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, July 10, 1962, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Bryan
Mr. Deming
Mr. Ellis
Mr. Fulton
Mr. King
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Shepardson
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Scanlon, Clay, and Irons, Alternate Members of the Federal Open Market Committee

Messrs. Wayne and Swan, Presidents of the Federal Reserve Banks of Richmond and San Francisco, respectively

Mr. Sherman, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Brandt, Brill, Furth, Hickman, Koch, and Willis, Associate Economists

Mr. Molony, Assistant to the Board of Governors
Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Hilkert, Heflin, Helmer, and Francis, First Vice Presidents of the Federal Reserve Banks of Philadelphia, Richmond, Chicago, and St. Louis, respectively

Messrs. Sanford, Eastburn, Baughman, Jones, Tow Coldwell, and Einzig, Vice Presidents of the Federal Reserve Bank of New York, Philadelphia, Chicago, St. Louis, Kansas City, Dallas, and San Francisco, respectively
Messrs. Link and Marsh of the Federal Reserve Bank of New York and Mr. Litterer of the Federal Reserve Bank of Minneapolis (Assistant Vice Presidents)
Mr. Schott, Manager, Foreign Department, Federal Reserve Bank of New York
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, the minutes of the meetings of the Federal Open Market Committee held on May 29 and June 19, 1962, were approved.

Before this meeting there had been distributed to the members of the Committee a report on open market operations in United States Government securities covering the period June 19 through July 3, 1962, and a supplementary report covering the period July 4 through July 9, 1962. Copies of both reports have been placed in the files of the Committee.

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

Since the June 19 meeting of the Committee, the money market has been firmer than in preceding periods as open market operations have provided somewhat less availability of reserves in conformity with the directive adopted at that meeting. Market atmosphere was conditioned by developments in Canada and by a growing feeling that international developments might require the System, despite a lagging domestic economy, to move further in a policy of less ease. The fact that free reserves fell below $350 million for three consecutive weeks tended to confirm these views even though the free reserve figure jumped back to over $400 million in the week ending July 4; the market has not paid much attention to the latter figure.

Although open market operations were conducted with a view to achieving a modestly lower level of reserve availability, seasonal market factors gyrated widely over the period requiring the System to supply a massive amount of reserves during the week ending July 4, ($951 million on balance in that week) with the result that System holdings of Government securities in the System Account reached an all-time high of $30,194 million on July 3, 1962. The free reserve figure for the current statement week is likely to be well over $400 million due mainly to a much higher than expected level of float over the past week end; efforts to reduce the reserve bulge were curtailed because of the auction of 1-year bills today. The prospects are that the System will have to sell more securities over the next few days to absorb reserves in the statement week ending July 18.

Banks generally seem to have had ample reserves with which to meet new demands for credit and there has been no redundancy of reserves such as had been the case in earlier periods. Federal funds rates have held for the most part between 2-3/4 and 3 per cent.

The Treasury bill market was subjected to considerable selling pressure around the end of June and the 4th of July holiday, most of which arose from banks adjusting their reserve positions; sales of bills in the last week or so have been confined largely to nonbank sources. The Treasury's continued offering of $200 million additional of bills in the regular weekly auctions has helped to keep pressure on bills and the market has become quite sensitive to the continued talk about higher interest rates. Dealers have been cautious in acquiring new supplies of bills, and in the auction last week the three-month bill rate rose to 2.93 per cent. The massive System purchases of bills last week reduced dealer holdings substantially but rates again moved up yesterday as the System sold a substantial amount of bills. In the auction yesterday the average rate on the 91-day bills was about 2.97 per cent and on the six-month bills about 3.10 per cent. Preliminary ideas for the auction today, in which the $2 billion maturing July 15 bills will be rolled over into a new one-year issue, suggest a rate in the neighborhood of 3-1/4 per cent.

The capital markets have reflected the uncertainties over the international situation with accompanying prospects for a less easy credit policy and also current rumors that the Treasury would offer a long-term security either for new cash or in connection with its August refunding operation. The atmosphere has been quite pessimistic and cautious with prices of Government securities declining continuously after the developments in Canada came to a head. Yields on most of the longest-term issues have risen well above 4 per cent, the rate on the 3-1/2's of 1990 being about 4.14 per cent

yesterday. This compares with yields somewhat below 4 per cent which had prevailed for some time previously. Dealer positions in intermediate- and long-term Government securities have been reduced to a minimum and market activity has been quite light.

Prices of outstanding corporate and municipal issues have followed a similar pattern but the supply of new issues has been somewhat reduced over the past three weeks. The AA-rated Consolidated Edison issue offered on June 19 at a yield of 4.26 per cent presented an obstacle to the corporate market as it was overpriced at issue and remained more than 75 per cent unsold until the syndicate was broken on July 5. It then traded down about 3 points from the reoffering price to a yield of about 4.45 per cent, and it is still only partially sold at that rate. The question may be asked whether the capital markets are being seriously inhibited by the less easy atmosphere in the money market. Inquiries indicate that buyers have become more cautious and price conscious in view of the recently-developed uncertainties over monetary policy and interest rates. However, this seems to be more a matter of investor psychology rather than any lack of funds for investment as prospective buyers are apparently holding off in expectation of higher rates. As the calendar of new corporate issues shows only slow growth for the next few weeks, these markets should be able to take care of themselves in the shorter run without undue strain and there seems to be no cause for immediate concern in this area. The large calendar of new issues in September may present some problems at that time.

The Treasury's plans for financing are not yet certain but the prospect is that it will continue to offer $200 million additional new bills each week through August 16, which will practically complete the cycle of thirteen weeks at $2 billion each. They are also thinking of refunding the $7.4 billion mid-August maturities through cash offerings rather than an exchange, which would permit them to borrow a moderate amount of new cash, say $1-1/4 billion. This should carry them through until early in October, at which time they will probably have to borrow more new cash. Meetings are being held with market representatives on July 24 and 25 to discuss the August financing and the Treasury will probably announce its plans after the close of business Thursday, July 26.

You will note from the Supplemental Report just put in your hands that effective July 5 the name of Blyth & Co., Inc., was added to the list of firms with which the Trading Desk is authorized to do business. We have found that the firm is conducting dealer operations in size, making primary markets, particularly in Treasury bills, and their financial position and reputation is unquestionable. They should be helpful to us in open market operations. In effect, Blyth will replace Bartow Leeds on our list of dealers, as the latter firm was liquidated after they were unsuccessful in raising new capital following the death of Mr. Bartow.

In response to Chairman Martin's invitation for comments on the Manager's report, Mr. Mitchell inquired whether Mr. Marsh felt that in the three-week period since the last meeting the churning in the market and other difficulties in making projections caused difficulty in having operations for the System Account conform to the terms of the directive issued at the meeting on June 19.

Mr. Marsh responded that he thought in general the tone of the money market had been approximately what the Committee wanted. The market had been somewhat firmer than before the June 19 meeting, which he believed was indicated to be the Committee's desire. The bill rate had pushed up a little and the market's performance--the churning and the problems created in making projections--apparently had been viewed as signaling a substantial shift in monetary policy. However, Mr. Marsh said that even though the free reserve statistics had fluctuated more widely than might have been desired, he thought the objectives of the Committee had been reasonably well carried out during this period.

Mr. Robertson inquired as to whether the rate pattern that had developed during this period was about what Mr. Marsh felt the Committee thought should take place, to which Mr. Marsh responded in the affirmative. This was true of the Federal funds rate and the bill rate; generally speaking, the pattern of short-term rates had been about what he understood the Committee wanted in issuing its directive at the June 19 meeting.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period June 19 through July 9, 1962 were approved, ratified, and confirmed.

Mr. Brill presented the following statement with respect to economic developments.

We don't as yet have much data to measure the state of the economy at midyear, but fragments available suggest that the economy has lost whatever momentum it had earlier in the spring.

1. June figures on manufacturing employment and average hours worked indicate that the production index either barely held its own last month or declined somewhat, following an increase of half a point in May and one and a half points in April. While the comprehensive man-hour data needed for a precise index calculation are still not available, we do know that manufacturing employment barely increased last month, while average hours worked in manufacturing declined by two-tenths of an hour, the second consecutive monthly drop.

2. The unemployment rate edged up slightly in June. Much of the increase reflected rising unemployment among adult male workers--not, as many newspaper stories have suggested, the result of an influx of teenagers. In fact, the labor force in June didn't show its usual seasonal rise because fewer school graduates and summer workers were seeking jobs than had been expected.

This failure of the labor force to show any significant increase has persisted throughout this recovery period. Analysis of population data and the structure of the labor force suggests that published figures may miss a large group of potential workers now recorded as outside the labor force but who would take jobs if there was a more rapid and substantial increase in economic activity. This "hidden unemployment" is of particular importance among youths, women of working age and for some men in the middle age group.

3. One area of demand that was of major importance in sustaining economic expansion earlier in the year--consumer buying--appears to have slackened somewhat in June. Auto sales were 7 per cent below the May rate and department store sales were also down on the month. While not conclusive, these data suggest that retail sales, which had edged downward in May, probably declined further in June.

4. Reduced business spending for inventories also is currently limiting the rise in activity. Inventories increased at a declining rate in April and again in May; in June, there was likely either no net addition to business stocks or perhaps a small decline. The using up of steel supplies accumulated in the pre-strike-settlement period accounts for much of the slowing, but in May there was also a halt to accumulation of inventories by nondurable goods producers, and only moderate accumulation at the wholesale and retail level. For the quarter as a whole, business additions to inventories are estimated at less than half the rate in the first quarter.

5. A special McGraw-Hill survey conducted in late June indicates that business plans for capital spending this year continue at about the levels indicated in earlier surveys. In one sense, this may be regarded as a favorable factor, in that the stock market break has not apparently depressed business spending intentions. It can hardly be considered a bullish factor, however, for the level of spending im - plied by the survey would represent less of a rise over the balance of the year than the increase in the year to date, rather than the accelerating trend typical of sustained recovery and expansion.

Turning to the few bright spots in the economic picture, the dollar value of construction put in place continued strong, rising further in June to a new high after an appreciable advance in May. Because of the way the figures are calculated, some of the June increase in activity merely reflects the rise in housing starts reported in earlier months. Nevertheless, the reported increases in activity were so widespread among types of construction as to suggest real strength in this area, with financing ample and, at least for FHA mortgages, available in May at lower cost than earlier in the year. We don't know yet the effects on mortgage financing of the more recent developments in money and capital markets.

