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, May 26, 1964, at 9:30 a.m.

PRESENT: Mr. Balderston, Acting Chairman
Mr. Daane
Mr. Hickman
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Shepardson
Mr. Shuford
Mr. Swan
Mr. Wayne
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Ellis, Bryan, Scanlon, and Deming, Alternate Members of the Federal Open Market Committee

Messrs. Bopp and Clay, Presidents of the Federal Reserve Banks of Philadelphia and Kansas City, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Brill, Furth, Grove, Holland, Jones, Koch, Mann, and Ratchford, Associate Economists
Mr. Stone, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Messrs. Partee and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Axilrod, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors

Mr. Coldwell, First Vice President of the Federal Reserve Bank of Dallas
Messrs. Holmes, Sanford, Eastburn, Baughman, Tow, and Green, Vice Presidents of the Federal Reserve Banks of New York, New York, Philadelphia, Chicago, Kansas City, and Dallas, respectively
Messrs. Fousek, Brandt, and Litterer, Assistant Vice Presidents of the Federal Reserve Banks of New York, Atlanta, and Minneapolis, respectively
Mr. Meek, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Arena, Financial Economist, Federal Reserve Bank of Boston

Upon motion duly made and seconded, and by unanimous vote, Mr. Balderston was elected Acting Chairman for this meeting.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on April 14 and May 5, 1964, were approved.

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 May 5 through May 20, 1964, and a supplementary report covering the period May 21 through May 25, 1964. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Sanford said that no change was expected in the gold stock this week for the fifteenth consecutive week. The Stabilization Fund now held $268 million in gold. Expected later this week was the usual French order for 30 tons, and the Spaniards wanted to purchase the small amount of $2 million by June 15. With only a comparatively small distribution from the Gold Pool for May, some reduction in the Fund's large holdings over the next few weeks was anticipated.

As Mr. Coombs informed the Committee at the two previous meetings, the heavy demand for Swiss francs during April and early in the period just closed had led to an increase rather than a reduction in the System's Swiss franc commitments and a rise in the Swiss National Bank's surplus dollars. Extensive discussions with the Swiss had been continued to find means, along the lines indicated earlier, to reduce the System's Swiss franc obligations (now totaling $200 million), and those of the Treasury, as well as the Swiss National Bank's current surplus dollar holdings. Not all of the suggested arrangements had been completed, but Mr. Sanford could report some progress. The U. S. Treasury yesterday had issued to the Bank for International Settlements a 15-month Swiss franc-denominated bond for about $70 million equivalent and then had sold the franc proceeds to the System. The System immediately used the Swiss francs to liquidate $70 million of its $100 million equivalent swap drawings on the BIS. In addition, it was hoped that the proposed credit arrangement between the Swiss National Bank and the Bank of Italy for $100 million worth of Swiss francs would be entered into this week or next week. In accordance with earlier plans, the Bank of Italy would then sell the Swiss francs to the System and use the dollars to liquidate its outstanding drawings of $100 million from the System. The System, on its part, would immediately use the Swiss francs to pay off its $100 million equivalent of drawings on the Swiss National Bank. These transactions would still leave the System with $30 million of Swiss franc swap drawings outstanding (on the BIS); the Treasury with $120 million of

forward market commitments; and the Swiss National Bank with some $30 million of surplus dollars on its books. Discussions on a package to deal with these amounts currently envisaged an additional issue by the Treasury of a Swiss franc bond to the Swiss National Bank, an increase in the amount of dollars the Swiss were prepared to hold outright, and possibly some sale of gold to the Swiss; the Swiss were watching their money market closely and considering what action was desirable and when.

The foreign exchange markets had posed no special problems during the past three weeks and there had been no exchange transactions for System account except for the $70 million Swiss franc liquidation referred to before and a sale of $500,000 worth of Belgian francs to the Treasury to cover interest payments. Although the New York exchange market had been quiet, there had been some fairly sizable flows of funds on the Continent. The Germans had continued to lose funds as a result of the proposed 25 per cent withholding tax on interest payments to foreigners, with the money being pulled back from the German bond market to Switzerland and Belgium, in particular. In addition, the Dutch money market had been extremely firm. As a result, Dutch commercial banks had been repatriating liquid assets held abroad as well as borrowing in the Euro-currency market. This inflow of funds had provided foreign exchange needed to cover the growing Dutch trade deficit. The Dutch money market might be expected to remain firm over the coming months, and the Dutch anticipated that they would be in and out of the exchange market as both buyers and sellers of dollars as these payments ebbed and flowed.

Meanwhile, the continued firmness in sterling despite the unsatisfactory trade position seemed to be the result primarily of the covering of the short positions taken by many traders earlier in the year. It was still necessary to anticipate some possible difficulties for sterling later in the summer. In mid-May, after 2-1/2 months of no change, the British Treasury bill rate rose almost 10 basis points. The covered interest rate differential in terms of Treasury bills was now just about zero, but further increases in British rates might occur. On the Canadian dollar market, the forward Canadian dollar had again been in demand, and despite Bank of Canada operations, had been at a small premium. As a result, covered interest rate differentials had again stood in favor of Canada, but the reported net flow of funds from the United States (all for investment in finance company paper) had so far remained small.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period May 5 through May 25, 1964, were approved, ratified, and confirmed.

Mr. Sanford noted that two swap arrangements were scheduled to mature in June; $100 million with the Netherlands Bank (on June 15) and $50 million with the National Bank of Belgium (on June 22). No drawings were outstanding under the Dutch arrangement. The swap line with the National Bank of Belgium, on the other hand, was fully drawn as it had been from the beginning, and consequently that drawing also matured next month. He recommended the renewal of the Dutch arrangement for another three months and of the Belgian

swap arrangement and drawing for another six months. In addition, a swap of $13 million of sterling for Swiss francs with the BIS would mature on June 10 and it might prove necessary to roll it over. This would be the fourth renewal of this swap.

Finally, the Bank of Italy's $50 million drawing on the System of March 17, 1964, would be due for its first renewal on June 17. Although it was anticipated that this drawing would be paid off by then as a result of the Bank of Italy's arrangement with the Swiss National Bank, in view of the delays that had attended the coming into being of that arrangement, it might be necessary to roll it over temporarily.

In response to questions by Messrs. Shepardson and Mills, Mr. Sanford said that the sterling-Swiss franc swap for which a fourth renewal was proposed was the only one of its kind and in his judgment was in a different category from the dollar-franc swap drawings. It originally had been entered into some time ago, when the Account owned sterling but had a greater need for Swiss francs. The sterling could have been sold for francs, but since this might have put some pressure on the pound a swap seemed preferable. There was no exchange risk, since the rates were fixed. He thought it would be desirable to terminate the arrangement when possible, and was hopeful that this would be soon. But he considered the matter much less pressing than in the case of dollar swap drawings to which, in his judgment, the Committee's general standards for limiting the number of renewals primarily applied.

