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, January 7, 1964, at 9:30 a.m.

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

Messrs. Hickman, Wayne, and Swan, 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. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Baughman, Brill, Eastburn, Furth, Garvy, Green, Holland, Koch, and Tow, Associate Economists
Mr. Stone, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Broida, Assistant Secretary, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, Secretary, Office of the Secretary, Board of Governors

Messrs. Mann, Ratchford, Rawlings, Jones, Parsons, and Grove, Vice Presidents of the Federal Reserve Banks of Cleveland, Richmond, Atlanta, St. Louis, Minneapolis, and San Francisco, respectively

Mr. Willis, Economic Adviser, Federal Reserve Bank of Boston
Mr. Sternlight, Manager, Securities Department Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 3, 1963, 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 December 17, 1963 through January 1, 1964, together with a supplemental report covering the period January 2 through January 6, 1964. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Coombs stated that the Treasury gold stock would remain unchanged this week. The Stabilization Fund had roughly $82 million on hand with prospective sales of at least $45 million in January. The Russians had been pretty much out of the market throughout December but might be back in sizable volume during January and subsequent months.

Mr. Coombs reported that since the last meeting of the Committee the Account had paid off $122 million of the swap drawing of $136 million

on the Bundesbank, leaving a balance of only $14 million. It also had paid off $10 million of the swap drawing on the Netherlands Bank, leaving a balance of $70 million. On the other hand, the swap drawings of Swiss francs on the Swiss National Bank and the Bank for International Settlements rose from $150 million to $220 million in order to mop up heavy repatriations of dollars banks at the end of the year. In the light of Coombs said, the increase of the Swiss franc s million to $300 million on November 22 seemed the right order of magnitude.

In recent years, Mr. Coombs continued, tended to bring about some strengthening of the dollar and weakening of the Continental European currencies during the first half of the year. Again this year, the seasonal swing might enable the Account to make good progress in paying off both the Swiss franc and guilder debts, which now amounted to a combined total of $290 million. On the other hand, the normal seasonal outflows from the Netherlands and Switzerland might be frustrated to some extent by a further tightening of credit in both countries. The increase in the Dutch discount rate last week from 3-1/2 to 4 per cent had been immediately reflected in a strengthening of the guilder rate. Nevertheless, the basic strength of the guilder had been undermined by the 10 per cent wage increase recently granted and Dutch officials continued to express fears of a sizable deterioration in the Dutch balance of payments. Mr. Coombs was not sure how those

two opposing tendencies would net out. But if credit conditions in Amsterdam tightened so severely as to prevent the Account from paying off the swap debt, he thought that urging the Netherlands Bank to accept a guilder bond issued by the U. S. Treasury would be fully justified. He had, in fact, already discussed this possibility with President Holtrop and was hopeful that the latter would agree. This would give the Account the "take-out" it might need.

Similarly, Mr. Coombs said, an anti-inflationary program now being put together by the Swiss Government might also make it more difficult for the Account to buy the Swiss francs it needed to clear up the Swiss franc debt. Here again, however, there were possibilities of further issue of Swiss franc bonds by the U. S. Treasury which could provide a take-out, if necessary. At the next Basle meeting on Friday of this week, Mr. Coombs said, he would discuss with the Bank for International Settlements and the Swiss National Bank such a Treasury issue in the amount of roughly $75 million.

The normal seasonal weakening of Continental European currencies during the first half of the year had often been accompanied by a seasonal strengthening of sterling, Mr. Coombs observed. It was conceivable that the Bank of England might take in a very sizable amount of dollars during the first quarter of 1964. The Account might, therefore, find it useful to draw upon its sterling swap line during this period with the anticipation that speculative pressures arising out of the British

election later in the year probably would enable such a swap drawing to be paid off without undue delay.

In response to a question by Mr. Mitchell, Mr. Coombs said he was hopeful that the recent tightening of money in Switzerland would not produce an actual inflow of funds; the more immediate risk was that such tightening would impede the normal seasonal outflow. It was his judgment that the authorities would use various direct controls to immobilize funds, and that they would try to avoid interest rate actions. The long-term rate was a politically sensitive matter in Switzerland because an increase would be reflected within six months or so in rates paid on outstanding mortgages in the country.

Mr. Mills referred to Mr. Coombs' statement that the System's guilder and Swiss franc drawings could be funded by issuance of Treasury bonds denominated in those currencies if the System had difficulty in repaying the drawings. He asked whether this would not amount to sweeping the matter under the rug temporarily, and whether the System would not be better off if it had some incentive to live more closely with the problem rather than postponing the day of reckoning. In reply, Mr. Coombs said that his understanding of the rationale of the swap arrangements was that they were intended to meet short-run problems. If a particular drawing took longer to unwind than had been anticipated because of market events or government policies, he thought it desirable to substitute a type of credit appropriate to a longer run

situation. Under such circumstances the problem was not the System's, but the Treasury's.

Mr. Daane commented that in his opinion this was the appropriate relation between the System's responsibilities and those of the Treasury.

Mr. Hayes observed that Mr. Mills had put his finger on a fundamental issue--to what extent should System swaps be used to reduce gold losses? In his judgment, security issues by the Treasury were appropriate to this purpose.

Mr. Hickman asked whether the object of the proposed drawing on swap line with England, and the subsequent sale of pounds, was to prevent a possible gold outflow rather than to eliminate the seasonal pattern in exchange rate movements, and Mr. Coombs replied in the affirmative. He added that the British authorities might be changing their thinking about the appropriate size of their dollar holdings. In any case, a swap drawing and subsequent repayment seemed to be a legitimate way of bridging a short-run improvement in the British international position during the first quarter. British elections in May or June probably would result in an outflow from that country, which would permit repayment of the drawing.

In response to a question by Mr. Deming regarding the outlook for further Russian gold sales, Mr. Coombs reported that the Russians had sold slightly over $500 million of gold in 1963, which was about $300 greater than their normal annual sale. It was his understanding

that their gold sales in connection with extraordinary wheat purchases might run to at least $700-$800 million. In 1964 their sales might be $300 million greater than normal, or perhaps as much as $400 million greater. He noted, incidentally, that the growth of offical gold reserves in 1963 had been fairly sizable. The Gold Pool had acquired and distributed to members $640 million of gold, while South Africa had also increased its gold reserves. In 1963, the total monetary gold stock had probably risen by at least $750 million, or nearly 2 per cent.

In response to other questions, Mr. Coombs said he had no firm basis for evaluating the accuracy of recent conflicting reports of the volume of Russian gold holdings. He thought their foreign exchange holdings could be ascertained, however.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period December 17, 1963 through January 6, 1964, were approved, ratified, and confirmed.

Mr. Coombs recommended renewal, on a three-month basis, of seven reciprocal currency arrangements maturing on or before February 6, 1964. The arrangements, with their amounts and dates of most recent renewals, were as follows: Bank of Sweden, $50 million, October 17, 1963; Swiss National Bank, $150 million, October 18, 1963; Bank for International Settlements, $150 million, October 18, 1963;

Austrian National Bank, $50 million, October 24, 1963; Bank of Japan, $150 million, October 29, 1963 (date of original agreement); Bank of France, $100 million, November 6, 1963; and German Federal Bank, $250 million, November 6, 1963.

Renewal of the seven swap arrangements for a further three-month period each was approved unanimously.

Mr. Coombs noted that the System had drawings of $20 million on the Bank for International Settlements and $55 million on the Swiss National Bank, and the Bank of Italy had a drawing on the System of $50 million, all three of which were reaching their first three-month maturity. He recommended renewal in each case for another three months, if that should prove desirable.

Mr. Ellis inquired whether the System's desire not to continue renewing the drawings indefinitely was understood by the Italian authorities, and Mr. Coombs said that it was. However, he noted, there was a problem of choosing among several alternative means of repayment. In his opinion, the most effective and appropriate method might be for the U. S. Treasury to redeem its outstanding lira-denominated bonds.