Some solace may also be found in the reduced rate of business inventory accumulation noted earlier. As a result of these reductions, while sales have continued to rise moderately, stock/sales ratios now are low. For all businesses combined, the inventory/sales ratio at the end of May was the lowest since the spring of 1959, and by the end of June were probably even lower. This suggests that if there is a pickup in demand, it is likely to be transmitted promptly to the productive processes without having to go through an extended period of using up surplus supplies.

The question is what will provide the stimulus to maintain demands. Some stimulation could be generated within the private economy. Most surveys report that while consumer confidence has deteriorated somewhat, consumer buying plans are still strong, even after the market break. If it is sustained, consumer demand could induce more optimism on the part of business, leading perhaps to some restocking of inventories and to at least maintenance of present capital spending plans.

The Federal Government is also likely to provide some stimulation, even in the absence of dramatic tax cuts or new spending plans. It may not be generally realized how large a shift in the direction of fiscal restraint has occurred in recent months. Seasonally adjusted figures on Federal cash flows show a shift from a cash deficit of about $12 billion (annual rate) in the first quarter of the year to a near balance between receipts and expenditures in the second quarter--a bigger quarterly shift by far than any that occurred in 1959-60. In part, the shift reflected larger than anticipated collections of individual nonwithheld income taxes; in part, also, it resulted from a

shortfall in cash spending. If receipts and payments move closer to Budget expectations in the third quarter, the Government would then be again running a fairly large cash deficit.

Altogether, if one takes favorable assumptions with respect to consumer buying and business response, plus a return to fiscal stimulation in the magnitude now scheduled, we might see further slow expansion in total GNP. It would hardly be enough, however, to provide a growth rate in the economy sufficient to reduce significantly the large volume of underutilized resources. Failing some additional strong stimulus, it seems most likely that we will drift through the summer without significant increases in over-all activity, and with a creeping up in the rate of unemployed workers and unemployed productive facilities.

Mr. Koch presented the following statement with respect to credit developments;

A principal feature of financial developments since the slight modification of monetary policy adopted at the June 19 meeting has been the steady firmness in the money market. The 3-month Treasury bill rate has increased from a little over 2.6 per cent to over 2.9 per cent. Federal funds have traded at the 3 per cent discount rate most of the time, and member bank borrowing from the Reserve Banks has increased moderately to a daily average of around $140 million. Interest rates charged Government security dealers by New York City banks have ranged from about 3 to 3-1/2 per cent, although dealers have usually been able to obtain considerable financing outside New York City at more attractive rates.

Bond yields have also risen. This first was apparent in muncipal securities beginning about six weeks ago. In recent weeks the rise has been most marked in the case of new corporate issues. The recent yield rises in the capital markets reflect in part the firmer short-term rate structure. They suggest the need to watch capital market developments carefully lest the moderately less easy monetary policy contribute significantly to a lower volume of new security financing and investment.

Free reserves averaged $365 million in the three weeks ending July 4, as compared with $440 million in the preceding three weeks. In the current week and lasting through most of the month, market forces, particularly a rise in float and a return flow of holiday currency from circulation, will provide the banking system with several hundred million dollars of reserves. Required reserves are also likely to drop as large Treasury balances are drawn down. Some of the easier reserve position resulting from market forces will be absorbed by the redemption of System held bills in the weekly auction

and by the maturing of the remaining outstanding dealer repurchase agreements with the System, but others will have to be absorbed by open market sales of securities. After the week ending July 25, some longer term reserves will need to be provided by appropriate System open market action.

It is still obviously too early to tell what the recent change in policy has meant, either internationally or domestically when it comes to reserve expansion, bank credit and capital availability, and liquidity developments. Outstanding bank credit did increase appreciably in June, and the increase was concentrated in loans rather than in investments. Moreover, the loan increase was well distributed among most of the various types of loans. Business demand for bank financing, however, has continued quite moderate. Outstanding bank credit in July and August, in contrast to June, is likely to show a much less pronounced advance, as the very high Government balances are drawn down, even though some of these balances continue in existence in private hands.

Capital market financing, particularly by corporations, was also in substantial volume in June. Corporate June financing was, however, significantly less than had been anticipated earlier, as the sharp decline in stock prices led to the postponement of several large convertible bond and common stock issues and a sharp reduction in the number of small stock issues publicly sold. In recent trading sessions, stocks have risen in price, and effective today margin requirements for stock market credit are reduced from 70 to 50 per cent. This reduction was made in recognition of the sharp reduction in such credit in recent weeks and an abatement in speculative psychology in the market.

In the second quarter as a whole, the total demand for funds--short-term as well as long-term, Government as well as private--declined rather sharply to about a $50 billion seasonally adjusted annual rate. In the first quarter, it had been $60 billion and in the fourth quarter of last year $65 billion. The recent drop was due mainly to a decline in Federal financing and to lower business borrowing to pay for additions to inventory.

Turning from credit and capital availability to liquidity, the seasonally adjusted money supply in late June was slightly above its late May level. It was down a little from the beginning of the year and about 2-1/4 per cent above a year ago. Turnover of demand deposits outside New York declined slightly in May, but is still averaging about 8 per cent above a year ago.

The recent slower growth of the narrowly defined money supply has reflected in part the sharp buildup in Treasury balances. In late June and early July, these balances amounted to almost $9.5 billion, as tax receipts exceeded, and Government spending fell

short of, expectations; as the weekly bill offerings were increased; and as funds were acquired through the sale of special certificates to foreign countries. As these large Government balances are drawn down, the money supply will increase even without further bank credit expansion. According to our figures, the Treasury could now probably satisfy its cash needs until mid-September, by continuing to increase the weekly bill issues by $200 million until the end of the cycle in mid-August, and then by picking up another billion or so in a cash financing of its August maturities.

Turning back to liquidity, time and savings deposits of commercial banks have recently been increasing at about the late 1960-1961 rate, that is, about 12 to 13 per cent a year, as compared with the 25 to 30 per cent rate characteristic of the months immediately following the change in Regulation Q. Total liquid assets, seasonally adjusted, declined a bit in May. In the second quarter as a whole, these assets rose at a considerably slower rate than earlier, due mainly to the reduced flow of time deposits to commercial banks and lower private holdings of short-term Government securities.

I should like to conclude my comments by taking a little longer-run look and by referring to the table I passed out to you this morning. It is a capsule summary of the effects of monetary policy thus far this year, that is essentially the policy that prevailed prior to the last meeting. It summarizes effects whether you consider them to be shown mainly by reserve availability, liquidity growth, credit availability, or interest rates.

My reading of the table is that monetary policy in the first half of 1962 comes out with a pretty good record assuming that the domestic economy needed stimulation and that the outflow of capital abroad was not unduly promoted. Most measures of credit availability and liquidity have increased more rapidly than economic activity, but not much more rapidly. The growth in bank reserves seems reasonable, considering the changed composition of deposit liabilities. Longer term interest rates declined until recently, whereas shorter term ones have risen somewhat. Finally, a policy of monetary ease followed continuously and for a longer period of time during this expansion than in previous ones does not seem to me to have produced either exceptionally aggressive bank lending or investing, or the creation of an excessive amount of liquidity in the economy.

Mr. Furth presented the following statement on the U. S. balance of payments and related matters:

The international scene still shows a paradoxical situation: our balance of international payments has been in a rather satisfactory state; but the dollar had further weakened on international exchange and gold markets.

This weakness has been accompanied by a wave of market rumors. Dollar weakness and dollar rumors feed on each other, and as Mr. Roosa pointed out in his report to the NAC staff the other day, the rumors are likely to become more vicious with the approach of the annual meeting of the International Monetary Fund in September. In the intervening period, the task of avoiding a speculative bear raid on the dollar will be as important as the continuing task of improving our underlying balance of payments.

Our international deficit completely disappeared in May, and according to preliminary figures also in June. Consequently, transfers of gold, foreign convertible currencies, and liquid dollar assets to foreigners dropped to about $200 million in the second quarter, only one-third of the figures for the first quarter and for the quarterly average of 1961.

Satisfaction with this result is tempered by the suspicion that much if not all of the improvement was due to the extraordinary shift in the flow of funds between the United States and Canada. If we could assume that this influence was small, our adjusted deficit would be not much more than half of last year's rate, adjusted for extraordinary receipts. But if we had to assume that the bulk of Canada's reserve losses was our gain, the adjusted deficit would be right back at the $3 billion annual rate that has dogged us for the past four years.

This uncertainty makes it even more difficult than at other times to forecast the development of our international payments for the current quarter. During the summer, our current balance is seasonally weak, largely because of the volume of foreign travel; on the other hand, we are scheduled to receive this month extraordinary payments of $475 million from France and Italy. These payments should offset the reflux of funds to Canada expected for the current quarter.

As to the underlying economic factors, our trade balance in April-May again showed a surplus close to $5 billion annual rate. Continued strength of demand in most foreign industrial countries, together with the continued slow rate of domestic recovery, permit the expectation that this surplus will be maintained in the foreseeable future.

The great unknown factor affecting both current and capital accounts is the future of our economic and financial relations with Canada. A reflux of volatile funds and a resumption of normal investments is virtually certain unless the recent stabilization efforts collapse. Moreover, the recent Canadian actions are designed to reduce imports into Canada, and this means mainly imports from the United States. They are equally designed, however, in the long run to reduce the dependence of the Canadian economy on inflows of foreign investment capital,

and this means to an even larger extent inflows from the United States. We cannot tell whether or not the reduction in our exports will eventually be offset by that in our outflows of investment capital.

On foreign exchange markets, the dollar has been weak against all continental European currencies, most recently also against the German mark. In itself, this development is not surprising: our recent balance of payments equilibrium has been the result of a surplus in relation to Canada and a corresponding deficit in relation to the rest of the world--which presumably means mainly a deficit in relation to Continental Europe. The countries that lost reserves were mainly countries that keep their reserves largely in dollars; the countries that gained reserves were those most eager to convert dollar accessions into gold. Thus, our balance of payments position involved the danger of a gold drain in spite of over-all equilibrium.

This danger has been magnified by recent market nervousness here and abroad. Reports about large withdrawals of European capital from the New York stock market are inconsistent with presently available U. S. data; but there can be no doubt about the flow of funds, of whatever origin, out of dollars into European currencies and especially into Swiss francs. This flow apparently reached particularly large dimensions last week. And part of these funds in turn are being converted into gold through the London market. The price of gold was driven up to $35.12 and the Bank of England had to spend most or all of its gold-pool "kitty" accumulated earlier this year in order to prevent the price from rising further.

Any large drain on our gold stock, however, would come from the accumulation of dollars by Continental European central banks rather than from the London gold market. Our first-semester deficit of $800 million was reflected in net gold sales and in net increases in foreign liquid dollar claims of $400 million each. Claims of international institutions rose by $500 million so that claims of foreign countries--apart from claims arising out of our swap transactions--actually declined. But official holdings of three major gold-reserve countries--France, Netherlands, Switzerland--rose nearly $600 million.