Mr. Sanford said that he considered the rule limiting renewals of dollar swap drawings to be a good guideline, but he did not think the Committee intended it to be absolutely rigid. It was possible, if the tide turned against the U. S., that the Committee might prefer to break the rule rather than to reverse a particular swap drawing under severe pressure. He thought that in any particular case the Committee would want to weigh the desirability of maintaining the rule against all other factors.

> Renewals of the swap arrangements with the Netherlands Bank and the National Bank of Belgium, as recommended by Mr. Sanford, were approved.
>
> Renewals of the drawing on the swap with the National Bank of Belgium, of the sterling-Swiss franc swap with the Bank for International Settlements, and, if necessary, of the Bank of Italy's drawing on the System, as recommended by Mr. Sanford, were noted without objection.

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 May 5 through May 20, 1964, and a supplemental report covering the period May 21 through May 25, 1964. Copies of these reports have been placed in the files of the Committee.

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

> The money market has had a generally firm tone since the last meeting of the Committee, with Federal funds trading at 3-1/2 per cent on every day of the period. Member bank borrowing from the Reserve Banks has averaged about $300 million in

the recent interval, almost $100 million higher than in the preceding period between meetings. This somewhat firmer tone reflects in part the unwinding of the very heavy concentration of reserves in the money centers in late April as a result of Treasury redeposits of individual income tax receipts. It may also reflect a somewhat faster pace of bank credit expansion following the somewhat sluggish performance of April.

The firming of the money market has not been accompanied by any significant upward pressure on Treasury bill rates. Nonbank demand for bills has continued strong even though long-term investors who temporarily put their funds in bills amid the uncertainties of March and early April appear to have reverted to their normal practice of placing funds in long-term issues. In contrast with March and early April, when investors wanted not merely bills, but bills of short maturity, recent demand has moved progressively toward the longer bill maturities. This tendency has reduced the yield differential between the 3- and 6-month bills to about 12 basis points, compared with 20-21 basis points in early April. While the approach of the June season for tax and dividend payments may exert an upward influence on bill rates over the next three weeks, the bill market has tended to get by similar periods in the recent past without much movement in rates.

Prices of Treasury notes and bonds moved higher during the first part of the recent interval, continuing at an accelerated rate the price recovery that had been in progress since late March. Over the past week or so the recovery has tended to falter. Whether this means the rally has run its course or whether the market is simply collecting itself for a further advance remains to be seen. It is worth noting in this connection that the recent gains have pushed the prices of a number of issues to levels close to the highs reached earlier this year. The majority of investor opinion now seems to have swung to the view that interest rates are not likely to push higher in the immediate future. The success the Treasury enjoyed in its recent refunding both reflected and reinforced that shift in the climate of opinion.

The Treasury does not definitely contemplate any new financing between now and the end of the fiscal year, except for the routine monthly offering of one-year bills. Should prices of Treasury notes and bonds improve significantly further, however, it is possible that in the second half of June the Treasury would offer a coupon issue, most likely a note, for cash in view of the large new money needs projected

> for the early part of the new fiscal year. Even so, the Treasury would still have to issue a tax anticipation bill to raise the bulk of its July needs, which may be as much as $4 billion. It is also a possibility, although not a prominent one, that the Treasury might undertake an advance refunding in late June if the market should become particularly strong. In late July the Treasury will, of course, have to deal with the problem of refunding its August 15 maturities.

Mr. Mills said that he had to confess to confusion about the technical objectives in handling the Account. He noted that the projections for the current statement week indicated positive free reserves of $5 million. Yesterday the Account had bought about $80 million in bills from foreign accounts. This purchase prevented the market from tightening, but did not introduce reserves. The demand for bills had been strong yesterday, Mr. Mills noted, but the Committee's directive called for accommodating expansion of bank credit. Could this be accomplished with the minimum level of free reserves projected for the week, or was all of the Account Management's attention focused on the interest rate structure?

Mr. Stone replied that attention recently had not focused primarily on the rate structure. The Account, in fact, had not conducted a single operation addressed primarily to the bill rate since October 1963. The recent stability of short-term rates, in his judgment, was due to a complex of factors, including structural changes in the market.

Mr. Mills commented that reserves had been injected or withdrawn periodically in conjunction with tightness or ease in the market. In his opinion this was bound, indirectly at least, to influence interest rates.

Mr. Stone replied that he had no doubt that the operations of the Account had influenced interest rates. He considered this to be part of the package of objectives the Committee had in mind in giving the Account Management its instructions. With respect to yesterday's purchase of $80 million of bills from foreign accounts, Mr. Stone said, the foreign accounts had directed the sale of these bills with the expectation of making payments to others in the amount of the proceeds. If the bills had been sold on the market member bank reserves would have been reduced by $80 million and, when the proceeds were paid out, those reserves would have been returned to the market. By buying the bills the Account Management prevented the reduction of reserves, so the net effect of the bill sale to the System plus disbursement of the proceeds was to raise reserves by $80 million. Thus, at the conclusion of the operation yesterday, the free reserve estimate for the week was raised to $36 million. In approaching operations yesterday, the Account Management had in mind the fact that it was going to have to supply a substantial amount of reserves over the next few days. The question was whether to wait until Thursday, or to do it Wednesday or today. The decision would depend on the market circumstances that developed.

Mr. Mills then asked what level or movement in free reserves Mr. Stone would consider necessary to accommodate an appropriate expansion of bank credit. It seemed to him that actions usually were taken to prevent negative free reserves but not necessarily to produce the level of positive free reserves that would accommodate expansion of bank credit in accordance with the Committee's directive.

Mr. Stone said the operational paragraph of the Committee's directive was written in terms of maintaining about the same conditions in the money market as in recent weeks. He interpreted this to relate to free reserves as well as to other measures of market conditions. He thought it was the wish of the Committee that free reserves should fall somewhere in the broad range between zero and $200 million. He did not think the Committee wanted to see net borrowed reserves appear, and certainly not for two or three weeks in a row. He did not think it desirable to give the market the idea that the Committee had changed policy when it had not. He regarded a free reserve figure in the zero to $200 million range as consistent with the Committee's intent, provided that the Federal funds rate typically was around the discount rate, and that borrowings were somewhere in the neighborhood of $200 or $300 million.

These were the conditions the Committee had indicated it would like to see, Mr. Stone continued. He interpreted it to be the expectation of the Committee that if these conditions were achieved, its intent with respect to the rate of bank credit expansion over the period also was likely to be realized.

Mr. Robertson commented that the way Mr. Stone stated his interpretation of the instructions was what gave rise to doubts in his and Mr. Mills' minds. Mr. Stone had said it was his understanding that operations should be conducted with a view to maintaining about the same conditions in the money market as had prevailed in recent weeks. But he had left out the

rest of the sentence in the second paragraph of the directive, which was "while accommodating moderate expansion in aggregate bank reserves." Mr. Robertson thought there was a feeling that Mr. Stone gave too much weight to the first half of the sentence. He hoped there was no intent to respond to one part of the instructions to the exclusion of the other.

Mr. Stone remarked that whether maintaining about the same conditions in the money market would result in moderate reserve expansion depended on the vigor with which the economy utilized reserves. This was something over which he had no day-to-day control. If bank credit demand became sluggish, as it had at times in the past, accommodating moderate reserve expansion would mean easier money market conditions.