The proposed renewal of the three drawings for a further three-month period each, if such appeared desirable, was 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 December 17, 1963 through January 1, 1964, together with a supplemental report covering the period January 2 through January 6, 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:

> As we approached operations during the past few weeks we were prepared to encounter the problems that so frequently beset the money and securities markets at this time of year. As matters turned out, however, the recent period was more like sleepy August than turbulent December, for the market mechanism handled smoothly and with great efficiency the seasonal strains and stresses that converged upon it. This result apparently reflects a considerable degree of advance preparation made by banks and other market participants in an effort to minimize the adverse impact on them of the wide and erratic swings in market conditions that have sometimes occurred in mid- and late December. Furthermore, corporations appear to have been unusually liquid for this time of the year, for they were sizable buyers of bills and suppliers of funds to the market during much of the period. For our part, we stood at the edge of the market, so to speak, injecting reserves at times, and absorbing them at other times, while aiming at keeping the machinery working smoothly against the background of a steadily firm tone and feel in the market. Operating in this way, we were content to let free reserves come out where they might--an approach that was necessary in any case since the reserve figures at times bounced around pretty capriciously.
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> As the written reports have indicated, Federal funds were at 3-1/2 per cent throughout virtually the entire period, while dealer lending rates generally remained in a 3-3/4 - 4 per cent range. Member bank borrowing was generally in the range of recent months except for a rise last week as banks prepared for the year-end statement date.
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> The securities market have generally been steady over the year-end period. In the case of Treasury bills, rates

on three-month maturities have hugged a 3.51-3.54 per cent range while the six-month bills ranged about 12 to 15 basis points higher. Toward the year-end, there was a better-than-seasonal demand for Treasury bills, which produced some rather aggressive dealer bidding in the regular auctions that preceded Christmas and New Year's. So far in the new year, however, there has been little evidence of the net demand that often tends to pull rates lower at this season. In yesterday's auction, the average rates were about 3.53 and 3.67 per cent, or very nearly the same as on December 16.

In the Treasury note and bond markets, the downward price trend that persisted through most of December leveled off just around Christmas and there was some price recovery in the final days of the year. While most market observers still feel that the major anticipated influences on the market this year--notably a prospective tax cut, good business, and a continuing external payments problem--will tend to produce higher rather than lower rates, there was also a feeling that the market had discounted these prospects to some appreciable extent. Still, the underlying market atmosphere remains a bit cautious as dealers and investors wait to see what balance may emerge between private forces of credit demand and supply, and what the Treasury may be offering in the period ahead.

The corporate and municipal bond markets have enjoyed a respite from major new issues during the past few weeks, with prices holding about steady. Starting today, however, some larger new issues will reach those markets and give a more realistic test to current rates. Particular attention will focus on the $130 million New York Telephone issue, scheduled for competitive bidding today. This is a Triple-A rated issue and yesterday's market talk suggested a reoffering rate around 4.50-4.55 per cent.

A special comment is in order regarding the bankers' acceptance market, which has experienced a larger-than-usual increase in supplies this year-end season. Moreover, since the period of seasonal rise in supplies started with inventories already at a relatively high level, total dealer holdings of acceptances have risen to new records in recent days. Nevertheless, there has been no apparent concern on the part of most of the acceptance dealers. One dealer limited his participation in the inventory rise by increasing his rates just prior to the last meeting of the Committee, but the others did not follow and by January 2 this dealer

returned to the rate level quoted by the other dealers in order to continue effective participation in the market.

To assist the acceptance market through this period of seasonal pressure the System gradually increased its outright holdings of acceptances to a peak of $71 million. System holdings of acceptances under repurchase agreements briefly reached a peak of about $95 million but had receded to $79 million by the end of the period.

Treasury financing plans recently have been in a state of flux. Unitl a few days ago it was anticipated that the Treasury would follow up this week's auction of $2-1/2 billion June tax bills with a cash offering of $3/4 to $1 billion in a note or short bond. Now it appears that the Treasury's cash position may be strong enough without this additional borrowing, but the Treasury is instead giving serious consideration to making an advance refunding offering, possibly with an announcement tomorrow and the books open next week. We understand that no final decision has yet been made on this financing. The market, incidentally, has no hint of this possibility. The Treasury will meet with its advisory committees near the end of this month and will announce on January 30 the terms for refunding the certificate and bond that mature on February 15, of which a little over $4 billion are held by the public.

The staff projections indicate a very substantial bulge in reserves from market factors in the next few weeks and accordingly I would recommend an increase in leeway for change in System Account holdings between Committee meetings to $1.5 billion.

After eliciting information on current competitive rate relations in investment markets between bankers' acceptances and negotiable time certificates of deposit, Mr. Mills asked why the acceptance dealers allowed themselves to be saddled with large inventories, rather than reducing them by adjusting their rates to meet competition. Mr. Stone replied that most acceptances were bought by banks as investments. There had continued to be some small buying recently, and the dealers

seemed confident that they would work their inventories down unless some sharp upward movement occurred in other market interest rates. He agreed with Mr. Mills' suggestion that the dealers might be worried about retaliation by their banker clientele to rate increases, but added that such increases probably would be made anyway if inventories were not reduced in the next week or two.

Mr. Mitchell asked whether in Mr. Stone's judgment Treasury bill rates would have been as stable as they had been recently if the Desk had formulated its objectives in terms of reserves rather than interest rates. It seemed to him that the advance preparation for seasonal needs by banks and corporations, to which Mr. Stone had attributed the recent smooth performance of the market, had been possible because market participants believed short-term rates were pegged, and it might not have occurred if the Desk had been following a reserve objective not known to the market.

Mr. Stone said that the New York money market banks had worked their heavy basic reserve deficiencies down close to zero as the mid-December tax and dividend date approached in order to have room to take on additional loans. In his judgment, such actions by banks would have made the market machinery work smoothly whether or not the Desk had operated with a reserve objective.

In reply to Mr. Mitchell's question of whether banks had not reduced their reserve deficiencies in December at the cost of further monetary expansion, Mr. Stone said he doubted that there was any

evidence to the effect that creditworthy borrowers who wanted loans in December could not get them. If the Desk had attempted to use a free reserve target, Mr. Stone continued, there would have been wide swings in market conditions because of shifts in the distribution of the given volume of reserves and changes in the intensity of reserve utilization. On balance, market conditions would have been firmer if the level of free reserves had been held stable.

Mr. Mitchell commented that stability in market conditions of the recent sort might deprive the Desk of useful signals. Mr. Stone replied that enough changes occurred to permit judging the market pretty well. For example, he said, figures on bank borrowings had fluctuated considerably in December, indicating changes in the degree to which reserve needs were not being met by the existing supply of reserves.

In reply to a question by Mr. Hickman, Mr. Stone said that if the Account had held free reserves at about $100 million recently the 90-day bill rate probably would have been several basis points higher than it was--perhaps around 3.60 per cent.

In response to questions about prospective Treasury financing operations, Mr. Stone observed that Federal tax receipts currently were considerably above the estimates of only a few weeks ago. While the Treasury's cash position might run rather low in April, it was possible that additional cash borrowings would not be necessary during the first half of the year except for $1 billion to be raised each

month in the one-year bill cycle. If the Treasury decided to carry out the January advance refunding, settlement would come shortly before announcement of the refunding of February 15 maturities. After the February refunding the way probably would be clear for monetary policy action until the announcement of the May refunding around the end of April. Whether a shift in policy about mid-February would be consistent with the tradition of even keel during periods of Treasury financings would depend partly on the condition of the market then. If the February refunding involved short-term issues only, as seemed probable, there was a reasonable prospect that the new issues would be rapidly distributed and that there would be no serious constraints on policy actions after about mid-February.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period December 17, 1963 through January 6, 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. Brill commented on economic conditions as follows:

I assume you are all as surfeited as I am with reviews of 1963 and prognostications for 1964. I had hoped to eschew this seasonal occupational hazard and focus instead on the very current economic situation. Unfortunately, at this time

of month current data are sparse. We have, as yet, only fragmentary indications as to the course of industrial production in December. These bits and pieces suggest that the pace of industrial activity held at about the November level or perhaps edged a bit higher; there is no evidence of a renewed upsurge in activity. Some industrial commodity prices crept up further last month, particularly metals, but the over-all wholesale price average remained unchanged at about the levels that have been prevailing over the past six years.

More bullish information comes from the consumer sector. The resurgence in retail sales after the slight November dip indicates that the December total set a new high, and by a substantial margin. Sales gains were recorded in all categories of durable goods and in most categories of nondurables. Sales of new autos were in record volume for the month, estimated at a rate of over 8 million domestically produced cars.

