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Trial "New Style" Directive for November 10, 1964 FOMC Meeting

1. Underlying domestic economic conditions appear to have continued favorable in October despite work stoppages in the automobile industry. Apart from the effects of these work stoppages, retail sales apparently remained strong in recent weeks. Stability has been maintained in over-all commodity price averages, but no improvement has been achieved in the unemployment situation.

Although declines in output in the auto and closely related industries are estimated to have reduced the index of industrial production for October between 2 and 3 percentage points, activity in industries not affected by the work stoppages probably was maintained or increased further. New car sales were down sharply on a seasonally adjusted basis in October, but sales at furniture and appliance stores and at outlets for nondurable goods were up. The over-all unemployment rate was unchanged at 5.2 per cent, about the level prevailing since spring.

In September manufacturers increased inventories at about the stepped-up pace of July and August. Distributors' stocks, which had been declining earlier, also rose. For the third quarter as a whole, however, total business inventory accumulation was small. Most recently, trade inventories probably fell again as dealer stocks of new autos dropped sharply.

Total construction activity edged down further in October. Residential building continued to run appreciably below the highs reached earlier in this expansion period.

Results of a recent private survey indicate that the rate of increase in business plant and equipment spending may moderate in the coming year. Reported plans for capital outlays in 1965 were 5 per cent above the projected 1964 total, implying a level of spending next year little changed from the rate of the current quarter.

The broad measures of wholesale prices for industrial as well as for all commodities have remained relatively stable. Strong upward price pressures are still limited to nonferrous metals, but selective increases continue to be announced for other commodities. Some of the individual price increases announced earlier in the summer have not been reflected in the broad indexes, suggesting that they may not have become effective. The consumer price index continued to rise at the slow pace of recent years.

Preliminary data suggest a deficit in the U.S. balance of payments in October of about $600 million before seasonal adjustment. A deficit of this size would be a little larger than in October 1963, but it would not represent deterioration from the third quarter of this year on a seasonally adjusted basis. As is usual in October, window dressing by Canadian banks resulted in large outflows of short-term capital from the U.S. In addition, U.S. purchases of new foreign bond issues increased last month, as a backlog of Canadian issues came to market following enactment of the interest equalization tax. The trade surplus rose in September, mainly as a result of higher exports in anticipation of a possible port strike.

2. Private demands for cash balances and bank credit slackened in October, in part because of the temporary dampening in over-all economic expansion. The money supply declined in the second half of the month, after increasing sharply in the first half, and rose at a 4.6 per cent annual rate for October as a whole. The demand deposit component rose at a 4 per cent rate in October, the same as in the year to date, while the currency component rose 7 per cent in October as compared with 6 per cent in the year to date.

Total loans and investments of all commercial banks probably declined moderately in October, partly offsetting the sharp September rise. The October reduction reflected a decrease in bank holdings of U.S. Government securities and security loans that more than offset moderate increases in other loans and in holdings of municipal and Federal agency issues. The rise in business loans was substantially less than in other recent months.

The flow of savings to financial intermediaries continued large. Time and savings deposits at all commercial banks rose $1.4 billion in October, more than in other recent months. Similarly, growth of deposits at mutual savings banks and of shareholdings at savings and loan associations has been rapid recently.

The combination of somewhat reduced demands for outside financing, a continuing large flow of savings, and growing investor confidence in current interest rate levels, has resulted in somewhat easier money market conditions and stronger bond markets in recent weeks. The flow of Federal funds increased in October, and while some transactions took place at a rate slightly above the discount rate, the average Federal funds rate for the month was a little lower than in September. Bank lending rates to Government securities dealers also declined slightly.

In securities markets, yields on long-term Government bonds at the end of October were close to their lowest levels since early August. Yields on recently offered corporate bonds and on mixed-grade municipal bonds have also turned down, although the indexes for seasoned higher grade issues in both markets have remained quite steady. Common stock prices have fluctuated around a level slightly below the record high reached in mid-October.

The somewhat easier money market conditions were accompanied by a slightly lower level of member bank borrowings than in September. With excess reserves also lower, free reserves were about the same on average. Total reserves and nonborrowed reserves declined in October, as a decrease in reserves held against Government balances more than offset a rise in reserves against total private balances.

3. In light of the apparent underlying strength in economic conditions and the continued general stability in broad commodity price indexes, but the failure of the unemployment rate to decline in recent months and the persistence of a sizable deficit in the balance of payments, it is the current objective of monetary policy to accommodate moderate further expansion in bank credit and the money supply in an environment of substantially unchanged credit conditions. It is expected that the continuing large flow of savings, supplemented by such bank credit and monetary expansion, will enable prospective demands for funds from Government as well as private borrowers to be met within a narrow range of fluctuation in longer term interest rates, but in a climate of seasonally firmer money market conditions than prevailed in October. With these ends in view, the Federal Open Market Committee seeks to supply sufficient reserves to support (1) the rise of currency in circulation over and above seasonal fluctuations, (2) actual changes in U.S. Government demand deposits and private time and savings

deposits, and (3) a seasonally adjusted annual rate of increase in the demand deposit component of the money supply over the months ahead averaging about the same as in the year to date.

4. To implement this policy, System open market operations over the next three weeks shall be conducted with a view to achieving weekly average free reserves around $50 million; provided however, that such reserves shall be permitted to move above or below this level in order to moderate any movements in the 3-month Treasury bill rate outside the range of 3.55 to 3.65 per cent or any serious constriction or excess in the availability of Federal funds or dealer financing.