

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, October 23, 1962, at 9:30 a.m.

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

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

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

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Brandt, Brill, Furth, Garvy, Hickman,
Holland, Koch, and Parsons, Associate
Economists
Mr. Stone, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market
Account

Mr. Molony, Assistant to the Board of Governors
Mr. Harris, Coordinator of Defense Planning,
Board of Governors
Mr. Williams, Adviser, Division of Research and
Statistics, Board of Governors
Mr. Yager, Chief, Government Finance Section,
Division of Research and Statistics, Board
of Governors

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Messrs. Ratchford, Baughman, Jones, Tow,
and Green, Vice Presidents of the
Federal Reserve Banks of Richmond,
Chicago, St. Louis, Kansas City, and
Dallas, respectively
Mr. Lynn, Assistant Vice President, Federal
Reserve Bank of San Francisco
Mr. Anderson, Economic Adviser, Federal
Reserve Bank of Philadelphia
Mr. Eisemenger, Acting Director of Research,
Federal Reserve Bank of Boston
Mr. Sternlight, Manager, Securities Depart-
ment, Federal Reserve Bank of New York

Upon motion duly made and seconded,
and by unanimous vote, the minutes of the
meeting of the Federal Open Market Com-
mittee held on October 2, 1962, were
approved.

During the evening preceding this meeting, the President of
the United States had announced a quarantine on the importation of
offensive military equipment into Cuba. Thereafter, the condition
of readiness known as DEFCON 3 was placed in effect.

At the Chairman's request, Mr. Harris described the implica-
tions in terms of the Federal Reserve System of DEFCON 3 being in
effect, along with the conditions that would exist should DEFCON 2
or DEFCON 1 be placed in effect. He noted that the Federal Reserve
System, through previous actions, had achieved a state of readiness
generally equivalent to that anticipated in a DEFCON 3 situation.
In the present circumstances, he suggested that the Reserve Banks
might want to take advantage of the psychological climate to urge

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commercial banks to initiate or improve their preparedness programs, with particular emphasis on the programs of the larger banks and on the duplication and positioning of vital records. In response to a question, he outlined the situation with respect to the availability of currency supplies, indicating that in his opinion the supply of Federal Reserve notes was adequate and satisfactorily distributed.

Mr. Hayes, speaking as Chairman of the Committee on Emergency Operations of the Conference of Presidents of the Federal Reserve Banks, expressed agreement with Mr. Harris that it would be desirable to take steps to spur the commercial banks into progressing with their defense preparedness programs. He suggested that the Committee on Emergency Operations might work out with Mr. Harris a draft of letter that could be used by Federal Reserve Banks in communicating with commercial banks in their respective districts.

Further discussion related to the conditions under which it was contemplated that the emergency operations of the banking system would go into effect, and the suggestion was made that it would be desirable for all concerned to review and clarify in their minds the steps that had been worked out in the area of defense planning.

Mr. Harris then withdrew from the meeting.

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Chairman Martin explained that this meeting had been called to convene at 9:30 a.m. as an experiment in the light of a suggestion by one of the Committee members that it would be helpful if more time could be available for the discussion of System foreign currency operations. This experiment had been decided upon before the occurrence of the present international crisis.

Chairman Martin then turned to Mr. Coombs for a review of the latest information on foreign exchange market developments.

In his comments, Mr. Coombs reported advice received at the Federal Reserve Bank of New York during the several hours up to the time of this meeting with regard to developments in foreign exchange markets and in the London gold market, such information being based primarily on telephone conversations with foreign central banks. In the course of his remarks, he also referred to certain current or contemplated U. S. Treasury operations in foreign currencies, along with current and prospective changes in the level of the U. S. gold stock and possible public reaction to the announcement of balance of payments figures for the third quarter of this year. In the light of the developments that he summarized, Mr. Coombs outlined certain possibilities that he foresaw with respect to the future course of Treasury and Federal Reserve foreign currency operations.