Mr. Robertson asked if Mr. Stone's operations would be different at all if the order of the two clauses in the second paragraph were reversed. Mr. Stone replied that they would, if this change were accompanied by a discussion indicating that the Committee wanted emphasis placed on having moderate reserve expansion. Then the Account Management would have to operate in terms of some aggregate reserve variable and let the chips fall where they might with respect to money market conditions. Most of the time, he thought, the two instructions were compatible, although not necessarily from day to day. There had been short periods when they were not compatible.

Mr. Robertson said he thought that as Mr. Stone construed the Committee's intent money market conditions were the primary factor and the rate of reserve growth was secondary, and Mr. Stone affirmed this statement.

Mr. Daane commented that the desired rate of reserve growth responsive to the strength of credit demand would be automatically accommodated if money market conditions, including the free reserves variable, were held within some fairly narrow range. Mr. Robertson said this would be true if everything worked perfectly, but this would not necessarily be the case, and in fact had not been during the past weeks. As a result, the Manager had to exercise his discretion in deciding which part of the instructions he was to follow.

Mr. Mills commented that there was a distinction between supplying reserves and expanding bank credit. To supply reserves did not necessarily mean that bank credit would expand; the reserves had to be employed by the banking system. His impression from reading the figures was that total reserves had not risen more than fractionally. In other words, the reserve support supplied had not been very great. Nevertheless, it had encouraged a considerable expansion in bank credit over a long period.

Mr. Balderston said that he had been impressed by the figures on nonborrowed reserves shown in table C-1 of the staff reserve memorandum. In the year ending with April, nonborrowed reserves had been increased by about $625 million. Member banks were, of course, left with whatever leeway they wished to exercise with respect to these reserves. But, in a sense, this was a test of what the Desk had achieved in a year's time, despite the day-to-day and week-to-week difficulties it encountered.

Mr. Stone said there was no question in his mind that frequently there was incompatibility on a week-to-week basis between the instructions relating to money market conditions and to reserves. He thought it important, in assessing the latter, to focus on trends rather than very short-run fluctuations. And he considered it the Committee's position to employ money market conditions for operations on a short-run basis, recognizing that it met every three weeks and could assess developments with respect to the various reserve aggregates at those intervals.

Mr. Swan said it seemed to him that at present, even in terms of money market variables, conditions were a bit tighter than was consistent with the directive. Free reserves at $36 million for the current week seemed a little low. Why wait until Thursday to begin providing the reserves that would be needed?

Mr. Stone replied that the preliminary reserve figures were hazardous; the money market itself was a much better indicator today of what the final figures would show than the present estimates were.

Mr. Mitchell noted that Mr. Stone had said he would not like to see negative reserves appear for two or three weeks in a row, but he had not seemed to be disturbed at the thought of their appearing for one week. He asked whether Mr. Stone thought negative reserves for a single week could have a significant impact on the market.

Mr. Stone responded that he had not meant to imply that he would be unconcerned about even one week; he had tried to avoid a negative figure

because it would, indeed, have some impact on the market. He thought the impact would be temporary if free reserves became positive again in the following week. But if negative reserves appeared for two or three weeks in a row that definitely would be read by the market as a signal that the Committee had changed policy.

In short, Mr. Mitchell said, if a negative free reserve figure was published for one week, it would raise a question in everybody's mind. Mr. Stone agreed, and added that while the Desk tried to avoid negative figures there was an unavoidable risk that they would eventuate if the Committee set a target under which free reserves would at times be below $100 million as well as above. Revisions in weekly average figures on a single day had been as large as $85 million. The risk of negative figures could be avoided, of course, by raising the target to $200 million or above.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period May 5 through May 25, 1964, were approved, ratified, and confirmed.

The staff economic and financial review at this meeting was in the form of a visual-auditory presentation, for which Messrs. Garfield and Hersey of the Board's staff joined the meeting. Copies of the text of the presentation and of the accompanying charts have been placed in the files of the Committee.

The introductory portion of the review, presented by Mr. Brill, was as follows:

In the chart show this morning, we're departing from earlier practices in several respects, and I'd like to say a few words to put these changes in perspective.

Formerly, the chart show presentation took the place of both the written staff review, distributed in advance of Committee meetings, and the oral staff interpretations presented at the meetings. It has become increasingly evident that within the necessary time constraint of a half-hour or so, we cannot adequately review all elements of the economy that should be brought to Committee attention and also study in depth specific elements of special interest to the Committee. To try to meet both objectives, therefore, we're experimenting with a new procedure whereby the comprehensive staff review is distributed as usual to the Committee in advance of the meeting, and the chart show is devoted to a more intensive analysis of a limited number of economic problems.

This morning our explorations carry into three subjects suggested by Committee discussion in recent meetings. The first is that of capacity utilization and prices--the relationships that obtained in earlier cycles, and the current situation and trends. Next we turn to a key problem in the financial scene--bank credit expansion, its sources, its composition, its relation to total credit flows and its repercussions on bank liquidity. Turning to the international scene, we will review developments in interest rates here and abroad and their relation to international capital flows. Concluding, we will draw on these special studies as well as the comprehensive staff review already distributed to appraise the balance of economic forces and its implication for policy.

The concluding portion of the review, presented by Mr. Koch, was as follows:

Our conclusion this morning is based not only on the selected elements in the economic situation as discussed earlier but also on the entire situation as analyzed in the staff report distributed to you last week.

As the report indicated, some of the economic news that has become available since our last meeting suggests a pick-up in the pace of the expansion. The 7 per cent rise in new orders for durable manufacturers in April, although covering only one month, was impressive, as was the rise in employment.

Our index of industrial production rose a full point last month, following three months of smaller gains. Thus, activity in the business sector seems to be catching up to the air of optimism that has prevailed there for some time.

Two features of the situation at the end of the first quarter favorable to expansion were the scheduled further rise in plant and equipment expenditures and a low inventory-sales ratio. Additions to stocks at both producers and distributors were small in the first quarter, although dealer stocks of autos rose.

Despite the rise in business activity this spring, the industrial commodity price average has remained stable, while prices of foods and foodstuffs are down a little in recent weeks. Regarding the recent rise in capacity utilization and its possible upward pressure on prices, we noted earlier that the situation appears rather different today from what it was in the expansion of the middle 1950's. This is due to a number of reasons, including a greater apparent business awareness of the threat of longer run competition, both from substitute products and from abroad. Recent price developments seem to bear this out. At this point further expansion in activity and general price stability appear compatible, assuming that inflationary developments abroad are held in check. Testing of markets will no doubt continue, however, and a close watch will need to be kept on price and cost changes.

Very recent data on the consumer sector are also stronger. Preliminary figures indicate that the rate of retail sales in the first half of May may have approached the February high. The latest Census Quarterly Survey of Consumer Buying Intentions, conducted in mid-April, suggests that buying of durable goods will rise further in the months ahead.

