continued down from a year ago. However, nonmanufacturing employment rose enough to hold total employment in the District slightly above the level of a year ago.

New bank credit extended in December recovered sharply from the low November figure to a level 10 per cent above a year ago. Bank loans were strong in January despite a high average loan-deposit ratio. District banks continued to find loans to foreign banks attractive, and they had increased the funds allocated to this purpose by about 68 per cent since July. They continued to bid for time certificates of deposit.

The fact that the Treasury was in the midst of a refunding and had just completed an advance refunding, Mr. Ellis said, suggested that policy should not be changed materially and overtly immediately. He felt, however, that the Committee's deliberations should be devoted largely to underlying issues and to the policy to be followed after the Treasury operations were completed. The present upward thrust in the economy came during a season of the year when some hesitation was common, and it was a source of satisfaction. At the same time, the evidence of the new McGraw-Hill survey on the rate at which capital expenditures would advance, and the stimulation to be expected from the tax cut, suggested that it was appropriate to remain alert to possible inflationary pressures from a superheated aggregate demand. It did not seem that the 5-1/2 per cent unemployment rate would stand as an impediment to labor demands in the forthcoming wage negotiations, and it appeared likely to Mr. Ellis that by next fall higher wage costs would be stimulating price advances.

In this atmosphere, Mr. Ellis continued, monetary policy had made its contribution in full measure, and since July, perhaps in more than full measure. The staff memorandum indicated that, since the discount rate action, reserves supporting private deposits had expanded at a rate of more than 7 per cent, and there had been an 8.6 per cent growth rate in total bank credit. While the staff analysis of the credit situation this morning was good, it did not present an argument to the effect that a 7 per cent rate of reserve expansion was sustainable. While the expansion rate varied from month to month, and it was possible to hope that it would slow down, the record since July did not suggest that the present degree of ease would result in more moderate and sustainable expansion.

Mr. Ellis' inclination was to seek a lessening in monetary ease to slow down the rate of monetary expansion, in view of the new stimulation to be provided by fiscal policy. Unfortunately, a problem was posed by the 4 per cent Regulation Q ceiling. Credit expansion could be expected to lift the short-term rate and bring the rate on CD's to the ceiling, thereby threatening a loss of as much as $10 billion of deposits unless the ceiling were lifted. The critical decision facing the Committee was whether it should provide reserves to whatever extent was necessary to prevent interest rate increases, or whether it should allow rates to rise and thus probably necessitate an increase in the Regulation Q limits. There might be negative reactions to an action raising interest rates immediately after tax legislation was enacted.

For the moment, Mr. Ellis concluded, he favored no overt action. He would continue policy in its present posture and watch for signals, such as solid evidence that industrial prices were beginning to rise, that indicated the need for a change in posture. In the absence of such signals he would make no material change in policy. At the same time, he found it hard to believe that month after month the Committee could continue to renew a directive which simply called for operations "with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks." There had been changes in recent weeks that in his judgment did not conform to the basic objective of policy. He would hope that the Desk would be a little more aggressive in seeking a somewhat lower rate of reserve growth.

Mr. Irons reported that business conditions in the Eleventh District had moved ahead quite satisfactorily during the past month. Industrial production in January was 7 per cent above the year-ago level, and oil production was up about 8 per cent. Construction contract awards were quite strong, particularly for residential construction. Retail trade figures were favorable. The unemployment rate in Texas (not seasonally adjusted) was around 4.6-4.8 per cent. New car registrations were high; apparently new cars were moving well in the major cities for which data were available. The District picture was pretty much the same as that in the nation, with some variations. Conditions were strong but not surging, and there were few evidences of imbalance at present.

District banking figures for the last three weeks relative to a year ago also were much like those for the nation, Mr. Irons continued. Loans, investments, and deposits were all down a bit. The Federal funds picture had not changed much; purchases by District banks averaged around $750-$800 million and sales about $350 million. Borrowings from the Reserve Bank were down somewhat.

Nationally, Mr. Irons said, economic developments were favorable, the underpinning was strong, and the economy appeared to be well balanced. There was a high degree of liquidity. Bank credit recently had not expanded as much as expected, but this was not damaging. Commodity prices were reasonably stable; although prices might be moving up in some areas, there was no strong evidence of inflationary pressures. The balance of payments problem was not solved, but there had been improvement recently.

Mr. Irons felt that in view of current circumstances and uncertainties, the Committee should have clear and convincing reasons before making any significant change in policy at this time. It would be a mistake, he thought, to try to anticipate the effect of the tax bill when it was not known what the final bill would be like nor what its consequences might be. Accordingly, he favored continuing the policy that had been followed in the past several weeks for the next 3 weeks, meanwhile watching developments closely.