Turning more directly to specific System operations, Mr. Coombs pointed out that the standby swap agreements with the Bank of France and the German Federal Bank, each in the amount of \$50 million, would mature on November 2, 1962. It was his recommendation that each of these agreements be renewed on a standby basis for a three-month period on the same terms and conditions as the present agreements.

Without objection, renewal of the standby swap agreements with the Bank of France and the German Federal Bank, as recommended by Mr. Coombs, was authorized.

Mr. Coombs stated that pursuant to the authorization given at the Committee meeting on August 2, 1962, arrangements had been completed with the Austrian National Bank for a \$50 million three-month standby swap agreement on the usual terms and conditions. If a swap should be initiated by the Austrian National Bank, he felt that the National Bank might want to give the Federal Reserve a deposit facility with the Bank for International Settlements; schilling balances would earn a return equal to the current U. S. Treasury bill rate. It would be agreeable to the Austrian National Bank to make the standby swap agreement effective October 25, 1962. If this was done, Mr. Coombs said, the Federal Reserve would make a drawing promptly under the swap agreement to absorb surplus dollars

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on the books of the Austrian National Bank. He anticipated that the Austrian National Bank would make gold purchases totaling around \$30 million during the fourth quarter of this year and that it would then make no further purchases until the latter part of next January. In his opinion the swap arrangement would be useful, and he recommended its approval by the Open Market Committee.

Chairman Martin noted that, in accordance with the suggestion made by Mr. Mitchell at the October 2 Committee meeting, the staff had distributed a series of memoranda on recent economic developments in several foreign countries, including a memorandum with respect to Austria. Other papers in the series related to the Netherlands, Italy, and Japan.

After a brief general discussion of the type of information developed by the staff memoranda, consideration of the proposed swap agreement with the Austrian National Bank resumed.

In the course of the comments that ensued, a member of the Committee observed that in the case of Austria a swap agreement was being proposed essentially for the purpose of deferring purchases of gold. In the case of France, on the other hand, no use of a swap arrangement for such purpose had been suggested. Question was raised as to the distinctions that might be drawn.

Mr. Coombs replied that the surplus position of France was of such strength as to render the use of swap arrangements in the

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existing orders of magnitude futile. In the case of Austria, the surplus was of much more modest proportions. Further, the possibility of utilizing swap arrangements was dependent on the attitude evidenced by the central banks of particular foreign countries. In the Austrian case, indications had been given to the Federal Reserve that the National Bank would be agreeable to stretching out contemplated purchases of gold through the use of such an arrangement. The French had not indicated that they would be so disposed.

Thereupon, the proposed \$50 million standby swap agreement with the Austrian National Bank, on the terms outlined by Mr. Coombs, was approved unanimously.

Mr. Coombs reported that the Bank of Canada had indicated that within the next few days it hoped to make a prepayment in the amount of \$125 million under its swap agreement with the Federal Reserve System. It also appeared that repayment of the remaining \$125 million before the maturity date of the swap agreement was likely. It was expected that the Bank of Canada would request, as the swap was paid off, that the paid-off portion be put on a standby basis.

No objection to such a procedure was indicated.

Inquiry was made, however, as to whether a \$250 million standby swap agreement with the Bank of Canada would not appear out of line with other similar agreements, such as, for example, the \$50 million agreements with the Bank of France and the Bank of England.

Mr. Coombs expressed the hope that in due course larger stand-by swap arrangements could be worked out with the central banks of some of the European countries. He noted, however, that although the Canadian economy was relatively small, a large volume of trade existed between the United States and Canada.