Evidence that consumers are willing to spend vigorously is most encouraging, indeed vital to the maintenance of optimism, for we are not now getting much thrust from most other sectors of the economy. Businessmen, by and large, are continuing to behave cautiously. There was some perking up in inventory accumulation at the manufacturing level in both October and November, concentrated largely in nondurable goods industries, but stock/sales ratios at both the durable and nondurable levels remained low and manufacturers have reported plans to reduce the rate of inventory additions in the first quarter of this year. As has been reported earlier, business plans for fixed capital spending were for a moderate increase in the fourth quarter of 1963, a leveling off in the current quarter, and another moderate increase in the spring quarter. While corporations are girding themselves with funds--capital market financing in December was large and the corporate calendar for this month continues relatively heavy--the business sector's current contribution to expansion remains modest.

State and local spending has continued to rise at a rapid rate, with another large increase in their payrolls and outlays for road construction recorded in the fourth quarter. Federal Government spending, however, has been lagging. Federal purchases of goods and services in the fourth quarter are estimated as not much higher than in the second or third quarters, even though the fourth

quarter figure includes the $1 billion increase in military pay. It is worth emphasizing how much the GNP advance in 1963 has depended on the private economy. Since early 1963, Federal spending for goods and services has increased by only a little more than $1 billion, or about 5 per cent of the increase in total GNP. In contrast, over the first two years of the cyclical expansion--from the first quarter of 1961 through the first quarter of 1963--Federal spending rose by $10 billion and accounted for almost 15 per cent of the increase in GNP. It is a testimonial to the underlying strength of private demands for goods and services that the economy could maintain a 4 per cent rate of expansion in real GNP last year with so little help from Federal spending and with only a shopworn promise of future tax relief.

This strength in private demands has depended in no small measure on the availability of credit. Consumers, for example, financed the record volume of auto and other durables purchases in part through an increase in their instalment indebtedness of about $5-1/2 billion last year, equal to the previous record expansion in 1959. They financed a rising volume of home purchases--and probably other types of outlays--through a record increase in home mortgage debt, tentatively estimated at about $15 billion or 10 per cent more than in 1962. The other strongly expansive sector last year--State and local governments--also tapped the capital markets in record amount; issues for new capital floated by these governments in 1963 totaled $9 billion, 6 per cent more than in the previous year.

Of course, we've had to take the bad with the good, namely, a record volume of heavily debt-financed apartment house and office construction, not all of which may ultimately prove to have been sound business ventures. This is always a hazard in a market economy subject in the credit area only to general controls; one can hope that credit-induced distortions are not widespread and that likely readjustments in this area will be orderly and noncumulative. For the economy as a whole, however, until fiscal policy takes over more of the task of sustaining expansion, it would appear that monetary policy remains saddled with the burden--and the risks.

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

The fairly steady position of the money and capital markets that came about early in November has continued in general to date. This development was initiated by market recognition of the fact that the Treasury felt that for international reasons, and for the time being at least, short-term interest rates could be too high as well as too low. It has continued because these earlier psychological and expectational influences have been backed up by somewhat less expansionary economic and financial developments.

In December, for example, the economic news becoming available was not quite up to the bullish business optimism that continues widespread. Secondly, there was a less intense demand for financing. In the capital markets, it was the municipal calendar that was light and, in the case of bank credit, loan demand was less strong. In the money market, the December 10 dividend date and the December 15 tax date both came and went without the usual signs of seasonal stress, and at the month end, too, the churning and pressure that usually characterize the money market was noticeably absent.

Bank credit in December rose less than in November, but the rise was about in line with the average increase earlier in the fall. Excluding the erratic security credit, total loan growth in December was also in line with that in earlier months, as was that in business loans. The December rise in business loans included heavy borrowing around the December 15 tax date, larger temporary borrowing by public utilities prior to capital market financing, and bank acquisitions of acceptances. A year-end bulge in business loans reflected a large sale of instalment receivables to the banks by General Electric as well as temporary borrowing by oil and other natural resource industries for tax purposes.

Another important aspect of recent credit developments has been the fact that banks have again been increasing their U. S. Government security portfolios and have apparently again become more interested in acquiring municipal securities. Banks seem to have been under a little less reserve pressure recently than they were prior to November. This may have been due to the fact that reserves were a bit more readily available than earlier, or that loan demands have been more intense, or possibly banks are becoming a bit more complacent about the somewhat larger borrowings from the Reserve Banks of recent months.

We have little additional information available on the recent course of the money supply and other forms of liquidity.

All that can be said is that the estimates given at the last meeting of the Committee are now firmer. The narrowly defined money supply through December has changed little since early November, following its rapid rise earlier. The course of the money supply has been considerably affected by that of Treasury deposits, which have increased recently. Time and savings deposit growth slackened markedly in December from the sharp November pace, excluding the large year-end rise in certificates of deposit due General Electric as payment for their instalment receivables.

An interesting aspect of the recent money supply growth has been the relatively sharper rise in the currency component than in the demand deposit component. Currency outside banks rose almost 7 per cent last year, as compared with a little less than 3-1/2 per cent in the case of demand deposits. This fact, coupled with the sharper growth in the total money supply, suggests rising transactions requirements for money. Demand deposit turnover has also tended to level off, fluctuating recently around the higher level attained about mid-year. In other words, the rate of use of existing money stocks may be reaching upper resistance points in certain sectors of the economy.

Turning to bank reserves, free reserves averaged about $175 million last month, as compared with around $75 million earlier. This rise in free reserves was due entirely to higher excess reserves, for member bank borrowings continued to average a little over $300 million. Nevertheless, money market conditions remained about the same, that is, slightly less taut than prior to November.

As to the future, we are now entering the period when we should be able to separate out more satisfactorily the effects of seasonal as contrasted with cyclical influences on expansion of bank credit, money, and reserves. I feel that the cyclical forces will continue strong and that they, coupled with the expected busy January Treasury financing schedule, will offset, in part at least, the usual seasonal forces that tend toward credit and deposit contraction and lower interest rates. In the first place, most money and capital market participants expect higher interest rates sometime soon and therefore any tendency toward lower rates is resisted. Also, bank lending officers now look for less seasonal loan liquidation than usual. Moreover, both the corporate and new municipal financing calendars for January look large. Finally, even mortgage rates are showing a little more firmness.

Developments in the first few days of seasonal easing that have already occurred are consistent with this interpretation. Bill rates have declined little despite substantial corporate demand. The Treasury has announced that it might accomplish its mid-month cash financing through a note or bond issue rather than a bill strip, or that its better than expected current cash position might enable it to skip this financing entirely. In the latter case, however, the financing calendar could still not be clear, for the Treasury might decide to move up its expected advance refunding from March to January.

Since the Treasury is anxious to achieve some debt lengthening, January is probably a more appropriate time to accomplish it than later, when the Treasury might have to compete with larger credit demands from a more sharply expanding economy. It should be possible for the Treasury to take such action now without putting undue downward pressure on short-term interest rates. However, given the prevailing interest rate outlook, it might result in some upward pressure on longer term yields. In event of an early advance refunding, an "even keel" monetary policy obviously would be called for, but the question that might be raised for the Committee would be whether it should try to cushion any upward pressure on longer term rates that might thereby result.

Mr. Furth gave the following report on the balance of payments:

The tentative weekly figures for December indicate a surplus for the month in the neighborhood of $450 million. If these figures could be taken at face value, the payments deficit for the fourth quarter would be at a seasonally adjusted annual rate of about $1 billion, little more than half of the third-quarter rate and less than one-fourth of the rate of the first two quarters. And the deficit for the entire year 1963 would be less than $3 billion, the lowest deficit in six years.

A large part of the December surplus may reflect withdrawals by U. S. corporations of funds deposited abroad, either for year-end window-dressing, or for good owing to the recent troubles in the Euro-dollar market. If the former interpretation were to prove correct, the economically meaningful surplus for December might have been as much as $300 million smaller. In that case, the deficit for the fourth quarter would have been somewhat larger than that for

the third quarter, and the deficit for the year 1963 in the neighborhood of $3-1/4 billion, only 10 per cent smaller than the deficit for 1962.