On Thursday, French official dollar holdings will be reduced by debt prepayments of $350 million to the United States and Canada, and by a gold purchase of $100 million. These transactions should wipe out France's "excess" dollar holdings. On the other hand, the flow of funds to Europe probably has increased official dollar holdings of Switzerland alone by

more than $100 million. Since the beginning of the month, the U.S. Treasury has sold $50 million of gold, half of it to Switzerland. The remaining increase in European dollar holdings likely to be presented for conversion into gold may be roughly estimated at $300 million.

This figure is large but not unmanageable. Market rumors nothwithstanding, there is thus no reason to expect spectacular gold losses if--and this is an important qualification--if further dollar flows to Europe can be kept within reasonable limits.

Mr. Treiber presented the following statement with respect to the business outlook and monetary policy:

Economic activity appears to be in a period of hesitation both statistically and psychologically. Although gains continued to be widespread in May and June, increases in a number of broad measures were smaller than in preceding months. Declining steel production associated with a reduction in steel inventories continued to exert a drag on industrial production generally, while retail sales edged down slightly. Construction, however, especially residential construction, continued strong. This was also true of automobile production until the interruption by a strike at a Ford parts plant in June. Prices continue relatively stable.

The economy's performance this year has been basically good although not as good as had been hoped for at the beginning of the year. Little progress, however, has been made in reducing unemployment.

Whether or not the stock market's behavior will lead to cutbacks in the spending plans of consumers and businesses is a major element of uncertainty. Surveys of consumer and business spending plans provide some reassurance but cannot be considered conclusive.

Loan volume at weekly reporting banks strengthened in June, except for "other security loans", which declined as stock prices plummeted. Particular strength was shown by loans to nonbank financial institutions and by real estate loans. Bank investments, particularly in "other" securities, were relatively strong in June. Thus, total bank credit advanced markedly, exceeding the gains in the corresponding periods of all recent years except 1958.

The banks have adequate liquidity. They are in a position to meet the credit needs that may arise in the course of a further advance in business activity.

Today the Treasury is auctioning $2 billion of one-year Treasury bills to refund a similar quantity of bills maturing July 16. In a couple of weeks the Treasury will be announcing its plans to refund $7-1/2 billion of notes maturing August 15. It now appears that no major new cash borrowing will be needed for the balance of the summer, particularly if the Treasury continues to add to the weekly bill offerings and if the Treasury conducts its August refinancing on a cash basis, taking in some extra money in the process.

The international position of the United States remains precarious as doubts about the international strength of the dollar continue to be expressed in many places. The latest statistics on our over-all payments deficit continue to be very good, but much of this favorable showing reflects the pronounced weakness of the Canadian dollar in the first three weeks of June. For the second quarter of 1962 it now seems probable that, thanks to the Canadian situation, our over-all deficit may be less than $1/2 billion, seasonally adjusted annual rate, compared with $1.9 billion in the first quarter. Now that the Canadian position is being stabilized, our capital accounts with Canada are bound to deteriorate over the coming months as the leads and lags turn around in favor of Canada and as Canadian borrowers come to our markets.

Fortunately, in the third quarter we expect some large European debt prepayments; this will certainly help the statistics for this quarter. On the other hand, we continue to feel the pressure of foreign borrowing operations--both long-term and short-term--in the New York market, and we seem to face a growing nervousness, both at home and abroad, as to the dollar's long-run outlook. In part this is based on skepticism with respect to the Government's attitude toward business and the attractiveness of business investment in this country. There is also growing uncertainty as to probable fiscal policy moves aimed at stimulating the economy, and uncertainty as to how such moves will be meshed with monetary policy.

While the domestic outlook evidences a number of uncertainties, I think that the policy of monetary ease that we have been following has done about all it can in making a sound contribution to domestic activity. Our international position, and particularly doubts over the dollar's long-run outlook, is an increasing cause of concern. It is important that monetary policy make a maximum contribution toward the restoration of international confidence in the dollar. To do so, monetary policy must be flexible and adjustable to our international needs.

I hope that over the next three weeks we will retain the gains achieved in monetary policy in the last few weeks. I think it would be desirable for the three-month Treasury bill rate to be generally in the range of 2-7/8 - 3 per cent, and for Federal funds to be in the range of 2-3/4 - 3 per cent. With such a money market climate, free reserves might be in the range of $300-350 million. I see no reason to change the policy directive, nor would I suggest a change in the discount rate at this time.

Mr. Bryan presented a statement substantially as follows:

Latest economic trends in the Sixth District are mixed. Many of our figures have gone down, as for example, money supply, bank loans, department store sales, and bank debits, among others. Nonetheless, judging from nonfarm employment, manufacturing employment, average weekly hours, and similar broader and more fundamental indices, it seems to me that the Sixth District is continuing a slow-paced increase in economic activity. As I see it, that situation is essentially similar to the nation for the period for which we have comparable figures.

As for policy, I could not at the last meeting vote with the majority, partially because I had perceived the figures from last December and January as exhibiting a mild tightening in reserve positions, and I was unable to see how we could proceed on a restraining policy more subtle than we have been doing: a subtle approach to restraint that I was in fact advocating in saying that I thought no change was in order. Likewise, it seemed to me that the appearance of great ease in the monetary system arose from the probability that our interest rate structure, toward which we have been feeling our way for many years, had at long last produced a supply of savings equal to the demand for them.

Now, I cannot find myself quarreling in any essential way with our policy, but my equanimity arises only because we have supplied reserves in amounts that have gone beyond a three per cent growth rate (measuring by total reserves), which I have thought for sometime exceeded a growth rate appropriate to our situation. Indeed, our latest daily averages, both for June and thus far for July, show adjusted and unadjusted total reserves moving further upward beyond a three per cent trend line.

With regard to the future I should like to pose four questions without attempts at anwswers. These questions trouble me deeply. I do not imply that these questions cannot be answered or will not be answered over time; what I am saying is that I do not know the answers.

1. Is it reasonable to assume that an adjustment in values as massive as has been exhibited in the equity markets, here and abroad, can occur without at the same time supposing that these adjustments will have equally massive effects?

I ask this question under the general canon of logic that the effect is proportionate to the cause.

2. How can we expect to make a decisive contribution to the balance of payments problem when the decisive and not self-correcting elements of that problem, to wit, military expenditures and grants-in-aid, are not amenable to the interest rate instrument that we are using?

3. How are we to assume that we can, with the interest rate instrument, curtail American investment abroad, the while not curtailing it domestically?

4. How are we, in the end, to reconcile fiscal policy and monetary policy?

For many years, now, we have had an essentially simple pattern of central bank action in the Federal Reserve System. In times of recession--all recessions have been mild in the postwar period--we have been prompt to ease reserves, to lower interest rates, and thus to encourage borrowing and investment. In times of boom we have pursued an opposite course. I am troubled to know the pattern of our future actions when our balance of payments and our fiscal problems, not of our making, sit like ghosts at the table with us.

Mr. Fulton said that there seemed to be a pervasive attitude of gloom among many businessmen of the Fourth District, particularly in the heavy industry area. This was a feeling that we had had whatever boom there was going to be and that the economy was topping out and would decline after the fourth quarter of the year. The reasons for this were attributed to the attitude of the Administration as interpreted by businessmen, to the profit-squeeze which was a very real thing, and to the stock

market decline. Mr. Fulton went on to say that industrial output seemed to be going along pretty well except in steel. In the latter industry, plant modernization plans that had been on the board for some time would be consummated because these were necessary for steel to improve its competitive position and to lower its costs. In industry generally, companies were gradually working off excess inventories. Steel companies were maintaining stocks higher than usual so that they could make immediate deliveries to consumers. There was no indication, however, of accumulating stocks of any kind either among dealers or retailers. There was no feeling that price adjustments were imminent in any line and as a consequence consumers were holding the lowest possible stocks.

Automobile sales took a nosedive in June and department store sales were also considerable lower in that month, although for the year to date they totaled 3 per cent higher than a year ago. Unemployment has worsened on a seasonally adjusted basis, Mr. Fulton said, the improvement that had occurred up to June of this year having disappeared. Construction activity is still high in relation to a year ago, but considerably lower in the fourth District than in the nation as a whole.

Bankers have about decided that there will not be a sudden increase in loan volume this year. As a consequence, they have been lengthening maturities on real estate and consumer credit loans and on certain securities in an attempt to increase income. All in all the District seemed to bear out the feeling that the economy has been topping out and that it has no substantial vigor left to carry through the balance of the year.

Mr. Fulton said that he was quite pleased with the results of monetary policy during the past three weeks. The firmness in the market had been good, but he would dislike to see the 91-day bill rate increased to a point where it would cause pressure for an increase in the discount rate. For the next three weeks, he would maintain the degree of firmness of the past three weeks, would not change the discount rate, and would use the short-term money rate as the guiding factor. The Manager of the Account should have such latitude as he needed in order to maintain the short-term rate at or no higher than the present discount rate.

With reference to the directive, Mr. Fulton noted that the last sentence as approved at the June 19 meeting spoke of "providing a somewhat smaller rate of reserve expansion." This might still be applicable, he said, but since available free reserves had come down considerably in this period, he felt it appropriate to change the wording and suggested something along the lines of wording that would provide for a rate of reserve expansion comparable to that of the past three weeks and which would preserve a moderately firm tone in the money markets.

Mr. Mitchell presented a statement as follows:

> Monetary policy is still on the Scylla-Charybdis course but I fear the lesser of these two perils is causing us to veer dangerously. No where in informed circles, and especially in this Committee, can there be any doubt that the overriding objective of U.S. economic policy is to keep the U.S. economy strong and expanding. Here, at any rate, we are committed to use every means at our disposal to do this by creating an environment in which consumption and investment decisions of citizens, businessmen, and investors will, in the main, direct

and determine the allocation of economic resources. Monetary policy, its critics to the contrary, is notable for the pervasiveness and impersonality of its effect and for its unique role in a free economy--and ours, I should add, is an economy that is far freer than any in Western Europe--no doubt I may as well say, in the World.

The latest intelligence on the state of the economy is disquieting. Concern about the slow rate of economic expansion has given way to a fear in many circles that the expansion will not continue. At best, industrial production was unchanged in June. Unemployment rose slightly and disguised unemployment, taking account of the slow increase in the labor force, rose more.