In the financial area, the pace of expansion of bank credit, the money supply, and other forms of liquidity seem to have slackened somewhat thus far this year compared with last year. Banks continue to sell Government securities and to moderate their acquisitions of municipals in order to meet sizable loan demands. As a result, their liquidity positions have been reduced further. Revised seasonal adjustment factors for our money supply series suggest that the recent annual rate of increase has been less than we had thought earlier, 2.9 per cent for the first four months of the year, as compared with 3.3 per cent in the same months of 1963.

Earlier in the presentation, we also analyzed several longer run aspects of the financial situation that are of particular relevance to monetary policy formulation. We concluded, first, that the private economy's liquidity, although it has risen contracyclically, does not look excessive when related to either private expenditures or to private debt; second, that the rise in liquidity has consisted mainly of near moneys rather than money itself and we can influence the rate of conversion of near moneys into money; third, that the large current share of total credit flows provided by commercial banks reflects essentially the structural shift in the savings flow and is not in and of itself a cause of inflation; and, finally, that the reduced current liquidity of banks as well as other financial institutions means that expansion of their lending and investing activities would likely be curbed promptly by lessened availability of bank reserves and the accompanying rise in interest rates.

Finally, on the international front, the table on the screen compares the annual rate of deficit in the balance of payments in the last 10 months to the average of 1959 and 1960, a period selected because in early 1960 European demand was in a cyclical phase similar to early 1964. It shows clearly that the major factor of long-run improvement has been trade. Nevertheless, our presentation this morning indicated that the rise in short-term interest rates and rates paid on time deposits since last summer has reduced and at times actually reversed outflows of money market funds into Euro-dollars.

It also showed that capital movements are influenced by a wide range of forces and conditions other than interest rates. Among these, the size and capacity of our financial markets and the general availability of credit here have been among the more important. Some modest reduction in credit availability might contribute to an increased reluctance on the part of banks to make marginal loans to overseas borrowers.

Domestic considerations, however, do not suggest the need for credit curtailment. Economic expansion still appears to be balanced in character and not so rapid as to be unsustainable. There is little evidence in financial or nonfinancial markets of a rebirth of inflationary expectations. There is still a way to go in achieving more satisfactory use of resources, and the current posture of policy can contribute to this objective.

At the conclusion of the presentation Mr. Daane commented that he thought the new technique of focusing on special areas was much more productive than the earlier, broader-ranging chart shows.

Mr. Hickman agreed, and added that he thought the particular areas that had been selected were those that warranted examination most. He congratulated the staff on both the choice of subject matter and the presentation itself.

Mr. Balderston then called for the usual go-around of comments and views on economic conditions and monetary policy beginning with Mr. Treiber, who presented the following statement:

Business expansion continues its orderly advance. In general, the outlook appears to be one of quickening tempo throughout the economy. April was marked by a good increase in industrial production and in new orders for manufacturers' durable goods. Manufacturers' inventories have remained steady while sales have risen. For business as a whole, the ratio of inventory to sales is lower than at any time since 1955.

Residential construction activity continues at a good level. So far, consumer buying, as reflected in retail sales, continues to show no discernible reaction to the tax cut. Apparently many consumers have been taking advantage of the tax cut to reduce their debt. This development lays a good basis for further expansion later.

The price picture continues about unchanged. While wholesale prices declined 0.1 points in April, industrial wholesale prices rose 0.1 points. Raw industrial prices have declined after substantial rises. Of the specific price announcements in the last few weeks, there have been more reductions than increases. Members of the National Association of Purchasing Agents expect a buyers' market over the rest of the year.

Total employment rose substantially in April but the increase in the civilian labor force was slightly larger. The over-all unemployment rate remained unchanged, as did

the unemployment rate for married men. The long-term unemployment rate, i.e., unemployment for 15 or more weeks, declined.

Bank credit showed little change in April following a substantial advance in March. Bank credit growth may have slowed down somewhat this year; but as yet the evidence is inconclusive. Current loan forecasts of the major New York City banks indicate a moderate loan demand. But bank loan-deposit ratios have risen further, and the banks could find themselves under pressure if loan demand should become vigorous as the economy gains further momentum.

So far this year our balance of payments experience has been quite encouraging. The good record is due, in part, to such transitory factors as large grain exports to the Soviet Bloc, unusually low imports, and small sales of foreign securities in our capital market. For the remainder of the year the outlook is not as good. We cannot expect such good results in a number of areas. We are likely to have a substantial deficit during the remainder of the year. I believe we will have to keep the balance of payments in the forefront of our policy considerations over the remainder of the year.

Britain's trade deficit rose sharply in April. Since the last meeting of the Committee, rates on British Treasury bills have risen somewhat. Continuing inflationary pressures on the European Continent could very well lead to higher interest rates there. If later there is a further increase in interest rates abroad, present United States short-term interest rates might well be inadequate to protect the United State against an adverse movement of funds.

The recently declared opposition of the AFL-CIO executive council to the Administration's guideposts for noninflationary wage settlements does not augur well for wage contract negotiations this summer. There could be strikes, delays, and inflationary wage settlements. A wage-price push would undo the gains experienced in our cost picture in recent years, with deleterious effects at home and abroad.

The present situation calls for a high degree of alertness. I am not persuaded, however, that it calls for a major change in policy at this time.

Within the present directive I would hope to see the Federal funds rate consistently at the discount rate, free reserves between zero and $100 million, the rate on three-month Treasury bills above the discount rate as well as below, and some increase in member bank borrowing. I see no reason to change the language of the directive except to delete the reference to the Treasury refunding.

Mr. Shuford said he would like to join with the others who had expressed appreciation for the revised form of the chart presentation. He thought it had been excellent.

Mr. Shuford then noted that national economic activity continued to expand, as the presentation had indicated. The latest data showed significant rises in employment and industrial production, and construction outlays continued at a high level. There had been impressive gains in new and unfilled orders of durable goods manufacturers. Personal income and instalment credit continued to rise in April. Retail sales had been high for the past three months, up at a 9.6 per cent annual rate from the previous three months. It seemed that the national economy was strong and that the expansion might be accelerating.

In the Eighth District, Mr. Shuford said, economic activity had not been as strong as in the nation. Data received in the last three weeks suggested continued hesitation. Industrial use of electric power in the major metropolitan areas had drifted down for the last several months.

Since the last meeting of the Committee, Mr. Shuford continued, there appeared to have been some contraction in the money supply, a development which he considered appropriate. Over the past year growth had been at the relatively rapid rate of 4 per cent. In light of the current rate of economic expansion and the prospects for acceleration, continued rapid increase in the money supply could contribute to an unsustainably high

rate of expansion. He would prefer a more moderate rate of increase in bank reserves and money even though this meant a little less ease in the money market.

Mr. Shuford did not favor an overt change in policy at this time. However, if strong credit demands should work in the direction of less ease, he was inclined to think that this should not be offset. His thinking ran in terms somewhat like those outlined by Mr. Treiber. He suggested that it would be appropriate for the three-month Treasury bill rate to fluctuate in the range of 3.50 to 3.60 per cent, and for free reserves to be held in or close to the $50 to $100 million range. He would not recommend a change in the discount rate. With respect to the directive, he shared Mr. Treiber's view that the one adopted at the last meeting remained appropriate except for deleting the reference to the Treasury refunding. However, he had no objection to the proposal that had been submitted to the Committee by the staff.