But in any case, the second half of the year seems to have shown such a decisive improvement over the first half that the deficit for the year as a whole, which until recently had looked much larger than for 1962, actually turned out to have been considerably smaller. Unfortunately, the public-relations impact of that development has been impaired by the statistical adjustments in the official presentation for 1962, which--despite the warnings of the Board's staff--made it appear that the deficit in that year had been only $2.2 billion instead of the economically meaningful figure of $3.6 billion. Consequently, some commentators have already made the mistake of stating that the 1963 results would show a deterioration rather than an improvement over 1962.

Trade figures through November suggest that a good part of the recent improvement was due to an encouraging export performance. This year, the wheat exports to the Soviets appear to be materializing, and economic conditions in most foreign countries are expected to remain propitious. Hence, we may expect a continuation and perhaps a further improvement of that trend during the current quarter.

In contrast to the trade accounts, the capital account proved disappointing in the fourth quarter, apart from the puzzling events of the last week of December. In the two months October and November, short-term bank claims on foreigners rose by $315 million, a rate close to the second-quarter record. Increased short-term bank lending to commercial banks in the United Kingdom, Germany, and Japan suggests that at least part of the loan demand that used to be satisfied in the Euro-dollar market has now, after the apparent shrinkage of that market, been redirected toward U. S. sources of supply. This development seems to confirm the view that a decline in the Euro-dollar market, while obviously welcome to the large New York banks, does not necessarily help to improve the U. S. payments balance.

Whatever the final figure for the U. S. payments deficit for 1963 may turn out to be, its financing was less painful than had been anticipated. In 1963, U. S. gold reserves declined $460 million, about one-half as much as in 1962. Other nondollar financing (including prepayments of foreign government debts; the issue of bonds denominated in foreign currency; the net increase in U. S. official short positions

in foreign exchange; and the decline in the U. S. position in the IMF) accounted for only $750 million, less than one-third of the 1962 figure. And at least $1.7 billion, or about three-fifths of the entire deficit, was financed by an increase in foreign holdings of uncovered dollars--as compared to a trifling $400 million, or one-ninth of the deficit, in the previous year.

This welcome development may be attributed to three main reasons. First, the payments position of some traditional dollar holders--especially in Latin America--greatly improved. Second, the Euro-dollar market absorbed on balance dollar funds that otherwise might have been converted into gold. And third, there seemed to have been a lessening of market uncertainty about the dollar in the European private financial community.

The new market attitude toward the dollar so far has had little effect on the monetary authorities of some of our European allies, whose policies still show little understanding of their share in the responsibility for maintaining a working international payments system. The latest incident is the increase in the discount rate of the Netherlands Bank. Its distinguished President has assured us by cable that the action will not lead to a flow of funds from the United States to the Netherlands. He may well be right. But he would have been more cooperative if, instead of raising the Netherlands interest-rate level, he had abolished the severe limitations on foreign access to the Netherlands money and capital market. Such an action would also have restricted domestic availability of liquid funds, and would have helped rather than hampered the reduction in the country's payments surplus--twin sources of inflationary pressures in the Netherlands. But international cooperation is apparently easier to preach than to practice, and good advice easier to give than to take.

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

The business situation contines to be good, with incomplete data for December suggesting further advances in steel, a continued high level of auto production, and a sizable gain in retail sales. On the other hand, additional

statistics now available for November are somewhat disappointing; and a relatively sober appraisal of first-quarter figures for 1964 may be warranted by such factors as the leveling tendency of Federal expenditures and housing outlays, and the indications that business fixed investment and auto sales may be no higher in the first quarter than in the quarter just ended. To my mind, however, these are merely qualifications in a generally favorable outlook. The expectation is still that economic activity will advance further in 1964, particularly in view of the increased likelihood of early action on tax legislation and the rather buoyant state of business sentiment. And we should not lose sight of the fact that in 1963 we have achieved all-time peaks in most over-all measures of the economy.

As for the balance of payments, very preliminary figures indicate that a very sizable surplus in December may result in a somewhat less adverse fourth-quarter balance of payments figure than seemed likely a month or two ago. Part of the December surplus is attributable to regular year-end amortization and interest payments on outstanding postwar loans and very substantial payments by Germany for military supplies. But it also appears that our request to the New York banks to refrain from foreign window-dressing operations met with a favorable response, and, in addition, there may have been a sizable repatriation of United States funds from abroad, particularly from Canada. We shall have to wait and see how much of the apparently good December figure represents a shift in seasonal patterns of money flows rather than a more fundamental improvement.

In any event, we should not allow ourselves to be lulled into a sense of false security by the results of a single month. Sustained improvement in our balance of payments remains imperative. Meantime bank loans to foreigners are rising as the large U. S. banks are still aggressively seeking loan outlets abroad.

It is well to bear in mind also the growing signs of impatience on the part of foreign central banks with our failure so far to make more significant progress towards solving our payments problem. They have become increasingly reluctant to take in additional dollars; the French in particular have been expressing their feelings in no uncertain terms at the Group of Ten meetings. Also, the Federal Reserve has outstanding gross swap drawings of some $328 million and the Treasury has $120 million in forward

commitments--which obligations should be liquidated soon. Tighter monetary policy in several European countries, including central bank discount rate increases, must be expected--the latest Dutch discount rate action being a case in point.

The growth of bank credit slowed down in the first four weeks of December, mainly because of weakness in security loans attributable to low levels of dealer inventories and generally cautious feelings about future rate movements. Most other loan components behaved about as they have over comparable periods in the preceding two years. By mid-December money supply proper showed a twelve-months gain of 3.7 per cent, and, together with time deposits, of 8.2 per cent, as compared with 7.5 per cent a year earlier. As several members of the Committee suggested at the last meeting, the question may well be raised whether continued expansion of credit and liquidity at recent rates can be considered sustainable or desirable, from a purely domestic standpoint. As George Ellis put it three weeks ago, the burden of proof must shift at some point to those who want to continue inflating the money supply at recent rates--and I would assume that George had in mind over-all liquidity as well as the money supply proper. Certainly there is no justification for keeping it up in order to cope with an unemployment problem which is in large part structural and susceptible to cure only by a concerted attack on a variety of fronts, mostly nonmonetary.

Although both international and domestic considerations point to the desirability of a more "neutral" monetary policy than the one currently in force, we are unfortunately faced with the prospect of a series of Treasury financing operations which would seem to preclude any appreciable policy change at this time. I should think we might well pursue the same general policy as in the past three weeks, and under the same directive. This would mean aiming at a firm money market with the Federal funds rate at the 3-1/2 per cent ceiling and the Treasury bill rate fluctuating around that level and more often above it than below. It would also seem appropriate to counteract any significant tendency toward the development of an easier tone due to seasonal factors.

Mr. Ellis said that throughout the year 1963 he seemed to have been reporting substantially the same description of the New England

economy: rising levels of income and spending, and stable or falling manufacturing output. This description was still apt. District manufacturing output lost more ground in November than it had gained in October, and manufacturing employment declined more than seasonally in November. In contrast, consumer spending continued strong. In downtown Boston, Christmas sales at department stores showed a gain of 8-1/2 to 11 per cent relative to last year.

The principal December financial development in the District was a contra-seasonal rise in commercial and industrial loans of about 2 per cent. Most loan categories other than soft goods showed gains. A stronger than seasonal rise apparently occurred in the nation as a whole.

Turning to monetary policy, Mr. Ellis said that the French discount rate increase of 6 weeks ago and yesterday's increase by the Dutch seemed to destroy whatever validity the proposition ever had that interest rate increases should be avoided in meeting domestic economic objectives. His appraisal of the national economy indicated considerably more strength than did the staff reports this morning. He felt that there had been no knots in the money market in December because of the volume of reserves supplied by the System. An alternative description of developments, he said, was that the System had supplied sufficient reserves to enable banks to increase their lending abroad.

The paramount question in his mind, Mr. Ellis continued, was whether the Committee should strive to facilitate the Treasury's advance refunding at present rate levels when there existed substantial evidence that the System might have to take actions that would influence rates upward about as soon as possible after the February refunding. Quite possibly, in view of the rate changes abroad and the strength of the domestic economy, there might be some willingness on the part of the Treasury to see the air cleared as to impending rate movements in advance of their refunding. This course might also be considered more equitable by dealers and investors.