Part of the difficulty lies in the steel inventory adjustment, but nondurable inventories also lag. More important, final demands in May and June were sluggish, so sluggish as to offset the favorable impact on economic activity that might have been expected from the relatively high level of housing starts and auto sales. Retail sales fell slightly in May and, according to indications from department stores and auto dealers, declined further in June. When the record is in we may have some instances of appallingly poor performance. The disappointing prospects for plant and equipment expenditures have been confirmed by recent surveys, and we can no longer lean on the hope that, as in the past, the surveys might have understated the prospective increase in capital outlays. These indications of sluggish consumer and business demand in large part pre-date the recent stock market decline.

The evidence is not clear yet but we are certainly in danger of experiencing another abortive recovery, as in 1959-60; at best we may have a disappointingly small rate of expansion. There is, therefore, a clear need for a stimulative monetary policy.

It is not responsive to our obligations to urge fiscal policy measures on the Administration. These matters are out of our hands. Though monetary policy certainly needs to take fiscal policy into account, there is no justification in the present circumstances for a tighter monetary policy on the basis of a possible later easing of fiscal policy. It is after the effects of fiscal action are clear that the implications for monetary policy should be assessed.

For the present, therefore, monetary policy should be moving toward greater ease. The economy is in need of greater, not less, stimulation than it needed a few months ago. And, quite apart from the economic rationale for greater ease, the Committee ought to reconsider its present posture: in the face of an apparent worsening in the outlook for economic expansion, right on the heels of the largest stock market decline in the postwar period, and at a time when, for whatever

reasons, the balance of payments is showing improvement, the Committee is on record as having moved toward a less easy monetary policy.

I have said that the domestic economic situation calls for greater ease. The only basis for qualifying this policy prescription, from the domestic viewpoint, would be a showing that monetary ease had been pursued so far and so long that it would be useless to expect further easing to do any good. Are we near that point?

The first and simplest answer to this question is that, if interest rates mean what we have always thought they mean, we have not carried monetary ease too far. Bill yields have been maintained above 2-1/2 per cent. If the public were excessively liquid, borrowers of short-term funds would not have to pay 2-1/2 to 3 per cent to attract funds.

Has bank credit expansion been excessive? On a seasonally adjusted basis, commercial bank credit increased about $9 billion in the first half of this year, as compared with about $7-1/2 billion last year and over $12 billion in the first half of 1958. In interpreting this year's credit expansion, it is essential to be clear on the effects of the change in Regulation Q. What the advance in time deposit rates did was to increase the relative importance of commercial banks as financial intermediaries. The public was induced by the increase in rates to hold more of its financial assets at commercial banks and less of its assets elsewhere. For example, the public purchased fewer municipal securities and put more funds into time deposits at commercial banks. This in turn made it necessary that the banks purchase an equivalent amount of municipals, if State and local borrowers were not to go begging. The alternative would have been a rise in interest rates and a contractionary effect on the economy. As we know, this did not happen, for banks bought municipals aggressively. My point is that much of the increase in bank assets this year reflects this shift in the flow of funds, toward commercial banks as intermediaries, all as a result of the advance in rates on time and savings deposits. If we interpret the entire credit expansion as having been stimulative, we overlook this important structural shift in the channels of finance.

On the basis of this analysis plus observation of interest rate levels, I find no support for the view that ease has been carried too far. And, the needs of the economy are such that further ease is called for.

In the present state of financial markets, even the slight move away from ease in recent weeks had a significant and unfortunate repercussion. The actions of the Canadian authorities,

> plus the lower free reserve levels here, have caused a sizable advance in both short- and long-term yields. Corporate new issue yields have risen almost 20 basis points and caused a syndicate break-up involving a large and important issue. This congestion in the market and rise in yields came at a time when the volume of new issues and the prospective calendar was quite light. It was the result therefore of psychological factors on the demand side, including a reaction to the apparent tightening in monetary policy. If such reactions continue, they are bound to cause further advances in interest rates, which will also spread to the mortgage market.
>
> The need therefore is for heavier open market purchases by the System, to establish a higher free reserve level. I would permit bill yields to decline somewhat from their present level to perhaps 2-1/2 per cent, without fear of undue capital outflows. This would help to put further downward pressure on longer term yields. If bill yields fall too rapidly or too far, I would concentrate System open market purchases in the intermediate-term area.

Mr. Mitchell went on to say that while he did not pretend to qualify as expert in European psychology with respect to the balance of payments situation he would comment thereon in the light of his recent trip to Europe believing that some of the best and most accurate impressions are the unconditioned pristine ones.

He found confidence in the dollar and U.S. policies to maintain its present relationship to gold very high among central bankers. Moreover, this confidence was not blind or unreasoned but based upon an understanding of current economic, fiscal, and monetary problems and alternatives. Among commercial bankers generally, there was less confidence but there was also less wisespread understanding of the basic issues. Confidence was lowest among those international bankers and financial concerns whose economic interest is served by high yields on very liquid assets.

In his view the role of higher short-term interest rates in favorably affecting the balance of payments was being overstressed in the determination of monetary policy in the United States. There are, in fact, only two broadly based money markets, New York and London; and in both the United States and Great Britain domestic considerations make lower short-term rates advantageous. Raising short-term rates here might only force a reaction in London to neutralize that action to the disadvantage of the British economic situation as well as that of the United States. Moreover, he continued, many of those who urge that the monetary authorities use their power to raise short-term rates are persons or institutions, here and abroad, who stand to increase their earnings from 10 to 20 per cent by a rise in the price of their services.

Mr. Mitchell praised the efforts of Federal Reserve personnel who have been establishing closer relationships with European central bankers. They have, he said, established a rapport and an atmosphere of trust and confidence with this group that is not too different from that which is typical within the Open Market Committee. This was a notable accomplishment. The concrete evidences of monetary cooperation are now established and he felt that they would become increasingly important to all countries as they experience the vicissitudes of balance of payment surpluses and deficits in the future.

Mr. Mitchell concluded by stating that he would shift the emphasis of monetary policy in the next three weeks toward greater ease, avoid any implication of discount rate change, and amend the Committee's directive to

strike the inference that bank credit expansion has been adequate, or more than adequate (last sentence of first paragraph), and make changes consistent with such a posture in the last clause of the second paragraph.

Mr. King suggested that the only question to be decided by the Committee today was what it should do about the wording of the directive. Mr. Treiber had suggested that there was no need for a change in the directive but his (Mr. King's) view was that if no change were made the Committee would be approving a policy that would take on a cumulative effect if it was renewed. If, in fact, the Manager of the Account had carried out the June 19 directive--and Mr. King said he believed this had been done to a reasonable degree--the Committee should take that action as a benchmark and should not risk having the directive call for a cumulative progression of the policy adopted three weeks ago. For this reason, he would subscribe to changes in the last part of the directive more or less as indicated by Mr. Fulton's proposal.

Mr. Shepardson said he could see no significant change in the economy during the past three weeks that would call for a policy change from that adopted at the June 19 meeting. He did not think it necessary or desirable to apply that policy on a cumulative basis, but he would favor continuing about what was aimed at in the policy adopted on June 19 when the Committee shifted toward slightly less ease than previously.

Mr. Robertson said he agreed with everything Mr. Mitchell had said. On the basis of the economic information presented to the Committee at this meeting and at the June 19 meeting, it was his opinion the June

meeting had been precisely the wrong time for adopting a tightened monetary policy. He believed that the results since that meeting had already begun to show up and, in his opinion, the action at the June 19 meeting should be reversed and the Committee should adopt a policy in keeping with the bad economic information before the Committee today.

Mr. Mills said that in his opinion the reasoning that was followed in agreeing to the policy adopted at the June 19 meeting argued even more persuasively for continuing that policy further at this time. The international balance of payments problems were still with us with a vengeance, and the mild counteroffensive that was adopted in credit policy on June 19 certainly deserved further implementation.

Speaking further of credit policy, Mr. Mills said that when it comes to the use of the terms "ease" or "restriction," a policy that seeks a level of around $350 millions of free reserves can in no sense be considered restrictive. That amount of free reserves provides a basis for credit expansion which over many years of Federal Reserve history has allowed for ample or perhaps too large an expansion of credit, with ultimate unsatisfactory repercussions. What possibly has happened is that the market and participants in the market have been spoiled by a very long and protracted period during which the System has injected new reserves into the commercial banking system. Now, in consequence, even the very mild, very modest shift that has been made in policy has brought questioning on the part of the market and the financial community as a whole.

While we are now in a summer period of lull and where the prospects for new capital issues coming onto the market indicate that the volume will be comparatively small for some weeks to come, Mr. Mills felt that an excellent opportunity was afforded to the System for letting policy simmer and for permitting the market and the financial community to become accustomed again to the very mild change that has occurred--one which may not have been sufficient to mark the counteroffensive against the balance of payments problem that may be shortly called for. In terms of credit availability, Mr. Mills said it was difficult to believe that a volume of free reserves such as has been available signals anything but adequate credit availability to the economy, especially in view of the fact that both the commercial banking system and business concerns have the ability to shift and interchange their assets to more constructive purposes when the opportunities for doing so have become apparent.

When it gets to the field of intangibles and business psychology, Mr. Mills said that it was very important to bear in mind the fact that any change in policy at this time toward greater ease would undoubtedly be regarded as weakness and vacillation on the part of the Federal Reserve System and would be destructive of the faith and confidence in the System's steadfastness in attempting to carry through a policy even in the face of outside criticism.

In concluding his remarks, Mr. Mills referred to an article in this morning's New York Times which commented on Congressional criticism of Federal Reserve policy and charged that the rise in the level of free

reserves during the latest week to a figure of $419 million was deliberately designed as a System retreat from such criticism.

Mr. Wayne reported that current business activity in the Fifth District had continued to improve gradually. Seasonally adjusted bank debits, nonfarm employment, and factory manhours reached new historical highs in May. Employment gains were quite general and, according to a panel of District business leaders, continued in June along with a slight further extension of the factory workweek. The May rise in manhours, however, was a blend of divergent trends: nondurables gained on balance despite losses in food and tobacco, while cyclically sensitive durables declined slightly as a group in spite of a sharp gain in machinery. Qualifying factors were also present in the recent survey to which he had referred, Mr. Wayne said. Of particular note was the change in new orders from increases that were still widespread six weeks ago to slight decreases during the past three weeks. Also, respondents again appraised the immediate future with reduced optimism. About two-thirds anticipated no immediate change, substantially the same proportion that held this view three weeks ago, but those expecting a decline increased from 15 per cent to 27 per cent. Preliminary reports indicated that some crops, particularly tobacco, in several counties of eastern North Carolina may have sustained serious damage as a result of recent torrential rains and high winds. In the three weeks ended June 27 District weekly reporting banks continued to show substantial increases in real estate and all other loans.