Mr. Hemmings reported that information available since the last meeting of the Committee indicated that employment rose in December in the Twelfth District as a whole; moreover, the rate of increase surpassed that for the nation, as it did during much of the latter part of 1963. Although practically all District States registered some gain in employment in December, the bulk of the increase had been in the Pacific Coast States.

An unusually sharp dip in the labor force plus the modest gain in employment caused the District unemployment rate to fall to 5.6 per cent from 6.1 per cent in November, Mr. Hemmings said. This was the lowest rate since the spring of 1963, but it was slightly higher than the 5.5 per cent figure of a year ago. Despite the December decline in the unemployment rate, another major labor market area--Tacoma, Washington-was added in December to the list of District labor areas classified as having substantial unemployment. There were now six such areas in the District compared with four a year ago.

Relatively few business data were available for January, Mr. Hemmings continued. In two instances, department store sales and steel production, the gains over a year ago had been less in the District than in the nation. However, the demand for nonferrous metals had remained firm. Hedge buying against the possibility of a strike by mid-year at District copper mines currently was a major factor in the strong demand for that metal. A pickup in demand for lumber and plywood, particularly from the California market, reportedly resulted in substantial price increases for virtually all dimension items as well as for plywood sheathing in late January.

In the financial area, total bank credit outstanding at District weekly reporting banks declined in the two-week period January 15-29 nearly three times as much as in the corresponding weeks of 1963. The reduction was about evenly divided between loans and investments. The reduction in holdings of U. S. Governments in these two weeks by District banks accounted for more than one-fourth of the total decrease for all weekly reporting banks in the nation.

The decline in demand deposits adjusted at District weekly reporting banks was substantially greater than in the corresponding weeks of 1963, as it was nationally, Mr. Hemmings said. The increase in total time deposits was about the same in amount as in 1963 and accounted for one-third of the total increase for all weekly reporting banks in the nation.

Daily average borrowings of reserve city banks in the District dropped off substantially in January, but the banks continued to have negative free reserves. During the two statement weeks ending January 29, banks in the District as a whole were net sellers of Federal funds.

In both weeks, a large portion of the net sales was accounted for by one bank, as it reduced bill holdings and placed the proceeds in the Federal funds market.

Mr. Deming observed that there had been no noteworthy new developments in the Ninth District in the past two weeks. More recent estimates of personal income confirmed a fairly sharp drop in December, reflecting the fall in farm prices and the delay in farm marketings. In January, nonagricultural employment in Minnesota was up fairly strongly. There seemed to be no particularly serious maladjustments in the District at this time.

One circumstance that seemed atypical and that was difficult to understand, Mr. Deming said, was the lack of exuberance in the District with respect to the business outlook. The "Minnesota Poll," a scientific public opinion poll conducted by Twin City newspapers, found sentiment not significantly different from a year ago. The Reserve Bank's opinion survey, which was banker-business oriented, continued to show more pessimism than a year ago. The Bank's poll probably had some seasonal in it, but the change in attitudes it indicated was quite marked.

The District banking situation was about the same as in the nation. Officials at some of the larger city banks recently indicated that they expected a smaller increase in loan demand in 1964 than in 1963. Mr. Deming thought there probably was some downward bias in their estimates, but in any event the estimates did not support an expectation of a strong increase in loan demand. Loan-deposit ratios at city banks in the District were about the same as in 1960, and up only a point in the last year. The trend at country banks was somewhat stronger.

Mr. Deming said he agreed with the views expressed by Mr. Treiber and Mr. Irons. He favored no change in policy at this time, and no change in the directive except for the elimination of the phrase on Treasury financing. He would not change the discount rate.

Mr. Scanlon said that the outlook for business activity in the Seventh District continued to be favorable. Retail sales had been at very high levels in recent weeks and output in major industries had been maintained or had increased. Virtually all of the business forecasts coming to the attention of the Reserve Bank were optimistic.

Mr. Scanlon observed that Mr. Treiber had mentioned wage contract negotiations later this year. Signs of labor unrest were becoming evident in some major Seventh District industries, he said, particularly in the case of firms manufacturing motor vehicles and construction machinery. The Reserve Bank would be watching developments in these areas with great interest.

As to policy, Mr. Scanlon believed that the recent posture had been satisfactory and that it should be continued until the next meeting of the Committee. He thought the directive could well stand, except for the reference to "an imminent Treasury refunding." He would not favor changing the discount rate at this time.

Mr. Clay said that at this juncture it appeared appropriate to continue essentially the same monetary policy. Weighing the various developments in the domestic economy, the situation remained one that called for sufficient reserve availability to permit member bank credit expansion on a seasonally adjusted basis. The projected improvement in business capital outlays was a much needed indication of expanding activity, but at present it was part of the broader pattern of moderately increasing economic activity that had prevailed for some time. Balance of payments developments also appeared to permit a continuation of the recent monetary policy posture. Except for the deletion of the reference to Treasury financing, the economic policy directive could be retained in its present form. The discount rate should be left unchanged, Mr. Clay concluded.