If the Treasury should agree, Mr. Ellis said, he would urge prompt action to raise the discount rate. If the Treasury decided not to make an advance refunding in January, it was likely that there would be an advance refunding in March. The choice might then be between acting now or waiting until April.

If the Treasury was unwilling to adopt the course he had mentioned, Mr. Ellis said, the Committee presumably should continue to operate within the framework of present policy; but there was room for improvement even within this framework. Free reserves should be allowed to fluctuate nearer zero. The Desk management should move rapidly to absorb the return flow of currency. Also, the Desk could resolve uncertainties on the side of less ease since banks would be experiencing a return flow of currency. He would take 3-1/2 per cent

as the 90-day bill rate target, and he would be surprised and delighted if the Desk were able to hold the bill rate at this level in the face of downward seasonal pressures. In his judgment recent rates of increase in reserves were excessive in light of the last line of the Committee's directive, which called for "accommodating moderate expansion in aggregate bank reserves."

Mr. Swan reported that the Twelfth District entered 1964 having recorded a faster rate of growth in the past year than the nation both in employment and in the labor force, and also in unemployment. While the course of District employment had been quite encouraging, especially since midyear, the major uncertainty at the moment appeared to be the potential impact of any leveling off or cut-back in space and defense-related industries. In all probability this impact would be greater than in the country as a whole. The relatively favorable employment experience in the District presumably had been accompanied by correspondingly favorable behavior of personal income. Paradoxically, the gain in retail sales, both recently and throughout the year, apparently had not equaled that for the nation.

In the financial sector, Mr. Swan said, weekly reporting banks in the District in December reported increases in credit extensions but at a lesser rate than nationally. In the last week of the year District banks were fairly heavy buyers of Federal funds and probably would be so again this week. Borrowings from the Federal Reserve Bank were more

than double their 1962 level, in contrast to the decline in member bank borrowings for the entire nation.

Mr. Swan said that in view of the Treasury financing program the Committee obviously should not change policy at the present moment. However, the Treasury financing apart, Mr. Swan saw nothing in the domestic picture or the international situation that called for immediate action. It seemed to him that the Committee still should see whether the so-called winter slack was going to turn out to be greater or less than usual. He was sympathetic with Mr. Koch's discussion of the outlook but did not think that this was a time to move, even within the area that might be allowed by the present directive. He preferred to continue the Committee's present policy. He thought it quite reasonable to offset seasonal declines in market rates, but if downward pressures turned out to be somewhat greater than seasonal he thought they should be permitted to affect rates. He would not change the directive or the discount rate at this time.

Mr. Deming said that in December credit at District banks expanded about as much as in December 1962, and considerably more than usual for that period. However, loan increases were about normal and significantly smaller than last year, except for business loans which showed above normal strength. Investment gains were appreciably larger than in December 1962 and in the average December. Total deposits were up quite strongly in December with growth well above normal and quite a

lot larger than in the same period last year. The gains came, however, in bank deposits and government deposits; growth in both other demand and time deposits was weaker than usual. The deposit gains put District banks on the selling side of the Federal funds market for the first time in some weeks.

As a result of the above-normal deposit gains and the smaller than usual loan increases, loan-deposit ratios for both city and country banks farm lending indicated continued strong farm loan demand, partly to finance holding operations into the 1964 marketing period. A number of country bankers reported an increasing proportion of farm borrowers as carrying maximum debts relative to probable earnings.

Mr. Deming said that one new item of interest might be noted with respect to the nonfinancial side of the District economy. The Minneapolis Bank's most recent opinion survey, taken at year end, indicated a sharp decline in optimism about the near-term outlook. This might be partly the reflection of the coldest December since 1927, but the change in sentiment seemed to be more than seasonal.

Mr. Deming said he would go along with those who felt the Committee should not change policy during the next few weeks. He thought there would be enough Treasury financing activity in this period to warrant mentioning such financing in the directive.

Mr. Scanlon reported that business trends in the Seventh District continued to be favorable. Retail trade rebounded sharply

in December from the depressed level of late November, while employment and production remained at high levels.

Christmas sales at District department stores in 1963 were well ahead of the record 1962 level. Growth in personal savings at commercial banks and savings associations lagged the 1962 period in November, and probably in December as well, reflecting strong retail trade.

Mr. Scanlon said that employment had been at least stable in the region in recent months. Unemployment compensation claims in the District in November and December remained well below the level of recent years and compared favorably with the national picture. Classifications were changed in November for two District labor market areas. Because of increased hiring by farm equipment manufacturers, the Quad cities area was estimated to have "low unemployment" (less than 3 per cent) along with six other District centers. South Bend, however, was moved into the "substantial unemployment" (more than 6 per cent) group as a result of the Studebaker cutback. No other District centers were in this class.

Mr. Scanlon reported a widely held view in the Midwest that a larger increase in plant and equipment spending was in prospect than the 4 per cent rise indicated by the McGraw-Hill survey in November. The motor vehicle and railroad industries in particular had announced increased expenditure plans in recent weeks.

Farm income in the Seventh District was reduced somewhat in 1963 as larger receipts from crops failed to offset lower income from meat animals. However, the smaller number of pigs farrowed since last summer, foreshadowing higher hog prices, together with lower prices paid for feeder cattle in recent months indicated that incomes of District livestock farmers would improve in 1964.

As usual, Mr. Scanlon said, December banking developments were difficult to interpret because of the demand for funds to meet corporate tax and dividend payments and because of year-end adjustments. District banks had continued to report strong business loan expansion, particularly in the case of loans to metals manufacturing firms. Loans at smaller banks that did not report industry breakdowns also rose more than usual. During the second half of 1963 business loans rose 8 per cent, compared with 7 per cent during the same period of 1962. Changes in other types of loans approximated the usual December pattern. Basic reserve positons of the large banks in Chicago and Detroit remained fairly comfortable, although these banks were unable to cover their needs in the Federal funds market.

With business prospects continuing favorable, Mr. Scanlon continued, it appeared that the demand for credit would rise further and possibly at an accelerated pace. However, the rapid rise of the money supply (narrowly defined) during the autumn appeared to have halted, at least temporarily, in December. In both 1961 and 1962 the rise

continued through December before leveling off. Because of the difficulty of interpreting these data and the proposed Treasury financing, Mr. Scanlon favored continuation of the monetary policy of recent weeks. He would not change the discount rate. He agreed with Mr. Deming that the Committee might refer to the Treasury financing in the directive.

Mr. Clay said that an examination of the data for the weekly reporting banks in the Tenth District and in the United States through December 25 showed a similarity in performance during the past year in several respects. Loans and investments combined advanced less than in 1962, while loans increased more. Both business loans and consumer loans showed larger increases than a year earlier. Total time deposits increased somewhat less than in 1962, although the second half increase was larger than the year before.

However, Mr. Clay said, there also were some significant contrasts in the performance patterns. This was particularly reflected in a greater acceleration in the liquidation of U. S. Government securities in the District than in the United States. It was reflected further in a greater moderation in the acquisition of other securities in the District. The net effect in the District was a decline in total investments, while in the nation it was a slowdown in the rate of growth. Another contrast was found in real estate loans. For weekly reporting banks in the country as a whole, such loans expanded more than a year earlier, whereas in the Tenth District the increase was distinctly smaller.

The factors that needed to be weighed on the national scene did not indicate any basic change in the economy, Mr. Clay said. The general pattern of economic developments, including the variations in pace of activity and economic sectors, was essentially in line with the shape of events over past months. At this juncture, it appeared to Mr. Clay to be in order to await further developments and to leave monetary policy unchanged. Whether seasonal forces would put significant downward pressure on short-term interest rates remained to be seen. He felt that some downward movement in rates should be accepted rather than reducing reserve availability on a seasonally adjusted basis. If the Treasury announced an advance refunding, there would be further reason for maintaining the same monetary policy posture that the Committee had been pursuing. Mr. Clay would keep the Reserve Bank discount rate unchanged. He thought the directive was suitable in its present form except for a possible reference to Treasury financing.

Mr. Wayne reported that the business picture in the Fifth District was mixed with some evidence that the rate of increase may have slowed in recent weeks. In November, construction remained strong, factory man-hours were up moderately, and nonfarm employment rose slightly. In December, retail trade apparently was quite good, in line with the national performance. On the other hand, bank debits declined in November and, more recently, insured unemployment had risen more than seasonally, while loan demand had weakened. Business sentiment, as

measured by the latest survey of the Federal Reserve Bank, also was mixed, with somewhat less optimism than was shown in recent surveys.