On policy, Mr. Wayne said that he was becoming increasingly concerned over the domestic outlook. Witness the trend in new orders of durable manufacturers, the most recent report of the National Association of Purchasing Agents, the slow rise in industrial production, the increase in unemployment, and the continued drop in contract awards, to mention a few items. These may not signal a downturn, he said, but he would not expect them to behave much differently if a recession were imminent. As a result, he wished even more than he had three weeks ago that he could urge further easing--or at least no additional tightening. He did not believe, however, that the international situation gave the Committee this much latitude. In the face of the heightened speculation in gold and the likelihood of capital outflows to Canada, he thought the policy adopted at the last meeting should be continued. For the three weeks ahead, he suggested action to maintain a bill rate near three per cent, realizing that this opened up the question of a change in the discount rate--a move that he was not yet willing to risk in view of the probable adverse domestic impact. He was prepared to argue, however, that it might be proper some time in the near future for the bill rate to move gently above the discount rate even though this might occasion increased discounting prompted by rate differentials. If this seemed like an unorthodox recommendation, the response was that these are unusual times. The Committee must be prepared to accept new policy combinations if policy is to make its maximum contribution to the solution of the present dilemma.

Mr. Clay said that once again monetary policy had to be formulated on the basis of the requirements of both the domestic economy and the international balance of payments. Developments in the domestic economy clearly

did not call for any tightening of credit and upward movement of interest rates. On the contrary, the domestic economy showed further evidence month by month that it needed added stimulus rather than restraint. Accordingly, he felt that the Committee could not very well support the view that monetary policy had done all that it could do or needed to do for the domestic economy and that now policy could be tightened without any negative impact on domestic economic activity. In a domestic situation that continued to fall short of a satisfactory performance, it could not be assumed that at some point the contribution of monetary policy had been completed and that policy could be reversed without detrimental effects.

If, in the Committee's view, monetary policy must be tightened because of international payments considerations, Mr. Clay felt that this action must be supported on the premise that the international aspects are so critical as to require credit tightening despite its negative impact on the domestic economy. It was difficult to judge accurately just what are the full ramifications of the international balance of payments problem, he said, although there was no denying that it constituted a serious problem to which this country must continue diligently to apply itself. Reports would seem to indicate, however, that substantial progress was being made toward improvement in the basic situation.

Mr. Clay noted that in recent weeks the shift in the Committee's policy had led to a lessening in the degree of credit ease and to a higher level of interest rates. While other factors may have played a role, the Committee's operations and the expectations created by those operations had had a pronounced impact on the money and capital markets throughout the

maturity structure. He hoped that this credit tightening action would not be carried further. The upward movement in longer-term interest rates was particularly disturbing to him in terms of its potential effect on economic activity. In keeping with this view on monetary policy, no change was recommended in the Federal Reserve Bank discount rate. In conclusion, Mr. Clay said that he could go all the way with Mr. Mitchell's position, except for Mr. Mills' point that the Committee might be charged with vacillation. This, however, should not prevent corrections of any over-playing of the hand during the past three weeks.

Mr. Scanlon reported that industrial production and employment leveled off in May and June in the major centers in the Seventh District. Continued declines in steel had been accompanied by smaller reductions in some other lines. Retail sales, after rising somewhat in May, declined in June; one large retailer of ladies clothing reported the poorest June in at least eight years, with business off 10 per cent from May.

Mr. Scanlon said that the Chicago Bank's contacts with academic and business economists revealed wide acceptance of the view that the economy was heading for a period of very slow growth for the remainder of the year. Projections by these economists of Gross National Product for 1962 now commonly were on the order of $560 billions or less. Much emphasis was placed on the lack of expansive forces in the economy; the uptrends in automobiles and defense outlays were believed to have had their main effect. Business outlook statements made at a recent forum by a number of executives of large firms headquartered in the Midwest expressed mixed views, Mr. Scanlon

said, ranging from moderately optimistic in the case of consumer and capital goods producers to outright pessimism in the case of representatives from the real estate and railroad industries.

The agricultural outlook was good, and farm income in 1962 was expected to be moderately higher in the Midwest and in the nation. Crop prospects were excellent as a result of favorable weather conditions. Cattle prices had been holding somewhat above last year, and smaller than expected spring and fall pig crops suggested that hog prices would remain reasonably favorable.

Credit demands at District banks appeared to be consistent with current business trends. During the three weeks ending June 27, business loans at weekly reporting banks rose, but at an appreciably slower pace than in comparable periods of the last three years.

Mr. Scanlon then reported on discussions during the past week with a number of major Midwest manufacturers concerning the impact of the tariff surcharges recently announced by Canada. While the probable effect was still uncertain, it was believed that the tariff increases were large enough to affect sales of items such as semifinished steel and luxury type automobiles. Farm machinery and auto parts for assembly in Windsor--which are important exports from the Midwest--are not subject to tariff charges, hence producers of these items would not be affected directly by the tariff charges. The effects of the devaluation of the Canadian dollar, however, would be more widespread. A construction machinery firm reported that the competitive position of its Canadian subsidiary had been improved in third markets in

comparison with the parent company. A farm machinery manufacturer raised its prices about 5 per cent to offset the effects of the devaluation and believes that sales were unaffected because of an improvement in crop prospects in Canada. Other exporters had not raised prices and were absorbing the "cost" resulting from the devaluation.

As to policy, Mr. Scanlon said that the current sluggishness in economic activity in the presence of what appeared to be rising uncertainty as to the trend of business indicated that the domestic economy would benefit from policies that would help to stimulate consumption and investment. He recognized that international capital flows must be given due consideration, but these would not appear to preclude continuation of monetary ease at this time. The results of open market operations for the two weeks immediately following the June 19 meeting were somewhat more drastic than he had understood the majority of the Committee intended, but in the circumstances perhaps the Desk had no choice. He hoped that actions during the next three weeks would help to impart a greater semblance of stability to monetary markets than in recent weeks. In terms of free reserves, a figure around 400 million dollars would be appropriate. He would not change the directive or the discount rate.

Mr. Deming said that the Minneapolis Bank economists summed up their appraisal of the Ninth District economy last Friday with the statement: "With current agricultural prospects bright, and with expanding employment and personal income, we find it difficult to be anything but moderately optimistic about the District at this point in time."

Mr. Deming wished to comment on two points. The first of these was that, in general, the most recent reports about the current situation based on the Bank's opinion survey confirmed the economists' summary statement he had quoted. Somewhat more respondents saw key economic factors up strongly than was true in the survey taken some six weeks ago. The great bulk of respondents, however, still viewed economic activity as being up slightly--less than 5 per cent from a year ago. With respect to the short-run outlook, the replies from the opinion survey were quite interesting, Mr. Deming said, when viewed against the answers given at the end of May and at mid-April. Two out of three respondents regarded further improvement as either probable or fairly certain, which represented a drop from the 75 per cent in that group at the end of May and 87 per cent in mid-April. Within this group, however, there had been a significant rise in the proportion regarding further improvement as fairly certain instead of just probable. The offset showed up in the group that looked for stability at present levels. Only two or three of the Bank's respondents saw any chance of a decline of activity in the near term.

Mr. Deming's second comment related to banking. He reported a continuation into early July of a fairly strong loan demand. The June loan increase at country banks in the Ninth District was the largest for any period since the start of the series in 1947. At city banks the rise had been exceeded in only one postwar year--1959. Demand had been general and across the board, Mr. Deming said, adding that so far this year total bank loans in the Ninth District had risen almost 8 per cent.

With respect to credit policy, Mr. Deming said that Mr. Mills had expressed his ideas as to the background for a policy decision. He had nothing to disagree with in Mr. Mills' analysis and consequently he would not change the Committee's policy. He saw no particular reason to change the wording of the directive, although some slight change along the lines suggested by Mr. Fulton would not be objectionable. He would make no change in discount rate at this time.

Mr. Deming went on to comment that implementation of policy, however, had given him sone concern. He had a feeling that the brakes had gone on harder in the two weeks following the June 19 meeting than he had contemplated would be the case. He had attributed this to the churning in the market and the difficulties of making projections of reserves, and, he would have been prepared to accept the explanation that difficulties in the estimates and the reaction of the market had made policy somewhat difficult to carry out in those weeks. The Manager's report indicated that that had not been the case, however. To be specific, on the basis of the June 19 discussion he would have thought the Federal funds rate would have been more often at 2-3/4 per cent than it was and less often at 3 per cent. He would have thought the bill rate would not have gone quite so far as it had gone. Mr. Deming said he was talking of small differences but ones that had continued over a longer period of time than he thought should have been the case. To sum up, he was completely sympathetic with keeping policy just as stated at the June 19 meeting, but his definition of the implementation would be to keep the Federal

funds rate in the 2-3/4 to 3 per cent range but at least as often at 2-3/4 as at 3 per cent.

Mr. Swan said that Twelfth District conditions were mixed but relatively satisfactory as compared with the United States as a whole. Increased uneasiness was apparent in business circles, especially those close to consumers, looking to the latter part of this year. There had been some pickup in lumber orders and prices, and construction contracts were up substantially in May. Department store sales were up in May and June. Agricultural prospects were good with ample supplies of irrigation water. There had been little change in the banking picture except for a somewhat tighter reserve position in the past week or so. Savings deposits continued to rise but at a much lesser rate than in the first part of the year and at a slower rate than a year ago.

In terms of policy, Mr. Swan said that in view of the over-all situation and the uncertainty that still existed, he personally would have been happier not to have had the recent tightening in reserve positions. There certainly was no basis whatever in the domestic picture for any further tightening. As to the international situation, he still came up with a question as to how many of these problems were outside the realm of monetary policy and, further, whether the modest tightening the Committee had been talking about afforded any basis for a counteroffensive such as Mr. Mills had indicated against the balance of payments problem. If the Committee was talking about the effect of competitive interest rates in the international area, it should be talking about much larger increases

than most of the members of the Committee would be willing to accept, given the total international and domestic situation.

Mr. Swan said that he had some of the same concern that had been expressed by Mr. Scanlon and Mr. Deming regarding the extent of the shift in policy in the two weeks immediately following the June 19 meeting. Perhaps the differences he was talking about were not very significant, but the extent of the shift that had taken place had raised questions of further tightening and of the possibility that the banking system would get into a still tighter position as a result of a series of very small moves or developments which of themselves would be very inconsequential, but which might add up to a total position that would not be satisfactory and which would reflect an unwarranted tightening in the over-all reserve situation. If the bill rate should move about 3 per cent even for a brief period, the pressure of banks for earnings would make administration of a 3 per cent discount rate extremely difficult, and actions that might be taken could bring about unexpected reactions. Assuming that an increase in the 3 per cent discount rate would be undesirable, Mr. Swan felt that a three-month bill rate farther below that figure than 2.97 or 2.98 would cause many to feel much better than if the bill rate were permitted to approach as closely to 3 per cent. He was using this as illustrative of the sort of feeling that had concerned him and was concerning him at the moment.