Mr. Wayne observed that Fifth District business conditions remained substantially as reported two weeks ago: holding at generally high levels. In manufacturing, the December gain in man-hours had turned out to be larger than suggested by early data, and January reports from industry sources indicated firm to strong markets in metals, lumber, furniture, textiles, apparel, and chemicals. Construction employment was showing considerable resistance to the usual seasonal declines, and the backlog of work probably was at an all-time high as a result of a record volume of contract awards in the last five months of 1963. Department store sales improved sharply in the final two weeks of January. Bituminous coal production and shipments were somewhat lower in January, but foreign loadings were up and the general outlook remained favorable. Consumer loans at District weekly reporting banks displayed better than seasonal strength in January, but business and real estate loans were somewhat weaker than usual. In the Federal funds market District banks were net sellers through the first three weeks of January but swung over to fairly heavy net purchases in the two weeks ended February 5.

A few remarks on the cigarette market might be in order, Mr. Wayne said, although solid facts were scarce. Except where certain new, highly advertised filter brands were involved, District cigarette plants had reduced the work week from a normal five days to four, and in a few cases to three. Some liquidation of excess stocks in January and February was a normal seasonal pattern. There was more to liquidate this year but how much more was not yet known, so inventories would be checked week by week for evidence to justify a return to full production. For one large producer this was already the fourth four-day week compared to only two such weeks required for last year's inventory adjustment. Meanwhile, reductions from year-ago levels in January State cigarette tax revenues reportedly ranged in some areas as high as 15 or 20 per cent, but changes of this magnitude appeared exceptional and might be temporary.

Nationally, Mr. Wayne continued, the flow of current information indicated that the economy continued to register a moderate and firmly based improvement. Two weeks ago he had noted a mixed behavior in prices, but since that time additional evidence pointed more toward price stability. On several occasions during the current upswing there had been patterns of price movements that looked like the beginning of an inflationary rise, but they had all collapsed after a few weeks. Such would seem to be the fate of this movement, although it was too soon to be certain.

In the policy field, Mr. Wayne believed that conditions in the money market for the past two weeks had been appropriate in view of prevailing conditions. Seeing nothing in the current situation to suggest an urgent need for a change, he favored a continuation of present policy and a renewal of the current directive, with elimination of the reference to Treasury financing. Obviously, Mr. Wayne said, he did not feel that a change in the discount rate would be in order.

In a concluding remark, Mr. Wayne commended the Desk for having appropriately carried out, under difficult conditions, what he believed to have been the intent of the Committee.

Mr. Mills observed that as he had followed the discussion around the table, it seemed to him that the problem that the participants were attempting to contend with was one of leads and lags, with the knowledge that it was necessary in monetary policy to lead against anticipated future events, and with the further knowledge that there was a lag between the time a policy was instituted and the time its impact produced economic and financial results. His own feeling was that it was still much too early to attempt to lead with monetary and credit policy against the possibility that the economy might overheat and at some unforeseeable future date produce inflationary pressures. It would be preferable to delay any leading of the economy and to accept the very minimal risk that delay at this time might provoke future problems. It was his strong belief that there would be ample time to take action against inflationary developments if and when they become truly evident. Mr. Mills thought that for the present there were good grounds for feeling that the economy needed the stimulus of a reasonably relaxed credit policy that would permit expansion along the lines recently experienced, as reflected in the statistics.

After these remarks, Mr. Mills presented the following statement:

> The most significant event that has happened since the Committee's last meeting is the upward revision in business plans for new plant and equipment outlays revealed in a new McGraw-Hill report. To the extent that these investment programs represent enlarged plant capacity, rather than future modernization of existing capacity, they indicate expectations of expanding market opportunities. In order for the economic multiplier effects of these prospective additions to capital investments to be fully realized in their own right as spending stimulants and as sources of new savings, it is crucially important that adequate credit be available to finance the resultant enlargment of output through distributive channels and on to final consumption. A more restrictive Federal Reserve System monetary and credit policy could block an advance into higher grounds of well-rounded economic activity.
>
> The current rule that an expansion in demand deposits adjusted and time deposits should be held to an annual rate of 3 per cent is tantamount to setting up an economic roadblock, in that mechanical adherence to the rule implicitly demands a curtailment of credit and a consequent contraction of demand deposits whenever the 3 per cent expansion factor is violated. Slavish adherence to what is only a theoretical rule that has been arbitrarily--if not arbitrarily and capriciously--chosen as an appropriate measure for bank credit expansion is bound to have deleterious economic effects, in that normal and natural forces working toward economic advancement stand to be subjugated to the confines of a theory whose empirical validity remains to be proven. If the Committee persists in a belief that monetary and credit policy should be guided and formulated according to a predetermined percentage factor for deposit expansion, it

would at least be preferable to raise the expansion factor from 3 per cent to 4 per cent and in that way dissipate the ungrounded fear of unwarranted credit expansion that has been expressed whenever estimated required reserves have exceeded the 3 per cent guideline.