With respect to national conditions, Mr. Wayne said that the performance of the economy in the closing weeks of 1963 demonstrated continuing basic strength at a high level. While data for December were quite incomplete, it now appeared that weakness in some indicators in November might well have been due to temporary or special circumstances.

As the new year opened, Mr. Wayne continued, no major sector of the economy afforded any obvious cause for serious concern and several sectors seemed to be in strong positions. Manufacturing and trade inventories remained at a very low level in relation to sales as they had been for the past year. The outlook for business investment was bolstered by a very large backlog of capital appropriations, record corporate earnings and cash flows, and a slowly but steadily rising rate of plant utilization. The chances seemed to be good that both corporate and consumer incomes would benefit substantially from Federal tax reduction before many months. Perhaps the prospects for exports were somewhat improved, also, Mr. Wayne said, especially for agricultural commodities. The outlook was more uncertain in the large sector of construction, especially residential construction, where mortgage indebtedness had been rising very rapidly for the past two years and had doubled in the past eight years. Consumer credit also had had two record growth years and was now at a high level in relation to disposable income. This

would suggest that consumers were relatively well stocked with durable consumer goods and that their debt load might be growing a bit burdensome. In general, the outlook appeared moderately favorable, but the steadily rising level of debt on the consumer was a factor that might temper the prospects for the future.

In the policy field, Mr. Wayne said, two aspects of recent market behavior struck him as significant. The first was the relative stability of the money market and the absence of tightness or sloppiness during the intense activity in December. The second was the moderate level of member bank borrowings considering the season, and the fairly generous availability of reserves whether the measure was total, nonborrowed, required, available, excess, or free reserves. In two recent weeks free reserves were higher than at any time since July, and were at levels which he expected none of the Committee had envisioned three weeks ago. The stability of short-term rates in the face of such a wide swing in free reserves were striking but perhaps not especially significant, Mr. Wayne said. He was not greatly concerned that reserves were so freely available in December. They contributed to the stability of the market, which was a desirable result, and apparently had not yet caused any damage, although the job of mopping up excess reserves in the weeks ahead had been made somewhat more difficult.

For the period just ahead, however, Mr. Wayne felt there should be a reduction in the availability of reserves. For some time bank

credit, the money supply, and time and savings deposits had been showing rising growth rates without corresponding increases in the industrial and commercial sectors of the economy. A continuation of the high level of reserve availability probably would encourage a still more rapid increase in bank credit and the money supply which he did not think the economy needed at this time.

Mr. Wayne said he was not suggesting a policy of restraint but merely a slightly slower rate of growth in reserves. He would not like to see any significant increase in short-term rates, but he believed that reserve availability could be reduced appreciably in the next few weeks without causing rates to rise, just as the opposite had occurred in recent weeks. He would not change the directive at this time unless some reference to Treasury financing seemed appropriate and he would not favor a change in the discount rate at present.

Mr. Mills said that his statement would attempt to reduce to more concrete proportions Mr. Mitchell's earlier observations on the System's monetary and credit policy. He then made the following statement:

> Since the Committee's last meeting, the background setting for monetary and credit policy has largely met the criteria for actions that I have submitted at recent meetings. The margin of free reserves available to the commercial banking system has risen, although supported by a higher level of Federal Reserve Bank discounts, and a seasonal expansion of credit has been accommodated without strain. Short-term interest rates, however, have fluctuated narrowly around the discount rate of the Federal Reserve Banks and have not been responsive to the increase in the supply of reserves. The contradictory divergence in the movement of reserves and in

the movement of interest rates indicates that a protracted period during which the U. S. Government securities market has been fettered by artificial controls has rendered market operators insensitive to the kinds of reserve developments to which they would have promptly reacted interestwise under free market conditions. This is an unhappy situation, and it is hoped that the Committee will take the new year as a corrective opportunity for relaxing the artificial controls presently administered over the U. S. Government securities market and for encouraging short-term interest rates to develop naturally in consonance with a supply of reserves aimed at providing appropriate credit availability to the commercial banking system. Such a policy would mark a return to free market principles and to reliance on unobstructed interest rate movements to guide decision-making, both on the part of operators in the financial markets and of Federal Reserve System policy-makers. It would be in line with an objective of fostering stable economic growth and would be the opposite of what has been the Committee's unimaginative and torpid policy directive of "no change." Adoption of the kind of policy envisaged would have the Manager of the System Open Market Account pay less attention to a narrow "tone and feel" of the market and more attention to the magnitudes in the supply of reserves and interest rate responses thereto than has been the case in his following the Committee's directives this many a past moon.

Mr. Robertson commented as follows:

The Treasury financing schedule, of course, precludes any significant change in monetary policy at this meeting, and probably at the next meeting as well. It seems to me that we ought to use this breathing spell to take a somewhat longer range view of policy than is ordinarily our practice.

Over the last three years we have made varying degrees of progress toward the ultimate economic goals commonly espoused for monetary policy. We have had a moderate but prolonged expansion in real GNP. There has been a gratifying degree of stability in over-all levels of industrial prices and costs. Our balance of payments figures for a good many quarters oscillated between bad and worse; but in the last half-year a striking shrinkage of the deficit has been recorded. On the labor side, however, we have won no respite from the historically high levels of unemployment that have plagued the economy in recent years.

We all know that there are statistical inadequacies attaching to the indicators we use to gauge our progress toward each of these goals. It is also true that many factors more compelling than monetary policy are at work in each of these areas. But none of these qualifications are enough to erase the fact that we have fallen further short of our employment objective than of any other basic target, and, accordingly, that short fall needs to be given prominent attention as we weigh monetary policy for the future.

I am convinced that ample money and credit availability can have a marginal stimulating effect on business activity and employment, just as I also associate a marginal (though more immediate and direct) stimulating influence with the proposed tax cut. I think we have gained some such stimulus from the bank credit and monetary expansion of this past year, even though I would have expected greater stimulus had the expansion not been accompanied by an artificially elevated level of short-term interest rates.

I hope we are able to maintain an expansive money and credit atmosphere long enough to see some appreciable inroads into the ranks of unemployed men and machines. To be sure, such a policy will have to be curtailed if and when any general price rise is generated, for price stability seems to be a practical prerequisite for sustainable high employment in the United States, in its present competitive world position. Similarly, an expansive monetary policy might have to be modified if the tax cut becomes a fact and generates an overebullient business and consumer response. But it would be most unwise to change monetary policy in <u>anticipation</u> of either of these eventualities. They are far from certain, and our records as forecasters are frankly not good enough to allow us to bet on the future. Furthermore we should remember that the tax cut itself will automatically raise the after-tax cost of borrowed money and, to that degree, provide the equivalent of a fractional tightening of monetary policy.

The balance of payments deficit I recognize as a pervasive constraint on the whole range of public policies. If it turns bad enough at some time in the future, every weapon--including an abrupt credit tightening--may have to be thrown into the breach. For crisis conditions, a crisis-style monetary policy is called for; and I think history indicates that such action can be effective, when supported by other appropriate policy measures. This is a kind of last ditch reassurance in which I think we can take some comfort. But in the absence of such

an extremity, I think the weight of argument distinctly favors a monetary policy aimed primarily at domestic rather than international considerations.

Among other things, rate maneuverings for international reasons are peculiarly subject to being offset by similar adjustments in other countries, and the Dutch have provided us with the latest in a long list of concrete demonstrations of this unhappy fact.

The plain truth seems to be that there is still not much hard evidence of any concrete improvements in our balance of payments as a result of the increases in U. S. interest rates during the past year. A comparison of the component parts of our own balance of payments improvement since mid-year suggests to me, at least, that a combination of other public policies and various private developments accounted for the bulk of that improvement--not our less easy monetary policy.

The much improved status of our current balance of payments problem seems to me not to call for any further tightening of monetary policy. Rather it would seem to provide us with some greater freedom of maneuver in applying monetary policy to our domestic problems.

All these considerations together lead me to advocate maintenance of money market and reserve conditions at least as easy and certainly no tighter than those which prevailed through December, not only for the duration of the Treasury financing period, but thereafter as well, until we can see a significant change in the economic picture.