There ensued a discussion during which Mr. Mitchell inquired whether it would be possible to provide the Committee with an outline of criteria according to which the appropriate size of swap facilities might be appraised. Mr. Coombs suggested that this had to be determined largely through experience; as money flows went back and forth, it was possible to make certain rough judgments as to the size of actual and potential swings. In his opinion, judgments would have to be formed primarily on the basis of what had occurred. After further comments had been made along these lines, Mr. Young suggested that perhaps the problem could be approached experimentally in an effort to suggest certain tentative criteria. Mr. Coombs pointed out by way of reservation, however, that in practice any theoretical targets would not necessarily be negotiable. Mr. Hayes commented that in looking at any prospective swap transaction, one obviously formed certain ideas based on factors such as the size of the country concerned and its relative importance in international payments. There might be a variety of theoretical criteria that could be put together as a backstop to that kind of instinctive feeling. Nevertheless, many

other factors would have to be evaluated in the light of circumstances as they actually developed. Mr. Mitchell then explained further the basis of his inquiry by saying that he was not proposing to restrict the element of judgment. However, a judgment should have some tangible underlying basis. In reaching a judgment on the appropriate size of swap facilities from one country to another, it would appear that there should be some quantitative evidence that would be helpful.

At the conclusion of this exchange of comments, Chairman Martin suggested that the staff continue its work to improve the documentation available to the Committee. Papers such as had been distributed prior to this meeting constituted a first step. At the same time, the Committee should not lose sight of the fact that the program of foreign currency operations was still experimental in nature.

Mr. Mills made the comment at this point that the System was moving continually into more substantial transactions in foreign currencies. He assumed that the Presidents of the Federal Reserve Banks would want to be giving consideration to the maximum amount of foreign currency assets that it would seem appropriate to put on the books of the Reserve Banks.

The Chairman then inquired whether there were any further comments with regard to System foreign currency operations or related matters, and none were heard.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System operations in foreign currencies during the period October 2 through October 22, 1962, were approved, ratified, and confirmed.

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 October 2 through October 17, 1962, and a supplementary report covering the period October 18 through October 22, 1962. Copies of both reports have been placed in the files of the Committee.

At the request of the Chairman, Mr. Stone commented on the latest reports that had come to him regarding the Government securities market. In general, although the underlying atmosphere was one of caution and nervousness, it appeared that the market was reacting rather calmly to overnight developments. While some selling was expected this morning, he did not look for any avalanche of selling to develop in the absence of a violent Soviet reaction to the President's announcement. If there should be such a reaction, the attitude of the market could, of course, change almost instantaneously.

Mr. Stone also commented that market attention was focused particularly on the \$250 million American Telephone and Telegraph issue. The bidding for this issue had been scheduled for later this morning. According to present plans, the financing was to

take place as scheduled. Whether it would take place would depend in good part on the extent of dropouts from the syndicates that had been formed.

Secretary's Note: It was reported later in the meeting that the financing had taken place as scheduled.

In supplementation of the written reports that had been distributed to the Committee, Mr. Stone then commented further as follows:

Since the last meeting of this Committee, the money market has maintained the same steady tone that has been characteristic of the past few months. Federal funds have traded in a narrow range of 2-3/4 to 3 per cent, and indeed, in the last two days, as if to underline the narrowness of that range, most of the trading was at 2-7/8 per cent. Member bank borrowing has been generally moderate, as there was a good flow of Federal funds to the money centers even when the funds rate held at 3 per cent for several days running.

Also, as in previous recent periods, there has been continuing downward pressure on short-term interest rates, and recently it has been, if anything, more difficult to cushion those downward pressures. This difficulty may be accentuated further if, as seems likely, the overnight developments with respect to the Cuban situation cause people to want to hold the shortest-term instruments while waiting out these new uncertainties. The three-month Treasury bill rate, which was 2.73 per cent (bid) yesterday, was just the same as three weeks earlier, but the six-month and one-year rates, and other short-term rates, have all moved down in the interim. This has added to the difficulty of avoiding a drop in the three-month area. Seasonally, we should not be getting into a period of additional liquidity needs in the private economy and some accompanying rate increases for bills; given the sluggishness in the economy, however, which is still at a high enough level so that corporations are continuing to build liquidity, it may be increasingly difficult to restrain the downward pressures on the short-term rate structure.

