DRAFT NOTES ON QUADRIAD MEETING WITH THE PRESIDENT
10:30 A.M., JULY 15, 1963

(The chronological order of the following notes may not be completely correct, but all of the major points are ~~covered.~~) characterized

1. Secretary Dillon opened the meeting by describing the proposed increase in the discount rate which he ~~described as~~ a new approach to monetary policy. He then noted that the balance-of-payments situation was currently developing to the point to where it bordered on a "run" on the dollar. According to Department of Commerce definitions, preliminary data show a second quarter deficit in the neighborhood of $5 billion at annual rates. (In part, however, this results from the conversion of the Italian non-convertible borrowing to a convertible basis. Also, there are other problems of definition of the deficit that need to be resolved.)

An increase in the discount rate and a somewhat smaller rise in the Treasury bill rate could save some $500 million in short-term capital outflows. This, together with the other actions which the President will announce later this week, would produce total balance-of-payments savings of some $2 billion.

The Secretary stated his belief that the rise in short-term rates could be effected with no significant impact on long-term interest rates or credit availability.

2. Chairman Heller ~~stated his opposition to~~ reviewed the "costs and risks" of raising the discount rate. He felt that the effect of the increase might not be confined to the short-term market, but could result in a rise in long-term rates, ~~The risks to the domestic economy would be too great to warrant such an action.~~ The revised Department of Commerce figures show that the increase in GNP in the last few quarters has been lower than preliminary estimates had indicated, ~~and that~~ the increase during the remainder of the year ~~would be smaller yet.~~ might be even smaller, ~~with the ... likely to be attributed to "monetary tightening."~~

The President then asked Chairman Martin whether he agreed with Secretary Dillon that the proposed action could be taken without affecting long-term interest rates, and whether it was Federal Reserve policy to prevent a rise in long-term rates. Chairman Martin stated, "Yes." Federal Reserve policy would be aimed in this direction; he could not predict with certainty that the effect of the action would be confined to short-term rates, but ~~the~~ Federal Reserve would make a major effort to achieve this goal. The President asked how this would be done, and Chairman Martin stated that the Federal Reserve would concentrate on purchasing intermediate and long-term securities to the maximum extent possible, and that the Treasury should concentrate its financing in the short-term market. Secretary Dillon agreed that this would be done.

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particularly because of the further narrowing of the differential between long and short rates that would slow the expansion

Chairman Heller pointed out that the rise in the discount rate would call forth substantial opposition from many Members of Congress and that any slowdown in the domestic economy which might occur, whether it actually resulted from monetary policy or not, would be blamed on the Administration and the Federal Reserve Board.

3. The President asked what the alternatives were to a rise in the discount rate. Chairman Heller stated that the balance-of-payments problem would be more effectively handled, at less cost to the domestic economy, through multilateral negotiations aimed at getting European countries to hold a large portion of their reserves in dollars. The President then noted the difficulties in getting European countries' agreement on this, in particular with respect to the French. The United States has no leverage except from actions which would harm the United States as well as Europe.

4. The President asked about the timing of the proposed increase in the discount rate. Chairman Martin stated that he wanted to announce the increase that afternoon (Monday, July 15). Seven Federal Reserve Banks have already proposed an increase. He planned to have Boston lead off with the announcement.

The President, however, stated his preference for timing the discount rate increase and his own statement on balance of payments as close together as possible. It was then agreed that the Federal Reserve announcement would be made Tuesday afternoon, and that the President's statement would be released Thursday at the latest. ~~and hopefully Wednesday.~~

The President stated that an increase in interest rates would make the passage of his tax program even more urgent. In this connection he noted that public support of the tax program by Chairman Martin would be especially useful.

5. Budget Director Gordon pointed out the importance of making an appropriate announcement to accompany the discount rate increase. The statement should stress the fact that the increase was aimed solely at short-term rates, and that the objectives of monetary policy at this time did not include a rise in long-term rates. Chairman Martin said it has never been Federal Reserve policy to make this kind of announcement, and they would not do so this time. He did state, however, that their announcement would cite the balance-of-payments situation as the sole reason for the discount rate increase.

The Budget Director also stated that a rise in the discount rate accompanied by an increase in long-term rates of as little as 1/8 percent could raise budget expenditures, on a full year basis, by as much as $1 billion.

6. Mr. Sorensen asked whether or not it would be possible to incorporate in the President's balance-of-payments message a more explicit statement of the objectives of monetary policy, with particular reference to the desirability of avoiding any tightening of credit in the long-term market. It was generally agreed that some statement to this effect ought to be included.

7. Chairman Heller pointed out the necessity of concentrating attention on total reserves rather than free reserves in the proposed operation. Because of the relationship between free reserves, the discount rate, and the Treasury bill rate, it is extremely important to avoid ~~make sure that~~ undue concentration on free reserves ~~does not~~ lead to a restrictive policy with respect to total reserves.

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8. The President again stressed the great importance of shielding the domestic economy from the impact of the discount rate increase in the light of the continuing heavy unemployment and modest pace of economic expansion -- and the importance of maintaining expansion until our economic goals have been reached.