Mr. Swan said that he personally would like to see a little retreat from the present policy position, but if there was to be no change in

policy, he would still like to have the wording of the directive make the intention of the Committee a little clearer than it seemed to him was the case with that adopted June 19. If the directive were renewed as it now stands, it would imply some further tightening. Therefore, he would hope for some change in wording, particularly in the last sentence of the directive to make clear that there would be no further tightening.

Mr. Irons said that conditions in the Dallas District were quite favorable. Industrial production was up and nonagricultural employment had increased. Construction was at an all time high; bank credit and deposits were up. In the country as a whole, the recovery had lost some of its vigor, but activity was still at a high level. The economy had done quite well in the past few months in absorbing a number of shocks.

Mr. Irons said that he was satisfied with the policy action taken at the meeting on June 19 at which he had not been present. With regard to current policy, he indicated that he would like to see a continuation of this slightly firming tendency, permitting short-term rates to drift to higher levels if market forces caused the move. He would not recommend a deliberate attempt on the part of the Account to force a sharply higher rate level. He said that a bill rate ruling slightly below the discount rate would be satisfactory, but he would not object if the discount rate were pierced by a small margin and, in fact, would like to see the market reaction to such a short-term rate level. Mr. Irons said he was not thinking of a 3.15 or 3.25 per cent bill rate but something close to the 3 per cent figure. A Federal funds rate at 3 per cent would be consistent with

his thinking, more so than one at a lower level, and free reserves in the market would be around the $350 million figure. He would make no change in either the directive or the discount rate.

Mr. Ellis said that there was little that he could add to the economic analysis that had been presented to the Committee, judging from what had been happening in New England where economic activities did not differ significantly from recent developments in the national pattern. Employment was up a shade less than the expected seasonal rise and manufacturing output was showing a fractional rise. At weekly reporting banks substantial gains were reported in June.

Mr. Ellis expressed the thought that many economists would agree that the economy had lost its momentum and that the high point was in the immediate past or the near future. He suggested use of the concept of "elbow room" to explain what the Committee thought it was doing at the June meeting. He had thought that there was some elbow room or "room to maneuver" between the effort to stimulate domestic credit expansion and the effort to hold down incentives for outward flow of short-term capital. In moving to close some of this gap the Committee did not intend to sacrifice its general position of ease. It was his understanding that the Committee approved a very small shift in monetary policy and one that would be only barely visible in the market. In the subsequent period, there had been on the one hand a weakening of domestic developments that had led some to expect more from monetary policy. On the international side, there had been a more rapid upward move in rates than he

personally had anticipated from the discussion at the June 19 meeting. The Manager had put this in terms of a "substantial shift in policy as interpreted by the market."

Mr. Ellis said that he felt the Committee certainly should not aggressively pursue a shift in policy any further. He came down, then, to the basic question--whether there was now sufficient ease. He still felt that there was sufficient ease at the present time. Credit is freely available. This led him to the decision that the Committee should not change the character of policy at the present time. It should presage this from the tone in the market and should continue a ready availability of free reserves. He thought this would be accomplished with a $350 million level of free reserves, using that figure as a floor for aims in operations until the Committee had demonstrated to the market that it really was not moving to a tighter position than was contemplated by the small shift in policy on June 19. This would still allow for a 3 per cent growth rate in reserve availability. Mr. Ellis said he also would like to preserve some elbow room below the 3 per cent discount rate and shared the views expressed by Mr. Swan in this respect. He thought a minimum change in the directive would be desirable. He would eliminate from the first paragraph the reference to declining stock prices and would change the second paragraph to specify that operations be conducted with a view to "providing moderate reserve expansion in the banking system and to fostering a moderately firm tone in money markets."

Mr. Balderston said he shared the views expressed by Messrs. Deming, Ellis, Scanlon, and others that the policy adopted by the Committee on June 19 was one that would continue to increase the reserves supporting private credit but at a somewhat slower rate. He had no fault to find with the operations of the Desk during the interim. He thought he understood the problem with which it was struggling and the turmoil that was going on. But he was concerned with the posture that the Committee adopted by its action at the June 19 meeting, an action that may have come right at the peak of the current expansion.

Mr. Balderston emphasized his concern that the posture that the Committee then adopted, however right it may prove to be in the long run, be understood. He gathered that the Committee was trying to walk between less abundant ease and an actual tightening. Words are misleading here, Mr. Balderston said. He had read in the press that the System had tightened credit, which he believed was not the case. To be specific in explaining his thinking, he thought that at the June 19 meeting the Committee sought to lower the rate of increase in the reserve base for private bank credit from the 3-1/2 per cent line that the Committee had actually followed from December to June to some new goal that would fall between 3-1/2 per cent and zero but certainly not below zero. The tremendous buildup in the Treasury balances with member banks had brought about a distortion in this guide, and he thought the Committee would not be able to tell what road it was really on until after the Treasury balances were reduded during the coming days. Only then would it know whether the line

it was following represented an annual increase at a rate of 3 per cent or 2 per cent or something else.

Mr. Balderston said that he hoped the public would not get the impression that the System was zigging when it should be zagging. In his opinion, it was very hard to have entered in the record after the end of this year words as loose as those in the current directive. He found the first paragraph of the directive adopted June 19 much more appealing than the one it replaced, and he liked it with the deletion that had been suggested by Mr. Ellis. However, he would change the second paragraph of the directive at this time in order to make it a little more concrete. He would accept all of what Mr. Ellis had suggested except that he was concerned about that expression, "a firm tone in the money market." He knew what it meant to him, but he was not sure what it would mean to others. He thought, however, the Committee could change the last three lines of the directive to indicate that policy should be directed with a view to meeting seasonal needs after taking account of the expected decline in Treasury balances with member banks. He would also like to see a reference to the steady increase in reserves supporting private bank credit. He did not believe at this juncture that the Committee should adopt as a long-run goal an objective that would actually tighten bank credit: the Committee's objective should be somewhere less than a 3-1/2 per cent growth rate, but certainly not below zero. He thought the directive ought to be changed, and he would accept the wording suggested by Mr. Ellis.

Mr. Francis said that business activity in the Eighth District had been showing some weakness since May. Unemployment rose more than seasonally

from May to June and both department store sales and bank debits decreased after seasonal adjustments. At banks, on the other hand, business loans increased sharply from May to June. Crop prospects were unusually good. Time deposits continued up, demand deposits were unchanged, and loans rose sharply while investments increased slightly.

Mr. Hilkert said that economic expansion in the Third District was continuing but appeared to be losing momentum. Labor force developments were favorable in May and June. Unemployment claims in Pennsylvania continued below the levels of recent years, claims in Delaware showed a similar pattern, unemployment rates decreased in most areas in May, and in June reclassification of several labor market areas indicated further improvement. Steel production in recent weeks had improved relative to the nation, electric power consumption was up in May, and construction contract awards continue to show good gains. On the other hand, manufacturing employment and average weekly hours declined slightly in May for both durable and nondurable industries, and department store sales slackened in June.

In banking, the most striking development had been the continued sharp increase in business loans, Mr. Hilkert said, although real estate loans also had been increasing significantly. Time deposits were still rising rapidly and so far this year had increased about as much as demand deposits had declined. Over the past several weeks, country bank borrowing at the Reserve Bank had increased somewhat, and reserve city banks had also borrowed small amounts. The basic reserve position of reserve city banks

had been negative in the recent 3-week period, indicating substantial Federal funds borrowing; nonetheless, in the last two weeks the city banks were net lenders of Federal funds.

Chairman Martin said that, as he had commented at the June 19 meeting, what makes monetary policy interesting is the fact that so many people have different views with respect to it and none of us can really prove our points. Mr. Bryan had asked four questions this morning, but he had not given us any of the answers. His own view, the Chairman said, was that monetary policy had done what it could to help the recovery and that it had about played itself out. He went on to say that it was easy to get into a pattern of activity where we think that, by just easing money or increasing expenditures or raising a deficit, we can achieve certain things. He believed that in time a point was reached where ease played itself out. Maybe that was not orthodox, to use Mr. Wayne's expression, but an unorthodox procedure was required.

The Chairman said he did not think that the Committee was going to be able to explain anything as clearly as the fact that it had had a very easy monetary policy, although one less easy since June 19 than it was before. It seemed inevitable that people were going to use words like "restrictive" and attach them to something such as had taken place in recent weeks. Markets would always have some contrasts, the Chairman said, and at any given time some people would use one word to describe the situation while others would prefer a different word. He was sure in his own mind of one thing: There had been a great deal of ease and,

using that relative term, lately there had been a little less ease. Some had referred to reserves that would provide for a rate of growth. He did not know what growth rate was correct, but he did have confidence in growth. As to the effect of the recent change in policy, one of the reasons that had been given for a rally in the stock market was the indication of some "tightening" in System policy. This did not prove anything, Chairman Martin said, but it illustrated how different interpretations could be put on these things by different people.

As he had indicated before, Chairman Martin said that he believed the System could be faced with a real crisis between now and the Annual Meetings of the Bank and Fund in September. It would be foolish for those in this room not to be questioning themselves in all respects. To use Mr. Ellis' words, the Committee needed some elbow room so that it could react in whatever direction was called for.

Chairman Martin said he did not believe the Federal Reserve was going to achieve anything at the present juncture by ease compounded by ease. However, he certainly did not think the Committee wished to tighten at this juncture. The difficulty in writing a directive became more apparent every time the Committee met. The Committee was engaging in a delicate operation. He agreed that, as one looked at the figures and noted the minimum amounts of free reserves since June 19, one could say that this had not been a delicate operation. He happened to have gotten more and more sympathetic with the Desk as he had continued to observe the operation over the years. He had come to realize the great difficulties of the

operation, and when he viewed the projections made by the Desk and by the staff here in Washington and considered the human factors that were involved and that came into play in these markets, he was convinced that the Committee was asking for too much in the way of precision in measuring these results. It would have been all right to have seen $375 million of free reserves instead of $306 in one week, but to try to put those figures together and to bring about the result was, to say the least, an extremely difficult thing to contemplate. He was saying that the Committee should be very careful about thinking that the projections of reserves could be made too precise. The staff should continue to strive for the best precision possible, but the Committee must be aware of the problem that it faced.