One factor that should help in that direction, of course, is the reduction in prospective System buying resulting from the Board's action last week to reduce the reserve requirement against time and savings deposits. The initial market impact of that move has been in the direction of lower bill rates, however, since it has been widely interpreted in the market, if not as a significant move toward ease, then at least as indicative of a slight leaning in the direction of an easier policy. Other market observers take the Board's statement at face value and regard the move mainly as a substitute for open market purchases in supplying seasonal reserve needs, but there is still a lack of real conviction in these views, and the market is looking to System actions in the period ahead for some signal as to the policy significance of the reserve requirement move.

The required reserves reduction also had a bullish impact on the bond markets, capping a period of firmness in those markets that has been based on increased doubts about the domestic economy and improved confidence in the dollar despite the fact that an uncomfortable feeling about what the third quarter balance of payments figures will show is beginning to seep into the market. Even after yesterday's price declines, which took place in a thin market as the country awaited the President's message last evening, Treasury bond prices were up nearly 3/4 of a point since October 1.

The bond market is currently giving attention to a number of topics aside from day-to-day price movements. The paramount one is, of course, the President's action of last night. Another is the Treasury's plan to auction \$250 million long-term bonds, which was the subject of a very well attended public meeting at the Federal Reserve Bank of New York last week; a number of important questions relating to marketing technique are still unresolved with respect to that offering, and these will have to be resolved in the next few weeks. Another topic of intensive market discussion is the terms of the Treasury's November refinancing operation, in which over \$7 billion November maturities and possibly nearly \$4 billion December issues are to be refunded. The Treasury is meeting with its advisory groups this week and is expected to announce its terms later in the week. Of course, the overnight developments will considerably complicate the Treasury's decisions on this refinancing.

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There followed a discussion relating generally to the reaction to the recently announced reduction in reserves required to be maintained against time and savings deposits. In reply to questions, Mr. Stone said there was still some tendency in the market to await a signal regarding the policy implication of the reserve requirement reduction. While the Desk had given something of a signal last Friday, and to a lesser extent yesterday, the market was still undecided as to whether the move represented some slight change of policy in the direction of greater ease or whether the Board's press statement was to be taken at face value. It was pointed out also that the market was aware that a meeting of the Open Market Committee was being held today. As to the need for System open market operations in the light of that action, Mr. Stone said the reserve estimates seemed to indicate that relatively little in the way of such operations would be required during the coming three weeks. It might be necessary to absorb some reserves temporarily in the week of October 31, but over the period as a whole the reserve requirement action should about match reserve needs. Asked for an estimate on reserves released at country banks that would not filter into the money centers, Mr. Stone said it was extremely difficult to quantify. However, the Desk would be prepared to deal with the market situation that would develop out of any significant "leakage."

In reply to an inquiry as to whether it seemed necessary to offset float fluctuations too precisely, Mr. Stone said the Account

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Management had been placing particular emphasis on the color, tone, and feel of the market, with the result that free reserves had been permitted to move in a rather wide range. It was his judgment that over the past several months a level of free reserves anywhere within the range of \$350-\$500 million had been compatible, depending on the particular circumstances, with the over-riding objective of maintaining the color, tone, and feel of the market. The precise level at which free reserves might fall within that range would depend on how reserves were distributed, the vigor with which the economy employed them, and their composition. All of these elements were reflected in the color, tone, and feel of the market, which was the primary factor to which the Desk had been giving consideration. He was quite content to let the precise level of free reserves fall where it might, as long as he observed the wishes of the Committee with regard to maintaining the color, tone, and feel of the market.

In reply to a question about conditions over the next couple of weeks that would be regarded by the market as a signal that the Board's statement on the reserve requirement action was to be taken at face value, Mr. Stone commented that if the Federal funds rate, for example, continued within the general range of the past several months and if the bill rate did not move down too much below present levels, this would indicate to the market that the reserve requirement action was not intended to signal a shift toward a policy of greater

ease. If, under present conditions, there should be a rush toward short-term securities leading to a moderately lower bill rate, but if the Federal funds rate and free reserves continued in their prevailing ranges, the market would read into this that there had been no change in monetary policy. On the other hand, if the Federal funds rate should move below 2-1/2 per cent and stay there, that might be taken as confirmation of the recent headlines which suggested that there had been a change in policy.