Mr. Shepardson said it seemed to him the expansion of credit in all areas, including rising consumer debt made possible by the easy availability of credit, provided strong evidence of the adequacy of the monetary expansion. He would favor some move toward less ease at this time were it not for the pending Treasury financing operations. Even in the face of the Treasury's program, he agreed with Mr. Ellis' suggestion that the Committee should, within the limits set by the present directive, work toward a lower level of free reserves and endeavor promptly to mop up return flows of currency, to the end of at least maintaining the present degree of firmness in the money market.

Mr. Mitchell said he aligned himself with those who thought there was no reason at present for tightening. He thought the concern that had been expressed by some about the future course of the bill rate was unnecessary; it seemed to him that the Desk had a rate objective well in mind and would not modify its approach unless so instructed by the Committee. Mr. Koch's suggestion that the Desk operate in intermediate and longer term securities seemed to him to be a good one. While he had no great allegiance to the notion of "operation twist," and doubted that much could be accomplished in this direction, this January was a good time to learn what could be done. If such operations were successful they would have important and significant advantages at present

Mr. Daane said that the policy prescription for this meeting seemed to him to be clear: an even-keel policy should be followed during the current and prospective Treasury financing. He thought there was no reason to believe that the Treasury would not have a financing in January as usual. The financing was likely to be outside the bill area and probably would take the form of an advance refunding, as suggested by both Mr. Koch and Mr. Stone. He thought the question facing the Committee was not a matter of the Treasury's willingness to accept a tighter monetary policy posture, but rather a matter of realism in dealing with a major financing. The financing would face rather rough sledding in the market even with an even-keel policy, he suspected.

Mr. Daane expressed the view that the Desk had done a particularly fine job recently. He observed that Mr. Stone, with characteristic modesty, had described their operations as simply standing at the edge of the market. Mr. Daane felt they had stood at the right place at the right time and in the right way, and the market's smooth performance was not divorced from what the Desk had done.

Mr. Daane then said he had two further observations. First, he thought the Committee quite properly had gotten away from a rigid view of reserve targets. This was reflected in the recent fluctuations of reserve figures concurrently with stability in the tone and feel of the market. He hoped there would continue to be flexibility of this sort. His own judgment was that the difference between, say, $100 million and $150 million in free reserves had little significant effect in terms of credit conditions throughout the country. He would not carry this notion too far; if the Committee were to move to a net borrowed reserve figure, clearly signaling a shift of gears, a considerable change in lenders' expectations and actions might be provoked. But he thought there might be a tendency on the part of some to overemphasize the importance of smaller changes.

Secondly, Mr. Daane said, he shared Mr. Mitchell's view that there should be less allegiance to rate targets than there had been in the recent past. He was impressed by the fact that on nearly every day

in December the three-month Treasury bill rate closed in the range from 3.51 to 3.53 per cent. He did not think rigidity in rates was a healthy thing for the market, for the System, or for the Treasury. In short, he would not be inclined to resist downward seasonal pressures on bill rates; if seasonal forces pushed the bill rate 10 or more basis points below the discount rate he would not view this as inappropriate. Nor would he be concerned if seasonal forces failed to appear and the bill rate moved in the other direction. Rigidity in the rate level, in his view, was having an injurious effect on the market, and he would prefer to see more fluctuation in some reasonable relation to the discount rate.

In conclusion, Mr. Daane said he favored continuation of the present policy and had no objection to mentioning Treasury financing in the directive. He did not favor a change in the discount rate.

Mr. Hickman reported that domestic business developments in the Fourth District continued to be somewhat obscured by the usual holiday oscillations. While signs of economic expansion had been visible during December, there were no clear evidences of an emerging boom. The forecasters, on the other hand, were quite uniform in their expectations. In this respect, there was a striking contrast between the tone currently being echoed by the forecasting fraternity and the tone that had been characteristic at this time a year ago. Then, the "standard forecast" had envisaged a mild recession for the first half of 1963, a projection which had failed to materialize. Now, the tone for 1964 was one of almost raucous optimism.

As had been mentioned at the last meeting, Mr. Hickman said, the business picture for November was mixed; figures available since then corroborated that point. In December, auto dealers set new sales records in each of the three 10-day periods. Department store sales reached new heights during the Christmas season. The steel industry was gearing itself to a strong output month in January, reflecting a substantial pickup in new orders of major producers. Scrap prices were rising sharply in response to new buying by the mills.

One further point on developments in the steel industry should be mentioned, Mr. Hickman said. Information had come to light on trends in productivity and labor costs in 1963 which indicated that, despite the unevenness of steel production last year, considerable progress was made in cost-cutting and productivity increases. This augured well for continuing improvement in steel profits. Altogether, business news suggested continuation of moderate expansion, somewhat blurred by random and seasonal factors.

In this climate, Mr. Hickman saw no need at present for a change in policy. Noting that the Committee probably would have an opportunity to move in late February, if the need should arise, he summarized the reasons for not moving now as follows: (1) There was no domestic boom; (2) price changes were mixed, despite an underlying inflationary potential; (3) bank credit expansion, though large since midyear, had moderated in recent weeks, presumably in response to System policy;

(4) the balance of payments position, although still unsatisfactory, improved in the second half of 1963 and, according to fragmentary figures, turned in favor of the U. S. in December. Interest rate relationships here and abroad continued to be reasonably satisfactory; and (5) since year end, the dollar had strengthened against most continental currencies.

In conclusion, Mr. Hickman said, it seemed to him that the situation was well balanced at the moment, that Committee policy had been appropriate, and that it should be continued for the time being. On the other hand, the Committee should be alert to arrest any tendency towards slack in the money market, seasonal or otherwise. In view of the unreliability of projections in this period, the Desk should be guided by the feel of the market. He would not change the discount rate but would change the directive as Mr. Deming had suggested. He would let the Treasury tailor its debt to the market as best it could, and would not engage in support operations in the long-term market.

Mr. Bopp reported that business in the Third District ended 1963 on about the same note as had prevailed during the year as a whole. 1963 was a good year only in a minority of Third District areas. In the majority there had been persistently high unemployment and withdrawals from the labor force. Department store sales ended the year even with 1962; in other Districts the typical increase was between 3 and 5 per cent.

Third District banking since the last meeting of the Committee had been characterized by some relaxing of the tight conditions prevailing through most of November and early December, yet pressure was still evident. Deposits and loans had been rising in recent weeks.

In view of current Treasury operations, Mr. Bopp said, no change in policy should be made during the next three weeks. He would retain the present directive except for adding a clause on Treasury financing, and he would make no change in the discount rate.

Since this seemed to be the season for it, Mr. Bopp continued, perhaps it was not inappropriate to look somewhat further ahead. As he read the forecasts, monetary policy apparently was already formulated for 1964. The economy would expand steadily at a quite respectable pace demands for funds would press increasingly on available supply, and interest rates would rise. Money would tighten itself, and at most the System merely had to follow with appropriate adjustments in the discount rate. It was almost a case of how to succeed at monetary policy without really trying

Mr. Bopp said that the current forecasts were, of course, being made in an atmosphere of over-optimism, and they cast monetary policy in a role of passivity that belied the facts. This was not particularly serious, he thought. But he was somewhat concerned about the easy assumption that rising business meant, pari passu, tighter money.

Even if the economy did behave as predicted, Mr. Bopp continued, it would be important in 1964 to examine the unspoken assumptions which linked rising business with tighter money. There were at least three of these assumptions: First, rising economic activity would bring excesses that contained the seeds of recession; second, it would bring higher prices; and third, higher prices would make it harder to balance the international payments. However, these assumptions might well not be valid. Until there was evidence of emerging excesses and maladjustments, that credit was financing mostly higher prices instead of more production, or was intensifying the balance of payments problem, there seemed to him to be no reason for System action to tighten credit or to be inactive and permit expansion to tighten credit.

It was entirely possible, Mr. Bopp concluded, that the economy would expand this year without these adverse conditions developing to any serious extent. So long as it was possible, monetary policy should be a positive stimulus and not a deterrent.

Mr. Bryan reported that business conditions in the Sixth District appeared excellent. Performance was better than nationally for non-agricultural employment, factory payrolls, personal income, farm receipts, and other series. Insured unemployment claims in the District had been at a low rate since April, and in November reached their lowest rate since the fall of 1953.

