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November 17, 1962

MEMORANDUM FOR THE PRESIDENT

Subject: Background for the Meeting with Chairman Martin

As background for your Monday meeting with the monetary policy "Quadriad," this memorandum (a) summarizes recent developments in the monetary sphere and (b) reports some misgivings about possible future developments.

I. Recent Developments

Within the framework of already existing policies and the constraint imposed by the balance of payments position, the Fed has continued to operate effectively to maintain relatively free credit availability at stable to declining long-term interest rates. Yields on long-term government and private securities have recently been in the neighborhood of their previous lows for the year (reached last May); in some cases new lows for the year have been set in the last week or two.

In part, this is due to the slowing down of the pace of economic expansion and the attendant weakening of the demand for credit. However, the fact that total bank deposits and currency increased by $2 billion in October -- the largest month-to-month increase this year -- suggests that the Fed has recently been permitting some expansion of total bank credit.

Free reserves have been maintained at about $400 million.

The Treasury bill rate has recently been nudged up to about 2.8 percent to check outflows of capital to foreign centers. In an apparent effort to prevent the transmission of these upward pressures to long-term interest rates, the Fed purchased nearly

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$160 million of longer-term (over one year) securities early this month, offsetting a portion of these purchases by sales of short-term securities.

Nothing further was done this past week, but the early-November "nudge" or "twist" operation again demonstrates what <u>can</u> be done.

II. <u>Apprehensions for the Future</u>

The three Council Members had lunch on Saturday with George Mitchell, your one-man minority on the Board of Governors. George's serious reservations with respect to current domestic monetary policy, and his proposals for change are summarized in the attached copy of his remarks at last week's meeting of the Fed Open-Market Committee.

His even more basic concern (not included in his written remarks) is with possible developments on the international front, and with the response that he fears would emerge if we experienced the sudden crisis of a run on the dollar. Unless we prepare carefully in advance for such a crisis, he feels that the inevitable response would be a sharp and drastic tightening of credit and related measures which would not only have bad domestic consequences, but set back for years the prospects for constructive developments in international monetary cooperation.

Although you have in operation a [illegible] on long-range balance of payments and international monetary problems, it may be advisable to turn our attention back to short-run preparedness on this front.

Walter W. Heller

Enclosures

CONFIDENTIAL

Comments of Governor George Mitchell
November 13, 1962

Formulating policy in the current economic atmosphere is exceptionally difficult. Fears of another postwar-type recession seem less pervasive than earlier, but hopes for a sustainable significant upthrust also seem to be rapidly fading into the oblivion of "no change." The economy continues to absorb jolts -- both economic and political, internal and international -- but it does it at per capita zero, i.e., with deflated GNP per capita showing no significant change, as it did between the second and third quarters and probably will between the third and fourth. An economy in which GNP is not rising faster than the growth in population is not the image we have of ourselves nor one that we want others to have of us. It conforms neither to our needs nor our aspirations and it is not an equilibrium situation for long.

Something will happen which will stir the economy from per capita zero. It may roll off the roof with everyone, including the foreigners, watching helplessly. It may get up and go, following a substantial reduction in taxes or a substantial increase in defense spending. It would more surely be in a go position if monetary policy gave the increasingly serious domestic needs a higher priority than it gives the intractable problem of trying to maintain an artificial rate structure for balance-of-payments purposes.

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The problem is approaching a crisis stage because the sort of economy we have is generating a large and increasing amount of savings, which in the free play of markets would be put to work by depressing the interest rate structure. In the corporate area, a high level of profits and a growing volume of depreciation charges is being maintained while inventory spending is reduced and capital spending is leveling off. The result points toward a glut of business funds available for investment and a decline in capital financing needs. In the consumer area, flows of savings continue to grow, at least those that can be categorized as "nondiscretionary." Debt repayments are beginning to catch up with new debt extensions, and the volume of savings flowing to pension funds and insurance companies grows with regularity. At the same time, we seem to be getting a shift in the structure of consumer saving, with the decline in the stock market and the diminished availability of corporate and municipal flotations forcing a diversion of savings into thrift institutions.

Against this background of rising private savings and declining private credit needs, the Federal Government doesn't appear to be much of a contracyclical force, at least through fiscal action. The cash budget was in balance in the second quarter, on a seasonally adjusted basis, and in only very small deficit in the third quarter. For the calendar year as a whole, the cash deficit is likely to be only $5 to $5 1/2 billion,

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