Question was raised as to the Desk's views regarding the need for offsetting day-to-day fluctuations in free reserves, within the general framework of maintaining the tone, color, and feel of the market, and Mr. Stone commented that it was difficult to appraise this kind of situation in advance. A daily inflow of funds to the central money market might be anticipated by the market. Whether the Desk would take any offsetting action would depend on the force of the inflow and its effects. If the bill rate and the Federal funds rate should decline modestly that would not bother him, but if the movement threatened to go further the Desk might have to take action. It might sell short-term bills, and if necessary resort to short repurchase agreements. If the weekly average free reserve figure should go as high as \$600 million, he would anticipate a general market reaction that the Federal Reserve was signaling a change in monetary policy.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period October 2 through October 22, 1962, were approved, ratified, and confirmed.

Mr. Noyes presented the following statement on economic developments:

In any analysis of the current economic situation, it would be foolhardy to try to abstract completely from the President's announcements of last evening and the very limited developments since then, some of which Mr. Coombs and Mr. Stone had mentioned. On the other hand, it is impossible to make any realistic appraisal of the economic forces which may flow from the political actions and military operations that lie ahead. Immediately, and perhaps for some time to come, the principal economic effect in the United States will be psychological. Not only is the magnitude of this effect indeterminable, even the direction is uncertain. There might be an increasing tendency on the part of the public--both consumers and business--to move generally in the direction of greater liquidity. On the other hand, there may be some tendency to accelerate buying, both on the part of businesses and individuals. The most likely possibility is that both of these things will be going on at the same time--some individuals moving one way and some the other. Hence, with all of the qualifications that this additional element of uncertainty demands, let me summarize briefly my observations as to the basic economic situation as it appeared at the close of business yesterday.

A number of things, coming together, had prompted me to attempt a somewhat more fundamental reappraisal of the economic situation than usual. Least important is simply the fact that it has been over two months since I have been personally responsible for this portion of the briefing. More important, we now have a fairly good idea of what happened in the third quarter. Most important, of course, we have abundant evidence that a reappraisal of the outlook has been under way in many quarters. A notable example is the meeting of the Business Council, at which a projection prepared by the technical staff was presented showing a small rise in GNP in the current quarter and a very small decline in the first two quarters of next year.

In the light of what was being thought and said about the behavior of the economy by responsible people, it seemed to me most reasonable to start with the presumption that the economy was at or near an upper turning point, and to test this hypothesis against the statistical data and other factual information available. My conclusion was that this hypothesis did not stand up very well under scrutiny. The strongest argument in favor of it seemed to be simply that it is now over a year and a half since business turned up and that we are therefore in a period when, on the basis of previous cyclical experience, we might look for a downturn. I found ample evidence that the expansion had been proceeding very slowly, that the rate of increase had declined, that a somewhat larger, rather than smaller, proportion of our labor force was fruitfully employed, and that we had made no real progress in the fuller utilization of our physical resources. But the positive evidence one would seek to support the conclusion that there had been, or was about to be, a literal decline was notably absent. In fact, the more reasonable presumption seemed to me to be that technical factors favored some increase in GNP in the current quarter, and perhaps even a little more than in the quarter just past, especially if the very favorable reception accorded the 1963 model automobiles carried forward. This is not to say that there are not real elements of weakness and declines of some magnitude in some sectors, such as the 15 per cent drop in housing starts in September. Furthermore, the results of recent surveys of buying intentions have not been encouraging. If one takes them literally, they suggest that the underlying demand for autos and other durables, pre-quarantine, was rather weak. However, most current data, such as the index of industrial production, showed a sidewise movement, and there is a continuing upcreep in the less volatile sectors of the economy.

It would be absolutely futile for me to speculate as to the course of events in coming days and weeks. As I indicated at the outset, my guess is that until the situation unfolds further the psychological impacts will tend to offset one another to a large extent. Hence, it seems to me that the most reasonable underlying economic assumption on which to proceed is that we are still dealing with a balanced economic situation--with a tenuous edge in favor of continued very moderate expansion in the period immediately ahead. Beyond that, it is evident that whatever value the forecasts and projections prepared to date may have had, they are now obsolete.