Nationally, Mr. Bryan said, the economy might have hesitated in November but on the basis of fragmentary evidence he suspected that there had been a strong comeback in December. There was optimism in December and continued strong demand for business loans. Vigor in automobiles, construction, and business investment did not indicate an imminent reversal in the uptrend in the economy.

Mr. Bryan saw no clear case for an overt change in policy, which he thought probably was ruled out in any case by the Treasury financing. Therefore, he had no suggestions regarding reserve figures; the Manager of the Account would have to be guided largely by the performance of market rates during the period of Treasury financing.

Mr. Bryan commented that he would like particularly to say, with Mr. Wayne, that by every reserve and money supply test the Committee had been injecting reserves into the banking system at a rate that seemed to him greater than sustainable in the long run without inflation, and greater than was warranted by either domestic or international considerations. He agreed with the commentary on the free market given by Mr. Mills.

In a final remark, Mr. Bryan said that inflation could occur even when there was substantial unemployment, given the present structural situation in the labor market. He did not believe that monetary policy could do much about this kind of unemployment.

Mr. Shuford reported that there had been no significant changes in the economic situation in the Eighth District since the previous meeting. The District had continued to operate at a high level and the growth over the past year had been good--probably a little better than in the nation as a whole.

Mr. Shuford said that he would favor no change in policy. As he had noted at the preceding meeting, Committee policy over the last year seemed to him to have been quite sound. The country had had a sustainable, moderate growth, and at the same time the System had contributed to meeting the international payments problem, although the problem had not been solved.

Mr. Shuford observed that he agreed with those who hoped that at some stage there would be less rigidity in short-term rates than in the recent past. But he recognized that during the past year the Committee had found it necessary to face up to a difficult problem--which it had hoped was a short-range problem--and had done so. This contributed to the rigidity of market rates. Mr. Shuford also agreed that the expansion in reserves had been large in recent months and should be reduced; he did not think it desirable for reserve growth to continue at its current rate for any extended period of time. On the other hand, it seemed to him that by meeting the two-pronged problem and at the same time providing moderate reserves over most of the year, the Committee had facilitated moderate, sustainable growth in the economy. On the

whole, he thought that policy had been quite satisfactory. There was much talk of extreme optimism, Mr. Shuford said, and it was possible that inflationary pressures were building up, but it seemed to him from the available statistics that inflation was not a pressing problem now.

Mr. Shuford favored a continued moderate supply of reserves at a lower rate than over the last few months. Otherwise he would make no change in policy. He did not favor a change in the discount rate. He hoped that the short-term rate would fluctuate around 3-1/2 per cent, but he would not be disturbed if seasonal forces pushed it lower. He had no objection to changing the directive to refer to the Treasury financing, but in general he preferred not to change the directive except when a change seemed rather pressing, and he did not think this was such an occasion.

Mr. Balderston said he agreed that a change in monetary policy, except to encourage free reserves to return to their early December level, was precluded between now and mid-February by Treasury financing activities. Were it not for the Treasury financing which he thought should be mentioned in the directive, he would have favored some tightening now.

It was not too early for the Committee to ponder the forces that would be bearing on monetary policy in the months ahead, Mr. Balderston remarked. He thought that the struggle of European countries and Japan to contain inflation would lead toward higher interest rates abroad. This would argue for higher rates domestically to inhibit outflows of

funds. It was his judgment that the discount rate change of last July might have been more helpful in slowing outflows than had been generally recognized.

If rates moved upward, Mr. Balderston said, the System must consider the loss of time certificates of deposit--especially those with six-month maturities--that banks would experience as market rates approached the Regulation Q ceiling on such certificates. However, he was concerned that lifting the ceiling might result in straining the quality of credit further.

Mr. Balderston said that he had been impressed by Mr. Wayne's statement, including his stress on the growing volume of consumer debt. Certainly the growth of home mortgage debt at the recent rate of $1.3 billion per month was something to be watched. Also, the Committee would be concerned this year with the outcome of wage negotiations, particularly those that would get under way in the auto industry in July. He had been gratified that output per manhour had held up as well as it had, a development which was not to have been expected. Even though wage rates increased 3 per cent last year, wage costs were kept down and this was reflected in prices. The U. S. had benefited so far by not inflating so fast as had France, Italy, and some other countries. If the struggle to keep wage costs down were lost this year because of high profits, he feared that the U. S. would join in the inflationary race.

His present thinking, Mr. Balderston continued, was that the Committee should await the position taken by the Congress and the Administration with respect to the budget. If budget spending was curbed, that would be a significant factor. He felt, therefore, that even after mid-February the Committee might want to assess the sentiment of the country, to see whether in fact the Federal Government was curbing spending, and to determine how many countries were joining the effort to curb inflation by raising their discount rates. If necessary, however, the Committee should be prepared by late February to move toward some further reduction in the reserves it was pouring into the banking system. It seemed clear to him that the money supply variable to be watched was not the narrowly defined one, which rose only 3.6 per cent last year. Liquidity was abundant everywhere and was flowing into the stock market and abroad. It was clearly beyond the control of the Committee to mop up that liquidity. If the future turned out as Mr. Balderston feared it might, he thought that forceful, vigorous, overt action by the Committee would be called for sometime after the middle of February.

Chairman Martin expressed the view that the Committee did not have any real problem with respect to policy at this meeting. He thought Mr. Balderston had pointed up effectively the fact that while the Committee had some indications with respect to fiscal policy it did not yet know what budgetary policy was going to be. A change in budgetary policy might make quite a difference in its approach, and the Committee was fortunate,

in a sense, that Treasury activities precluded it from taking any action at this moment. He had pointed out at the last meeting that by deciding not to change policy then the Committee was deciding against such action in the immediate future. At least, this was the case if the Treasury decided to go to the market, and he thought there was every indication that it would.

Parenthetically, Chairman Martin emphasized that the fact that the Treasury was considering an advance refunding was confidential, and should be so considered by all persons in the room.

After noting that the Committee members would not favor discount rate action at this time, the Chairman said that the Committee seemed to be agreed on no change in the directive except for the addition of a reference to Treasury financing.

It was decided after discussion that this reference should be made by inserting the phrase, "and taking into account prospective Treasury financing" after the phrase, "To implement this policy," in the second paragraph of the directive.

> Thereupon, upon motion duly made and seconded, 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 economic policy directive:

It is the Federal Open Market Committee's current policy to accommodate moderate growth in bank credit, while maintaining conditions in the money market that would contribute to continued improvement in the capital account of the U. S. balance of payments. This policy takes into consideration the fact that domestic economic activity is expanding further, although with a margin of underutilized resources; and the fact that the balance of payments position is still adverse despite a tendency to reduced deficits. It also recognizes the increases in bank credit, money supply, and the reserve base of recent months.

To implement this policy, and taking into account prospective Treasury financing, 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.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Clay, Daane, Mitchell, Robertson, Scanlon, Shepardson, and Shuford. Vote against this action: Mr. Mills.

In dissenting, Mr. Mills commented that, in accordance with his previously stated position against a policy of "no change" and his concern that damage to the economy was implicit in the continuation of that policy, he believed that a somewhat more liberal provision of reserves would yield beneficial economic returns, and without complicating the Treasury's financing program.

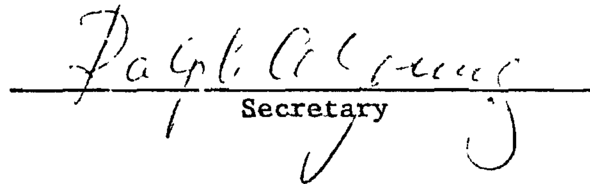
Upon motion duly made and seconded, and by unanimous vote, section 1(a) of the continuing authority directive was amended, in line with the earlier suggestion of the Account Manager, to authorize the Federal Reserve Bank of New York, to the extent necessary to carry out the current economic policy directive:

(a) To buy or sell United States Government securities in the open market, from or to Government securities dealers

and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing United States Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account (including forward commitments, but not including such special short term certificates of indebtedness as may be purchased from the Treasury under paragraph 2 hereof) shall not be increased or decreased by more than $1.5 billion during any period between meetings of the Committee.

It was agreed that the next meeting of the Committee would be held on January 28, 1964.

Thereupon the meeting adjourned.



Secretary