Mr. Bryan reported that recent statistics seemed to indicate that activity in the Sixth District was going along about as in the nation. There were the usual number of series in which the District was doing less well than the nation and in which it was doing better, but he could not read any particular significance into the recent District data.

It seemed to Mr. Bryan that national developments were proceeding in surprisingly good fashion. He saw no evidences of an uncontrolled boom, and certainly none of recessionary tendencies. Accordingly, he

advocated no change in policy. In terms of free reserves, he favored a central target of about $100 million, in full recognition of the circumstances that required that the Manager have some leeway in that figure.

With regard to some of the preceding discussion, Mr. Bryan remarked, he appreciated fully the psychological jar that might come from a negative free reserve figure. However, he felt that the longer the period that reserves remained positive the greater would be the jar when they became negative. He did not know how long the Committee could go without a negative free reserve figure, but if it was much longer he suspected that the economy would get a considerable jolt from the appearance of such a figure despite the fact that expansion easily could proceed with constant, moderately negative free reserves. Over the past year, total reserves had increased by more than 3 per cent, although the movement had not been steady. For the time being, and in terms of a longer run than three weeks, he favored aiming for expansion in total reserves at an annual rate of about 3 to 3-1/2 per cent. He did not favor a change in the discount rate at this time.

Mr. Bopp reported that economic conditions continued to improve in the Third District. Unemployment claims had declined seasonally to a level lower than in recent years. Help-wanted indexes had risen both in Philadelphia and in the United States, and department store sales again had gained over last year but still did not match the nation.

Business loans at weekly reporting banks had increased slightly during the past three weeks, but by more than in the same period last

year. The basic reserve position of reserve city banks stood now at about the same level it had been for the past six weeks, and activity at the discount window had been light.

Perhaps he was overlooking something, Mr. Bopp said, but it seemed to him that determination of policy in the present environment came down to a few clear issues. The Committee was concerned with three problems: underemployment of resources, the balance of payments, and inflation. Only the first of these was a matter of current urgency. This was not to say that the Committee could ignore the other two. The balance of payments remained a problem and could become an acute one at any time. Some prices had been going up and perhaps enough more would follow to qualify as an inflationary movement. But at the moment neither the balance of payments nor prices seemed to him to justify a move toward restraint.

In this situation, he agreed with Chairman Martin that the Federal Reserve should not "take the lead toward higher interest rates." He would continue to use monetary policy to stimulate economic activity. He would make no change in the directive (except for deleting the reference to Treasury refunding) or the discount rate.

Mr. Hickman said that the keynote of economic news for April, as the chart show had indicated, was the sharp spurt in productive activity. Of major importance was the snapback of new orders for durable goods after two months of decline. Retail sales remained about the same as in March at a very high level. The evidence continued to suggest balanced, orderly growth at a sustainable rate for the economy as a whole.

An important question at this time was whether there would be sufficient strength from other sectors of the economy to offset the expected leveling in production of autos and steel. Both auto sales and auto output advanced more than seasonally in April. On the basis of fragmentary data for May, however, both were expected to decline somewhat from recent high levels. Steel production, seasonally adjusted, increased from March to April and was possibly increasing slightly further in May. All reporting steel producers in the Fourth District expected new orders to be less in May than in April on a seasonally adjusted basis.

Regardless of the strength in aggregate demand over the near future, and recent near-record increases in employment, Mr. Hickman continued, he could not expect that the large number of young and relatively unskilled entrants into the labor force this spring would find jobs easily. There were increasing instances of shortages of skilled workers along with a surplus in the unskilled group. This was clearly reflected in the percentages of unemployment in the various labor market categories. April unemployment among teenagers was an uncomfortably large 16.2 per cent,

while for married men (as distinct from adult men discussed in the chart show) it stood at a record low of 2.9 per cent. Recently, there had been repeated reports of serious shortages of skilled labor in the machinery industry. In view of the expected large demand for capital goods, this could create a bottleneck and lead to higher prices for machinery and machine tools. These structural problems in unemployment were not susceptible of easy solution by monetary means.

The various measures of bank reserves in recent weeks appeared to Mr. Hickman to have been quite consistent with the Committee's directive and intent. Free reserves had averaged lower over the past three weeks than in most recent months, while borrowings had been somewhat higher. On the other hand, intermediate- and long-term yields had moved slightly lower, partly because of expectational factors and partly because of strong nonbank demand.

Although these drifts in yields might seem minor in themselves, and not wholly undesirable from the standpoint of the domestic situation, Mr. Hickman continued to be bothered by their possible adverse implications for the U. S. balance of payments. With inflationary pressures persisting abroad, certainly no movement toward lower yields could be expected there. Under these circumstances, he thought the Committee should consider the desirability of some firming of rates here. This could be done under the terms of the present directive. He would delete the reference to the Treasury refunding, but he had rather mixed feelings

about the other revisions suggested in the staff's draft. In particular, the reference to the recent quickening of business orders was based on only one month's showing of a very volatile series. Also, he was not sure in what sense manpower was "underutilized" in view of the fact that unemployment among married males was now at a record low.

Mr. Daane said that at the recent American Bankers Association meeting in Vienna he had found a perceptible change in attitudes with respect to the U. S. balance of payments performance. In his judgment there was, perhaps, too much confidence expressed that the U. S. was beyond the problem and that there was no longer any need to be concerned with it. The Europeans were concerned with their own inflationary problems. To Mr. Daane this underscored the need Mr. Treiber had mentioned for the Committee to keep the balance of payments in the forefront of its considerations. He thought the Committee could not put the problem aside at this moment even though the first quarter figures were so much better. A slippage could have a very adverse effect, and he did not think there was anything in the recent improvement to indicate that it was permanent. In the light of this, and in light of the attitudes he had found abroad, Mr. Daane thought it behooved the Committee to keep the balance of payments problem in mind.

Having said that, Mr. Daane remarked, he would add that in his judgment the recent quickening of domestic economic activity was what the Committee had wanted and what it would like to see continue. He saw nothing in the domestic area to justify a change in policy. He would make

no apology for maintaining policy unchanged because he thought that current policy was contributing to the Committee's goals. Operationally, he would not go along with suggestions that it was desirable to try to push interest rates up or free reserves down. On the contrary, Mr. Daane thought that the Committee had been living a little too dangerously with respect to free reserve figures. He would give the Manager the latitude suggested by the range of zero to $200 million, but he would prefer to have any errors on the higher side rather than have the Manager skate too close to zero and run the risk of showing negative free reserves.

Mr. Daane said that he would not change the directive in the manner suggested by the staff because he thought it implied too much in the reference to "recent quickening." He would stay with the present directive, except for deletion of the Treasury financing reference. He would not charge the discount rate.