I have argued continuously for the elimination of artificial controls over interest rates and the abandonment of a pegged United States Government securities market. The arguments for a restoration of free market principles to the securities markets can be applied with equal cogency for a return to the principles of dependence on the evolution of natural factors in the credit markets, rather than adherence to a mechanistic theory of the supply of reserves, as the better guideline on which to formulate monetary and credit policy.

Mr. Robertson said he was pleased by the similarity of the conclusions that had been expressed around the table up to this point. He then made the following statement:

We are hearing a good deal about "anticipations"--anticipations of somewhat greater plant and equipment expenditures, anticipations of greater consumer spending, anticipations of possible inflationary price movements that might result--all in response to the tax cut. But it seems to me there is one other "anticipation" that ought to be worrying this Committee--that is, how much of the stimulative effect of the tax cut has <u>already</u> been anticipated in our markets. To the extent that has happened, any <u>further</u> upward push has been reduced, and the need for any changes in monetary policy has been correspondingly diminished. How shall we know how much of the tax cut has been anticipated, and how much additional stimulus remains? The only thing we can do is to wait and see.

In times like these, monetary policy should be based on facts and events--not on pure guesses as to what the future holds. And the facts of the moment are that unemployment is still high, prices are generally stable, and the balance of payments has shown a marked improvement. To my mind, that adds up to a need for a continued stimulative monetary policy--continued until enough adverse developments actually happen in our markets to show that a change is needed.

I know it is argued that if we wait until an inflation actually starts before we tighten monetary policy, it will be too late. But I for one am not of that view. I think resolute tightening action on our part, whenever price increases become general and substantial, can brake that inflationary rise. We might have to stand some rather sizable interest rate increases in the process, but I think some people will be surprised at how quickly our financial institutions--with their already much reduced liquidity positions--respond to a tightening policy. It is because I have confidence in the effectiveness of resolute tightening actions in such an environment that I am prepared to argue for our being resolute now in adhering to a stimulative policy.

I would translate that objective into an instruction to the Manager to continue reserve availability at least as ample as in recent weeks, without worrying about incipient or modest movements in market interest rates, so long as they remain orderly.

Of course, the reference to Treasury financing should be dropped from the directive.

Mr. Shepardson said that in his judgment the description of the economic situation given by the staff and others this morning, and the uncertainties as to the type of tax cut that would be enacted, the effects it would have, and the extent to which it had already been anticipated, all argued for continuation of present policy during the ensuing 3-week period.

Mr. Mitchell said he would accept Mr. Irons' description and analysis of the economic situation and his policy recommendation.

Mr. Daane observed that he shared Mr. Noyes' lack of confidence in the precision of the estimates of the multiplier and accelerator effects involved in the tax cut. He also was quite skeptical with regard to the immediacy of the effect. In any event, he said, he agreed with those preceding speakers who thought that policy should not be changed unless there was a clear and compelling case for change on grounds either of the domestic economy or the balance of payments, and no such grounds were apparent at this time. Therefore, he would make no change in present policy, and would resolve doubts on the side of watchful waiting. He would not change might have to stand some rather sizable interest rate increases in the process, but I think some people will be surprised at how quickly our financial institutions--with their already much reduced liquidity positions--respond to a tightening policy. It is because I have confidence in the effectiveness of resolute tightening actions in such an environment that I am prepared to argue for our being resolute now in adhering to a stimulative policy.

I would translate that objective into an instruction to the Manager to continue reserve availability at least as ample as in recent weeks, without worrying about incipient or modest movements in market interest rates, so long as they remain orderly.

Of course, the reference to Treasury financing should be dropped from the directive.

Mr. Shepardson said that in his judgment the description of the economic situation given by the staff and others this morning, and the uncertainties as to the type of tax cut that would be enacted, the effects it would have, and the extent to which it had already been anticipated, all argued for continuation of present policy during the ensuing 3-week period.

Mr. Mitchell said he would accept Mr. Irons' description and analysis of the economic situation and his policy recommendation.

Mr. Daane observed that he shared Mr. Noyes' lack of confidence in the precision of the estimates of the multiplier and accelerator effects involved in the tax cut. He also was quite skeptical with regard to the immediacy of the effect. In any event, he said, he agreed with those preceding speakers who thought that policy should not be changed unless there was a clear and compelling case for change on grounds either of the domestic economy or the balance of payments, and no such grounds were apparent at this time. Therefore, he would make no change in present policy, and would resolve doubts on the side of watchful waiting. He would not change