The same thing was true when it came to language in the directive, the Chairman said. He had gone back and read the minutes of the meetings many times, as he was sure that the other members of the Committee had done. He had read the directives repeatedly, and if one were to read these without the background of the meetings he could understand how a person might think they were just words. This was one of the problems whenever he was called up to discuss this question before a Congressional Committee. Words could mean one thing to one person and another to anyone else. This was particularly true in the shading that sometimes was suggested in these discussions. For this reason he wanted to reiterate the things he had said before about the difficulty of writing these records. It certainly was not feasible for 19 persons sitting around this

table to draft this kind of a directive in precise language that would suit all the aims expressed. It might be possible to come nearer to it if the Committee could spend two or three days each time in working on their expressions, but to some extent that was a question of the best use of the time of the people concerned.

So far as today's meeting was concerned, Chairman Martin said that it was certainly evident that nobody wanted the world to think that the Committee went blithely on as it had been doing over a long period of time saying that there was not enough ease. In his judgment, a fairly good case could be made that the amount of ease over a period of time had been misdirected. That perhaps was true for nonpurpose loans on securities and loans in the unregulated area where the Federal Reserve was unable to reach certain credit. But this was not new and the answer required legislation, which in the Chairman's opinion would not be easy to get.

As to the wording of the directive, Chairman Martin said that the phrasing Mr. Ellis had suggested was perfectly all right with him, as would be the wording along the lines suggested by several other persons. He thought the present policy was right, and he felt that a clear majority of the Committee considered that it applied at the present time and did not want the situation to get any tighter. He repeated that this was a delicate operation, but the international situation was such that, with the difficulties in the gold market that were familiar to all, and with the weakness in the dollar abroad, the Committee would be remiss in its

duty if it was not showing an awareness of the situation through monetary policy at this time. If the System had to raise the discount rate as a result of developments in the balance of payments, it would not look too foolish in doing so if it had followed the current policy of a little less ease.

Chairman Martin said that so far as he personally was concerned he did not think that additional ease was going to help the economy at this juncture. As a matter of fact, he thought it would have the reverse effect. He had no reason to quarrel especially with others except to say that those who disagreed with this particular view were, in his opinion, wrong.

The Chairman then inquired as to whether the members of the Committee wished to make some change in wording of the directive that would maintain the same policy as that adopted at the June 19 meeting, with the clear understanding that it did not favor any further tightening than had been achieved recently. While the specific wording of the directive might vary so far as he was concerned, Chairman Martin said that he did not think it feasible to try to spell out in precise terms how the policy of the Committee should be implemented. At his request, Mr. Sherman then presented a directive that would have deleted from the opening paragraph any reference to declining stock prices and which would be changed to incorporate in the second paragraph the wording that had been suggested by Mr. Ellis in his comments as follows:

> To implement this policy, operations for the System Open Market Account during the next three weeks shall, to the extent consistent with the behavior of financial markets, be conducted with a view to providing ~~a-somewhat-smaller-rate-of~~ MODERATE reserve expansion in the banking system ~~than-in-recent-months~~ and to fostering a moderately firm tone in money markets.

After several of the members of the Committee had indicated that wording was acceptable to them, as was the clarification of policy indicated in Chairman Martin's statement in the preceding paragraph, the Chairman inquired whether any of the members of the Committee wished to vote against its adoption, and Messrs. Mitchell and Robertson stated they would dissent.

> 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 effect transactions for the System Open Market Account in accordance with the following economic policy directive:

> It is the current policy of the Federal Open Market Committee to permit the supply of bank credit and money to increase further, but at the same time to avoid redundant bank reserves that would encourage capital outflows internationally. This policy takes into account, on the one hand, the gradualness of recent advance in economic activity, the availability of resources to permit further advance in activity, and the unsettlement of financial markets. On the other hand, it gives recognition to the bank credit expansion over the past year and to the role of capital flows in the country's adverse balance of payments.

> To implement this policy, operations for the System Open Market Account during the next three weeks shall, to the extent consistent with the behavior of financial markets, be conducted with a view to providing moderate reserve expansion in the banking system and to fostering a moderately firm tone in money markets.

There had been distributed to the Committee a report from the Special Manager of the System Open Market Account regarding System and Treasury operations in foreign currencies and on foreign exchange market

conditions for the period June 19 through July 4, 1962, as well as a supplementary report for the period July 5 through July 9, 1962. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Chairman Martin called upon Mr. Sanford for comments on foreign exchange market conditions and System operations during the period since June 19, and Mr. Sanford made a statement substantially as follows:

> Throughout the period since the Federal Open Market Committee meeting of June 19, the dollar has been weak against the European Continental currencies; it has been on or close to the floor in terms of the Swiss franc, French franc, guilder, lira, and Belgian franc and more recently has sagged against the DM, though remaining above the floor. On the other hand, the dollar shows a net advance, in terms of the pound. In the special case of the Canadian dollar, this currency is now being quoted somewhat above its par of $0.92-1/2, whereas three weeks ago it was at its lower support price.
>
> Turning first to the Swiss franc, the strength in that currency relative to the dollar has resulted in substantial intervention by the Swiss National Bank, whose reserves increased $100 million in the two weeks ended June 30 and $57 million since that time through Monday, July 9. Using part of the dollar gain, the Swiss National Bank purchased $25 million of gold from the United States on July 5. Several factors have contributed to the inflow of funds into Switzerland: (1) market uncertainties related to the Canadian exchange crisis and the decline in world stock markets; (2) the repatriation of Swiss funds for mid-year window dressing; and (3) nervousness arising from the recurrent rumors of an impending United States gold embargo.
>
> Going to the French franc, only brief easing late in June from its ceiling position occurred on market expectations that the French franc portion of Canada's International Monetary Fund drawing would be converted into dollars in the market; this did not materialize as the drawing was converted directly by the Bank of France. At this point, I would mention that the Bank of France has given us preliminary notice of a considerable package of transactions to be effected on July 12. Included are: (1) the prepayment of nearly $300 million of debt to the Export-Import Bank and of $62 million to Canada, and

(2) the purchase of about $110 million of gold from the United States to be added to French reserves.

The Italian lira had a brief decline in the early part of the reporting period, which was caused by a moderate outflow of funds after the Italian Government announced its intention to nationalize the electric power industry. But with seasonal influences exerting their pressure, the lira was soon back to its ceiling and, after consultation with the Italian authorities, a total of $8 million in lire has been sold by the Bank of Italy for Treasury account. Such sales (from Treasury Borrowings of lire) are designed to absorb dollars which would otherwise flow into official Italian hands and increase Italy's potential gold demands. We have been informed that the Italian Government will prepay $178 million of debt to the United States, sometime in July or August.

The other currency that I would comment on especially now is the Deutsche mark. That currency was already advancing as the period opened, principally because of repatriation of funds by German banks to counter stringent liquidity conditions in Germany and to acquire domestic assets for mid-year balance sheet purposes. The Bundesbank purchased a sizable amount of dollars, and further upward pressure on the mark appeared likely. Discussions with the Bundesbank indicated to us that any further strengthening of the mark might best be met by intervention in New York as well as Frankfurt. Accordingly, the System sold a total of DM 18 million in the period between June 20 and June 25. Up to this time, the DM did not go above $.2506-1/2. On Thursday. July 5, however, a very rapid advance in the rate occurred in Frankfurt, before the opening of the market in New York. This rapid rise was attributed to two factors: (1) with all the other Continental currencies at or near their ceilings, the DM had become the cheapest European currency to acquire, and (2) there appeared to be occurring some extraordinary flow of funds into Germany, for the purpose of acquiring a new Federal Republic Issue of 6-1/2 per cent securities. Again in consultation with the Bundesbank we sold a total of DM 19 million on Thursday, July 5, DM 6.5 million on Friday, and DM 18 million yesterday, July 9. At the close Friday in New York, the DM was quoted at $0.2509-1/4 whereas it had been as high as the equivalent of $0.2511-5/16 in Frankfurt; and on Monday, July 9, it was quoted in New York at $0.2512-5/8 before the System entered the market at an early hour and closed at $0.2512-1/8, as compared with the equivalent of $0.2513 at its highest point in Germany. Today, early reports from Germany place the DM at about our closing level last night. These operations were aimed at preventing erosion

of the rate structure such as might have occurred if there had been no intervention.

Sterling fluctuated between $2.8092 and $2.8098 until June 25, when it was adversely affected by reported sales by Continental holders in order to acquire Canadian dollars to cover short positions in that currency. After this dip, the rate held around $2.8085 until the last few days, when it has declined to around $2.8055, owing in part to reported flows from sterling into DM's. The covered interest arbitrage differential, figured in terms of Treasury bills, is virtually nil at this time (July 9).

The massive demonstration of United States and other foreign cooperation extended to Canada was generally well received both in Canada and abroad and put an immediate end to the heavy attack on the Canadian dollar. While the exchange rate has advanced to above par and the Bank of Canada reportedly has on occasion gained some dollars in moderating the upswing in the rate, only a slight reversal has been evident in the adverse pattern of commercial "leads and lags" that previously developed. In addition to Bank of Canada market intervention on both sides, the U. S. Treasury has purchased some moderate amounts of Canadian dollars, both to meet future requirements and to assist the Canadian authorities in their support operations. A forward market for Canadian dollars has reappeared and the three-month forward Canadian dollar has been quoted at a discount of about 2.00 per cent per annum. With Canadian Treasury bills at about 5.35 per cent and United States bills at 2.90 the covered interest arbitrage differential in favor of Canada is about 0.44 per cent per annum. Some short-term funds have on occasion been reported flowing into Canadian Treasury bills and finance paper.

Transactions consummated for System Account during the period since June 19 include:

1. The acquisition of Belgian francs equivalent of $50 million under the reciprocal swap arrangement previously approved by the Federal Open Market Committee. Such Belgian francs are on deposit with the Societe Nationale de Credit a l'Industrie, carry the guarantee of the National Bank of Belgium, and earn interest at 2-3/4 per cent, the same rate that the Treasury pays on the special certificate of indebtedness held by the Belgians.

2. The acquisition of Canadian dollars equivalent of U. S. $250 million under the reciprocal swap arrangement previously approved by the Federal Open Market Committee. Such Canadian dollars are held

in a money employed account with the Bank of Canada and are earning interest at the rate of 2 per cent, the same rate that the Treasury pays on the special certificate of indebtedness held by the Canadians.
3. Sales of DM 61-1/2 million, (equivalent in dollars is $15-1/4 million), as previously reported to this meeting.