Mr. Mitchell commented that he agreed with Mr. Daane that the Manager was causing the Committee to live too dangerously. He would be prepared to raise the free reserve target to $250 or $300 million if this was necessary to avoid the risk of ending up with a negative figure. He would rather postpone having net borrowed reserves until the Committee wanted to give the market a jolt, rather than produce a negative figure inadvertently and have to operate to raise it in the following week.

Mr. Mitchell thought that the differences in view among Committee members were quite small, but nevertheless significant. Most seemed to

feel that over this long period of economic expansion the Committee had maintained a policy of moderate ease. In his judgment, however, there had been a gradual move from ease to tightness. To him conditions appeared quite taut at present. Banks were extremely illiquid, and the turnover in deposits was high and continuing to rise. These circumstances were symptomatic of greater tightness and tension than many thought existed. Small probings toward greater firmness in monetary policy could cause difficulty, and could contribute to thwarting the national objectives of increasing activity and reducing unemployment. He thought the Committee was doing about the right thing but that it was cutting matters a little too finely.

Mr. Mitchell said he was prepared to accept either the existing directive or the staff draft. In the latter, he agreed with Mr. Hickman that it might be desirable to omit the reference to business orders, since the rise was a one-month development. He would substitute the word "apparent" for "recent" in referring to the quickening of the expansion. In general, he thought it desirable to revise the directive frequently, and he was satisfied with the staff draft even though its tone seemed to suggest something to some people that it did not suggest to him.

Mr. Shepardson said that he, too, had found the new type of chart show much more helpful to him than earlier ones. With respect to economic developments, all the information before the Committee seemed indicative of a gradual and sustainable expansion in business. The Committee certainly was concerned with the problem of unemployment, but this

problem had different segments and in his judgment the segment that appeared to be most serious was not susceptible to relief by monetary policy. He thought the Committee had been providing the opportunity for expansion of business. If there was to be healthy and sustainable expansion, it had to come out of a growth in business itself; the Committee's obligation was to accommodate this growth and not to overstimulate the economy.

It seemed to Mr. Shepardson that the Committee had been following an appropriate policy as measured by the amount of expansion in reserves. He was pleased that, if anything, there had been a little less reserve expansion in the recent period. This, he thought, was well within the scope of the guidelines that have been given the Manager. He favored continuation of the present policy as reflected in the indicators of recent weeks. On the directive, Mr. Shepardson thought there was some advantage in the draft proposed by the staff. He agreed with Mr. Mitchell on the desirability of changing the word "recent" before "quickening" to "apparent."

Governor Robertson made the following statement:

> At each of the Committee meetings since the enactment of the tax cut, discussion here has suggested the need for a policy of "watchful waiting," pending clarification of the resulting stimulus to business activity. There has been concern about a possible boom in business capital spending, a sharp upsurge in credit demands, and the triggering of a wage-price spiral. But in the weeks that have followed, the facts as they have come in describe a continued relatively gradual business and credit expansion. The very latest

statistics suggest a slight quickening in the rate of business advance, but this seems no more than what might have been expected--or even hoped for--if the economy is to make some steady headway in employing its idle resources. Meanwhile, a remarkable restraint has characterized business price and inventory policies. No spurt of inflationary ebullience has developed. Signs of improving employment are appearing, without yet any sign of approaching bottlenecks that could create distortions in the growth of output.

It seems clear that we are moving upward in a gradual advance in activity that is not threatening to get out of hand, and to my mind this justifies a positive policy of continuing to provide a generally stimulative monetary environment. Economic developments calling for a less stimulative policy may well develop at a later date, but that is no reason to tighten credit at this juncture.

There may be some thought that the recent substantial flow of bank credit to foreign customers represents a development to which monetary policy should attend. I could not disagree more. General monetary policy needs to be adapted to general credit conditions, and, in general, credit conditions in this country do not call for restraint. Foreign loans by big domestic banks are a very narrow and special kind of credit outlet. It sometimes seems hard to distinguish the portions of such credit that finance part of our heartening trade surplus and the portions that have an unrequited adverse effect upon our balance of payments. It strikes me as rather ironic that sizable amounts of this foreign lending are being made by some of the same big bankers who have been bemoaning the "payments problem." It might not be amiss to seek an appropriate way of reminding some of the most aggressive foreign bank lenders of this seeming irony, and also of the desirability of prudent limitations on their exposure to foreign currency hazards, and of the wisdom of avoiding pyramided credit extensions not closely related to the financing of our international trade.

As for the directive to the Desk, I would be agreeable to continuing the present language unchanged, aside from dropping the reference to Treasury financing. And I would hope the Manager could implement this by achieving both objectives mentioned in the final paragraph, namely relatively the same money market conditions and some moderate expansion in aggregate bank reserves. (As a practical matter, if we start to experience a persisting shortfall in aggregate reserve expansion, then I should like to see the Desk allow a little compensating ease in the money market in order to cushion the reserve contraction.)

Mr. Robertson added that he had no objection to the staff draft, with the substitution of the word "apparent" as suggested by Mr. Mitchell. He also agreed with Mr. Mitchell that it was desirable to revise the directive frequently.

Mr. Mills said he was in agreement with the position taken by Mr. Mitchell, although he would not be quite as free and liberal as Mr. Mitchell would in raising the level of free reserves. On the other hand, Mr. Mills said, he thought the Committee should guard against allowing the level of free reserves to move down to or touch the zero level.

Mr. Mills added that he would be prepared to accept either the existing directive or the proposed revision with the substitution of the word "apparent" for "recent." However, he did not think the Committee's problem ended with considering the wording of the directive if in the course of its implementation by the Management of the System Open Market Account it was subject to another interpretation. The matter had come up often, but he thought there were good reasons to believe that the Committee had been trapped into specifying objectives in terms of magnitudes, particularly in terms of some specified general level of interest rates or volume of free reserves. He thought the conduct of operations by the System Open Market Account had been handicapped in that regard. The way to break free from these shackles was to move toward allowing the market as such to give direction to the System's policy rather than for the System to give a positive direction to the market as to what its specific intentions were. The mechanics of the shift toward a more flexible policy would be

to not offset fully the fluctuations that occurred in the vault cash factor and the float factor. If, as it originally did, the Committee allowed such changes to pass by with less notice the result would be a more responsive market, and one that would give more leads to System policy. Care would have to be taken to avoid negative free reserves, but he had no concern in that regard.

By and large, Mr. Mills said, he would accept the directive and he would hope that the Committee could move toward more flexibility in its policy actions, becoming more responsive to the market and permitting the market to move more slowly to its (the Committee's) ideas rather than forcing its views on the market.

Mr. Wayne reported that the trend of Fifth District business continued upward, and improvement seemed more broadly based as a result of recent developments. The District's principal manufacturing industries had continued to increase production. Textile producers had all the current business they could handle and, although few chose to talk about it, there was considerable evidence that most of the prices were now reflecting some of the recent 6.5-cent-a-pound cotton cost reduction. Retail trade showed noticeable improvement in the first half of May, according to retail store executives polled in the recent survey of the Richmond Bank and as reflected in its department store series. The latest statistics on building permits and contract awards indicated substantial new additions to the already large volume of District construction projects. In line

with expectations, first quarter cash receipts of District farmers were 1 per cent below last year's level. In the latest three weeks, loan demand, especially in the business sector, appeared to have been somewhat stronger in the District than in the nation as a whole.

For the country as a whole, most of the available information indicated that the economy was moving forward with considerable strength and with no notable signs of inflationary pressure. The large increase in employment and the substantial rise in industrial production last month were solid contributions to the general improvement. Weekly data through mid-May suggested some gains in retail trade, although it remained to be seen how substantial these were. The corporate profits picture remained favorable, supporting general expectations of rising investment outlays in the months ahead. Continuing strength in new orders for durable goods and in manufacturers' backlogs also made for an encouraging prospect. The one doubtful element in the current situation was the highly volatile housing starts series. Expenditures for new construction, however, were apparently holding firm at their peak level. As Mr. Wayne saw it, the over-all picture was one of strength at a high level of activity.

In the policy area, Mr. Wayne said he found himself in almost complete agreement with Mr. Daane. He was convinced that the Committee's moderate course over the past several weeks had been the correct one. The money market had shown encouraging stability in the face of shifts in expectational patterns, and business expansion was apparently proceeding

without undue inflationary pressure. The balance of payments problem continued of diminished urgency, although preliminary April figures were a reminder that this problem was still with the Committee. On the whole, Mr. Wayne felt that the Committee's policy of moderation had paid off thus far and he saw nothing in either the domestic or the international situation that indicated a need for any change at this time. He would leave the discount rate unchanged. With respect to the directive, he could accept either the old one, deleting the reference to Treasury refunding, or the staff draft.

Mr. Clay said that thus far in 1964 bank credit in Tenth District weekly reporting banks had expanded slightly more than last year. This was the net result of a much larger increase in loan volume and a much larger decrease in security holdings. Both real estate and consumer loans had expanded somewhat more than a year ago, and loans to nonbank financial institutions had shown marked strength relative to 1963. Business loan volume, however, had shown pronounced weakness this year, although there had been a marked increase in business loans during the first half of May. The loan categories most important in explaining the recent improvement in business loans were durable goods manufacturing, retail trade, and the transportation, communication, and other public utilities group. The growth in loans to retail trade was especially striking, and came on the heels of laggard growth in retail trade loans during the previous 4 months.

Holdings of U. S. Government securities by District weekly reporting banks had been sharply reduced in recent months. This Government

security liquidation was a continuation of a pattern dating back to the middle of 1963. Part of the pressure on the security portfolios of District banks appeared to stem from the lethargic pace of deposit growth, principally I.P.C. demand deposits. The time deposit component presented a different picture. Since year end, these deposits had grown more than in the comparable period last year. This represented an extension of the accelerated growth of time deposits during the last half of 1963.

Mr. Clay remarked that in analyzing the performance of the national economy and in determining the appropriate public policy prescription, it was necessary to distinguish the yardstick that was being applied. The achievements of this business upswing were notable indeed in terms of the degree of expansion, the length of its life span, and the stability of prices. Another yardstick had been and continued to be this accomplishment weighed against the economy's resources and its potential for growth in an orderly and sustainable manner. It was from this latter viewpoint that a continuation of the Federal Reserve System's current monetary policy had to receive its justification.

The pattern of bank credit expansion during this upswing had differed markedly from that of other periods in that it had not shown the typical reduction in the rate of credit expansion as the upswing progressed. It was also true, however, that the economy's resources and productivity continued to grow, that a substantial unemployment problem persisted, and that the likelihood of price inflation did not appear

imminent. Recent economic developments exhibited considerable unevenness, but there was evidence of some acceleration in certain important sectors. It had to be recognized that commonly accepted projections for the year-end level of economic activity implicitly involved a significant acceleration in the over-all pace of economic activity.

Mr. Clay expressed the view that for the period immediately ahead it would be appropriate to continue monetary policy essentially unchanged. The staff draft suggested for the current economic policy directive appeared to be quite satisfactory, although he also would be satisfied with renewal of the old directive. He concluded by observing that the Federal Reserve Bank discount rate should remain unchanged.

Mr. Scanlon reported that businessmen in the Seventh District continued to be optimistic. Total department store sales for the last four weeks were 11 per cent over last year's volume. He saw little evidence of any tendency for prices to rise at the wholesale level. Even capital goods firms with rising backlogs indicated that prices had been raised only slightly since last fall. Leaders in the machine tool industry, however, were encouraging one another to raise prices. In this industry production would increase more rapidly were it not for shortages of trained labor.

Mr. Scanlon said that demand for credit by both businesses and consumers at District banks appeared to have strengthened in recent weeks. Business loans of District weekly reporting member banks were 9 per cent

above the level of a year ago in mid-May. In the previous twelve months the rise had been 10 per cent. These increases were slightly greater than those for the nation. The large Chicago banks had continued to show fairly comfortable reserve positions, with deposit gains in the past three weeks more than covering loan expansion and with a very small net position in the Federal funds market. They had continued to increase their outstanding CDs.

Although turnover of negotiable time certificates had been very heavy in recent months, Mr. Scanlon said, there was less concern at large banks that reductions in outstandings might become serious. In part this reflected the easing of bill rates, plus the experience that, despite a high withdrawal rate in April, outstanding negotiable CDs rose sharply. In addition, a general confidence had developed that the ceiling rate on time accounts would be raised if the differential over bills declined appreciably at some time in the future.

With the pace of economic activity apparently accelerating, Mr. Scanlon continued, and in view of prospective rate increases abroad, it might be appropriate to permit short-term rates to move slightly higher in response to seasonal pressures in the months ahead. His own judgment, however, was that the Committee should continue the current policy during the next three weeks. Therefore, he would renew the current directive, deleting the reference to Treasury financing, and he would not favor changing the discount rate at this time. He shared Mr. Mitchell's view with respect to the directive prepared by the staff and could accept it with the word change that had been suggested.

Mr. Deming reported that the Ninth District economy was going along in good form. Recent rains had helped crop prospects and had generated some optimism. There had been a slight quickening in the pace of bank credit expansion in early May, although it was not up to last year's rate. The expansion was stronger at country banks than at city banks.

As he had mentioned before, the Minneapolis Bank did a survey of some of the large industrial concerns headquartered in the District with operations both within the District and beyond, and in some cases international. These firms were asked about prospects, in terms of output, employment, prices, and profits, for the next three months relative to the past three months. Responses in the most recent survey, taken last week, indicated general optimism which seemed to have taken on some of the air of exuberance. This was true with respect to output, employment, and profits. In connection with prices, one or two of the firms said their prices would go up over the next three months and one or two said they would go down, but most indicated that their prices would stay about the same.

With respect to policy, Mr. Deming said he was in substantial agreement with Mr. Daane; he would favor continuing policy as it was. He had no strong preference as between the existing directive or the staff dr with the proposed change in wording.