The Chairman suggested that, unless there was objection, the Committee ratify and confirm the transactions in foreign currencies since June 19, as reported by Mr. Sanford and as presented in the written reports submitted to the Committee.

Mr. Ellis stated that he had no objection to ratification of such transactions but that he would like to have a discussion later during the meeting of certain aspects of the foreign currency operations.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System transactions in foreign currencies during the period June 19 through July 9, 1962, were approved, ratified, and confirmed.

Mr. Sanford stated that he had just received over the telephone a report and some recommendations from Mr. Coombs, who had returned to New York from Europe last night. The substance of Mr. Coombs' comments as presented by Mr. Sanford was as follows:

The European exchange markets are being swept by recurrent rumors that the U. S. is drifting towards devaluation, a gold embargo, exchange controls, or similar drastic measures. Much of the anxiety has apparently been generated by the stock market decline which has revived memories of the 1929-33 experience, while widely publicized reports of developing antagonism between the Administration and the business Community have weakened foreign confidence still further. The London gold market has been subjected to heavy buying pressure with demand during June running at more than twice the April figure. As a result the reserves accumulated by the Gold pool have now been drawn down nearly

to zero. I believe it will be possible, however, to reactivate the gold sale consortium to which European central banks have contributed $135 million if the demand for gold should threaten to create an unduly heavy drain on the U. S. gold stock.

Heavy buying pressure on the Swiss franc has also developed with the result that the dollar holdings of the Swiss National Bank had risen by last Friday to a point $210 million in excess of their informal ceiling of $175 million. In the light of this situation my negotions with President Schwegler and Dr. Ikle of the Swiss National Bank over the past weekend resulted in agreement on their side to a stand-by swap operation of $200 million incorporating most of the provisions in our swap arrangements with other central banks. Schwegler and Ikle suggested, however, that it would be preferable from their point of view if the swap arrangement were broken into two parts: first a $100 million stand-by swap directly between the Federal and the Swiss National Bank, and second, another $100 million stand-by swap between the Federal and the Bank for International Settlements. In both cases we would swap dollars against Swiss francs, with the BIS obtaining Swiss francs through a third swap arrangement of its own with the Swiss National Bank. Our swap with both the Swiss National Bank and BIS would be initiated on a stand-by basis with the prospect, however, of an immediate drawing of $50 million under each one for purposes of mopping up $100 million of the present surplus dollars held by the Swiss National Bank. Both swaps would carry an idential interest rate on both sides based upon the U. S. Treasury bill rate; in both cases we would be offered time deposit facilities at the BIS for investment of any Swiss franc balances we might hold. The swap arrangement would be for three months but the Swiss have requested a special provision for liquidation of the swap on two days' notice at the initiation of either party; this request apparently arises from the insistence of their lawyers that the Swiss National Bank must be covered against the contingency of an outbreak of war.

Supplementing this swap arrangement I believe that the U. S. Stabilization Fund would be prepared to undertake further forward operations up to, say, $25 million while the Swiss National Bank itself would expect to undertake forward operations on its own. Finally the Swiss National Bank might be prepared to let its dollar holdings remain somewhat above the present $175 million ceiling but would probably wish to purchase gold in moderate amounts, say $25 million. I would strongly recommend to the Committee their approval of these swap arrangements. Unless we can through such arrangements mop up a sizable proportion of the dollars recently taken in by the Swiss National Bank we face the prospect of very large gold losses which might easily

trigger off an avalanche of demand from other quarters. In this connection I would like to note that the buying pressure on the Swiss franc now seems to be spreading to other European currencies, with the Bank of Italy, the Bank of France, the Netherlands Bank, the Bundesbank and the Belgian National Bank all reporting sizable dollar receipts on Thursday and Friday of last week.

Next I should like to report that a Bundesbank official strongly hinted to me over the weekend that the Bundesbank would like to be included in our network of swap arrangements, in the usual amount of $50 million. I think this would be a useful step and would like to ask the Committee approval in principle of such a swap, with final approval of the Federal Open Market Committee to be sought by telegram covering the specific arrangements proposed.

After Mr. Sanford had completed presentation of Mr. Coombs' report and recommendations, he went on to say that the latter had indicated considerable urgency and expressed the hope that the swap arrangements with the National Bank of Switzerland and the BIS could be completed within the next few days for announcement July 20. As to the proposed swap with the Bundesbank in the amount of $50 million, Mr. Coombs' recommendation was that the Committee give its approval in principle to a swap on the usual terms with the understanding that the details would be presented to the Committee for approval before the arrangement was completed.

Chairman Martin noted that at the May 29 meeting the Committee authorized the Special Manager to pursue negotiations with the National Bank of Switzerland looking to a dollar-Swiss franc short-term swap in the amount of $150 million, and he called for comments at this time on the recommendation now being made for a dollar-Swiss franc swap for a total of $200 million to be split, $100 million to the National Bank of Switzerland and $100 million to the BIS, the arrangement to be for a three-month period on generally the same basis as other swap arrangements.

In the course of the discussion of these proposed swaps, Mr. Bryan stated that he understood that their purpose was to mop up some of the excess dollars that were going to Switzerland. He had approved entering into such agreements with some reluctance at the outset, on the general grounds that the central banks were merely attempting to iron out fluctuations in the market and not attempting a fundamental correction of a balance of payments problem with this device. Noting that the dollar was now weak in relation to practically all of the important European currencies, he posed a question as to the possibility of an avalanche that would overwhelm the central banks. Mr. Bryan said that he was troubled as to how long the central banks might go on mopping up these surplus currencies.

Chairman Martin responded that there was no question but that the purpose of the swap arrangements had been and still was the ironing out of temporary fluctuations. It was possible, of course, that there could be an avalanche. As to this particular swap with the Swiss, to date no such arrangement had been completed. The Swiss were not in the International Monetary Fund, he noted, and in his view it would be a poor time to withdraw from making this type of arrangement which could help iron out these temporary movements of funds. Because there might be critical problems to deal with between now and the Annual meetings of the Bank and the Fund in September, it was his opinion that the completion of a swap arrangement with the Swiss along the lines proposed would be desirable.

After Mr. Mitchell had commented that he felt this would represent an important additional arrangement, Mr. Ellis inquired whether the Swiss would regard it as a temporary arrangement.

Mr. Sanford stated that the Swiss were obviously interested in international cooperation. They were embarrassed by the rise in their dollar holdings and this proposal was one way of preventing those dollar holdings from getting converted immediately into gold--an arrangement that they believed to be in the interest of the whole international community. How soon it could be reversed was a matter of guess, but in the last analysis it would keep the movements of gold on a more orderly basis. At some time, of course, the swap would have to be liquidated, but if the arrangement worked as contemplated it would at least have reduced the gold loss by the United States for the time being.

Mr. Swan noted that if the Swiss swap arrangement were authorized, the present limitation of $500 million of foreign currencies that might be held in the System Account under the continuing authority directive would have to be increased.

Chairman Martin responded that, if the Committee approved the proposed arrangements, he had in mind increasing the total authorization to $750 million, an amount that would cover the $200 million swap for Swiss francs and also the proposal for a swap arrangement with the Bundesbank in the amount of $50 million.

Mr. Ellis said that his question regarding these proposals derived from the concept that led the Committee into this operation in

foreign currencies. He noted that the Committee's discussions at the time this program was authorized contemplated that the currency operations would attempt to deal with temporary and reversible movements of funds. He saw no problem in the proposed arrangements as such, but he felt that every time one of these proposals came up it should be subjected to the original tests that the Committee had in mind in adopting the Authorization and Guidelines for these operations. His question was whether the Committee was developing an additional philosophy to be used in guiding the foreign currency operations that went beyond the original concept of short-term temporary adjustments.

Mr. Mitchell said that he did not understand the approach of Mr. Ellis. The Committee had been talking about helping the balance of payments situation. Presumably all of the members believed the dollar was not overvalued and that in these circumstances its convertibility could be sustained once there was a chance to make a few adjustments. In terms of the Committee's authorization, it seemed to him that the Committee was trying to protect the dollar against a psychological run or the effects coming from it. He did not believe that this was a program that could be put on a three-month baais, rather, it was one the Committee would hope could be renewed until it met its objective.

Chairman Martin remarked that the swap arrangements were obviously buying time, as Mr. Sanford had suggested earlier. He then noted that Mr. Coombs' recommendations were for (1) approval of swap arrangements with the Swiss National Bank and the BIS in the total amount of $200 million to

be split evenly between the two banks, the terms to be on the basis outlined in Mr. Coombs' message to the Committee earlier during this meeting; (2) approval in principle of a swap arrangement with the Bundesbank in the amount of $50 million, the details resulting from negotiations to be submitted to the Committee for approval. If these were approved, the Chairman said, it would be necessary to increase the limitation in the continuing authority directive, and he proposed an increase from $500 to $750 million.

He then inquired whether the Committee wished to approve these three proposals.

Mr. Mills stated that he would approve but that he had strong reservations along the lines indicated by Messrs. Bryan and Ellis. He felt that there had been some altering of the concept of the Committee's engagement since the plan for the foreign currency operations originally had been adopted. He had reservations about the whole program, but he would approve the new proposals. The Committee should go into each of these arrangements with its eyes open and not in the belief that it was following the same path as when the arrangements were originally discussed.

Chairman Martin said that he agreed that the Committee should go into each arrangement with its eyes open. He then suggested that unless there was disagreement the Committee:

1. Approve the completion of a dollar-Swiss franc swap arrangement with the Swiss National Bank and the Bank for International Settlements as recommended by Mr. Coombs in the total amount of $200 million;

2. Authorize the negotiation of a $50 million swap arrangement with the Bundesbank, the terms to be submitted to the Committee for approval; and,

3. Increase the limitation in the continuing authority directive from $500 to $750 million.

No disagreement with these proposals was indicated.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the Federal Open Market Committee approved the following continuing authority directive on System foreign currency operations:

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines on System Foreign Currency Operations issued by the Federal Open Market Committee on February 13, 1962:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs
Belgian francs
Canadian dollars

Total foreign currencies held at any one time shall not exceed $750 million.

Mr. Sanford stated that he would like to bring one other point to the attention of the Committee. The New York Bank has been studying various methods of accounting for profits (such as the small ones that have resulted from the recent sales of DM) and possible losses from foreign exchange transactions, from the point of view of the valuation of the foreign exchange portfolio and the point of view of settling with the other Reserve Banks. This was not a pressing matter, and it was a complicated subject. In due course, he expected that recommendations would be developed for

discussion with the Board's staff concerned with such matters, and subsequently with the Federal Open Market Committee.

The date for the next meeting of the Federal Open Market Committee was set for Tuesday, July 31, 1962.

Assistant Secretary