Mr. Swan said that following the first quarter, in which there had been some modest gains in business activity, the Twelfth District appeared

to have marked time in April and early May. Total employment in the Pacific Coast area was about the same in April as in March; a decline in the Pacific Northwest was offset by an increase in California. The unemployment rate also was unchanged. April saw another decline in defense and space-related employment and present indications pointed to further reductions at least through July. Housing starts were up in April but construction employment declined in several States. In the lumber industry orders were down in early May from a year ago and there had been some slight weakening of prices.

On the other hand, Mr. Swan said, bank loan demand in the District in recent weeks appeared stronger than a year ago. This was particularly true of business loans, and the increases were widely distributed among the various loan categories. The large banks were still net sellers of Federal funds in the four weeks ending May 20, but member bank borrowings from the Reserve Bank ranged from 10 to 15 per cent of the national total, considerably more than the District's share in previous months.

On policy, Mr. Swan said that he saw no basis for tightening in either the domestic or international picture. It seemed to him that the signs of an increase in the pace of expansion--in industrial production, in new orders if they had in fact risen, and in the firmer tone of the labor market--should be welcomed, particularly since they had been accompanied by little change in commodity prices and by few indications of unsustainable developments. He noted that the upward courses in bank reserves, bank credit, the money supply, and time deposits all had been moderate in recent

months. In general, he favored no change in policy. In this connection, he observed that apparently there had been a somewhat firmer money market in the past three weeks than previously, with the Federal funds rate constantly at 3-1/2 per cent, free reserves down slightly, and borrowings up. Bearing this in mind, he favored no further tightening, however slight.

With respect to the directive, Mr. Swan expressed a strong preference for the draft proposed by the staff. It seemed to him that the first paragraph of the directive should reflect the current situation, and that there had been enough change in the general picture since the last meeting to warrant revision of this paragraph. He agreed with the language change suggested by Mr. Mitchell.

Mr. Coldwell reported that conditions in the Eleventh District were almost unchanged recently, with production, income, and sales at record or near-record levels. There were some problem areas, such as cattle, where prices were down sharply and marketings were rising with dry conditions and cost of feed, and the petroleum industry, where drilling activity was still declining. The major integrated oil companies were all right financially but the independent companies were having a difficult time. Crude oil prices were weakening and stocks were high. Loan demand was quite good at District banks and the large banks were working every penny, to the point of scheduled deficit positions. They were making continual Federal funds purchases and were borrowing from the Dallas Bank more than occasionally.

Mr. Ellis said that business in New England continued to be good but it was not spectacular. Manufacturers' new orders were rising, but with output level from month to month manufacturing employment was relatively stable. There seemed to be less concern than earlier about unemployment, and unemployment insurance claims continued below year-ago levels. Nonresidential building was running 24 per cent ahead of 1963, and residential building showed a gain of 36 per cent. Real estate loans of weekly reporting banks were 19 per cent ahead of last year as the banks sought outlets for the continued rapid inflow of time and savings deposits. The rate of growth of CDs in a year's time exceeded the national rate by a substantial margin. District banks had drastically decreased their loans to brokers and dealers over the year. Thus, while business in the District was not spectacular, its effect on District banks was nearly so.

Turning to monetary policy, Mr. Ellis said that for some months the Committee had been in a posture of "wait and see," wating to see how the economy would respond to the tax cut. The evidence as to the reaction of business was beginning to be clearly established; the expectations of a rise in capital outlays had been confirmed by the substantial increase in new and unfilled orders in April. Consumers were responding somewhat more slowly.

In this situation, Mr. Ellis thought it appropriate that policy should continue in a posture of watchful waiting. His uneasiness stemmed

from the feeling that it would be better if the Committee were watching more as a neutral, from the sidelines, rather than as a participant. Unfortunately from his viewpoint, it was clear that a move to neutrality now would be viewed as an aggressive move. Such aggression did not seem appropriate to the Federal Reserve, especially in view of the market's reaction to the Chairman's recent statement before the Advertising Council. Mr. Ellis therefore fell back on Mr. Iron's suggestion of three weeks ago that the Committee instruct the Manager to resolve doubts on the side of less ease while maintaining a posture of watchful waiting.

Mr. Ellis said that he had found the discussion about the directive this morning highly interesting. It was a useful illustration of the continuing need for the Committee to give more attention to its directive and to assume more responsibility for judgments that now were left to the Account Manager. His personal view was that the Manager had been doing very well in implementing policy. He noted that Mr. Stone had described the free reserve target in terms of a zero to $200 million range. He had thought the target range was $50 to $150 million, but he was delighted to accept the Manager's version of a range from zero upward. Along with that he would suggest fluctuation in the bill rate from 3.44 to 3.60 per cent, the range that had prevailed over the last six months.

Referring to Mr. Bryan's comments, Mr. Ellis said that the Committee seemed to be caught between the alternative of giving the market an occasional psychological jar with a negative free reserve figure, or

avoiding this and setting up the chance to really jolt the market when it wanted to change policy. He would prefer the occasional jar, and have the market come to recognize that a single low free reserve figure should not be taken as signifying a change in policy. The Committee could then move in gradual steps rather than in jolts.

In concluding, Mr. Ellis said he thought the directive should reflect recent developments. Accordingly, he favored the draft proposed by the staff with the substitution proposed by Mr. Mitchell of "apparent" for "recent."

Mr. Balderston commented that he also would like to express his appreciation for the new form of the chart presentation given to the Committee this morning. He was especially happy about the strength and balance of the economy in May, as recorded in the presentation. He was not suggesting that May would prove to have been the high point of the expansion, but he thought it might be a point to which the Committee would look back in the future as reflecting the kinds of economic conditions that it desired and that it had hoped for before the tax reduction.

Mr. Balderston said that the consensus of the Committee clearly favored a continuation of the policy of recent weeks. Parenthetically, he noted that he was among those who had been pleased with the implementation of policy since the last meeting.

After a discussion of the specific language of the directive to be adopted, Mr. Balderston suggested that a vote be taken on the staff

draft with the substitution of the word "apparent" for the word "recent" before "quickening." Messrs. Daane, Hickman, and Mills each indicated that he had certain reservations about the proposed directive but did not consider them sufficiently serious to warrant dissenting.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following current economic policy directive:

It is the Federal Open Market Committee's current policy to accommodate moderate growth in the reserve base, bank credit, and the money supply for the purpose of facilitating continued expansion of the economy, while fostering improvement in the capital account of U. S. international payments, and seeking to avoid the emergence of inflationary pressures. With the recent Federal income tax reduction, continued strength reported in consumer buying plans, and anticipated increases in business capital expenditures as immediate background, this policy takes into account the indications in most recent data on production, business orders, and employment of some apparent quickening in the pace of domestic expansion. It also gives consideration to the continued relative stability in average commodity prices; the persistent underutilization of manpower and other resources; the country's improved, though still adverse, international payments position this year; and the interest rate advances over past months in important markets abroad.

To implement this policy, System open market operations shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves.

It was agreed that the next meeting of the Committee would be held on Wednesday, June 17, 1964, at 9:30 a.m.

Thereupon the meeting adjourned.

Secretary