Mr. Brill presented the following statement on financial developments:

With financial markets shaken by two jolts--first the unexpected reduction in reserve requirements and most recently the Cuban crisis--it is exceptionally difficult to bring basic market forces into focus. Over the week end it appeared that the first of these jolts, the reserve requirement reduction, was being put into better perspective as some financial commentators began a reappraisal of their initial rather flamboyant interpretations. It is too early to say how markets will respond to the international crisis, although Mr. Stone's comments are reassuring. Our capabilities for dealing with unreasoning waves of hoarding of goods or of cash may still be tested. So, too, may be our capabilities and plans for dealing with even graver situations. The necessity of reviewing procedures for meeting a wide range of alternative developments is obvious.

It is not necessarily "ostrich-like" to assume as one alternative, however, that a decade and a half of cold war crises has blunted the impact of the present crisis, and that unless hostilities actually develop, financial markets may, after an initial flurry, again respond principally to the same kinds of supply and demand tugs that were shaping interest rates in recent months. In the absence of clues as to how the country is rising to its latest challenge, we cannot afford to ignore the nature of current financial demand and supply forces other than those that may be introduced by the Cuban situations.

The current situation must be assessed first in the perspective of recent developments. As Mr. Noyes has already indicated, the performance of the economy during the summer and early fall was far from satisfactory. To what extent did interest rate developments reflect this? Short-term rates fell by about one-quarter of a point over the July-August period, and levelled off at 2-3/4 per cent throughout September. Long rates clung to their higher midyear levels through most of August, but slipped in September to about an eighth of a point or more below July averages.

Was this the order of adjustment that one might have expected in light of fund demands and supplies? I think not. Still crude estimates of the flow of borrowing and the flow of saving for this period suggest to me that, by

and large, it was skillfully handled operations by the Treasury and the System that kept the rate decline within such narrow boundaries. Evidence to support this view is still only partial, but the magnitude of the figures available is impressive. The volume of long-term saving flowing through institutions reached exceptional proportions. If we sum the inflows to savings banks, savings and loan institutions, life insurance companies, and pension plans along with the growth of time and savings deposits at commercial banks, the total funds available for long-term investment in the third quarter rose by much more than did borrowing demands. Corporate and municipal financing in the capital markets fell off substantially, and was offset only in part by maintenance of a high volume of mortgage borrowing and a moving of a moderate amount of the Federal debt into the longer term area in mid-summer.

In the shorter term area, business loan demand has been erratic, but recently has shown more strength than earlier in the year. This may well have been accounted for by two factors: an apparent move toward interim bank financing by public utilities in expectation of declining long-term market yields, and a bunching-up of bank borrowing in the metals industry--probably the automobile and auto supplier group, where there was a greater concentration in time of model changeover than had been true for several years.

On balance, however, business financial operations were tending to depress short-term rates in the third quarter. For example, normal rates of provision for corporate income taxes would have meant net sales of Government securities by corporations of over \$1 billion in this period, whereas we currently estimate that the corporate sector was a net buyer of perhaps as much as half a billion dollars of Governments in the July-September period. Further, Treasury operations plus the passage of time, which had added almost \$5 billion to the available supply of short-term instruments in July and August, removed over \$8 billion in September. To have kept short rates to a decline of only 1/4 of a point in July and August and to have kept them virtually constant in September under these demand and supply pressures was quite a feat, and I conclude that it reflected largely the market's own assumption that we would have operated more vigorously to counter any further downward pressures.

How long rate levels could have been maintained under these conditions is anyone's guess. It is doubtful that they could have long withstood increasingly widespread

expectations of imminent economic downturn, or the increasing supplies of investment funds that would have been generated even if a downturn was averted before year-end. For example, a rough estimate of corporate sources and uses as they might appear under conditions of moderately rising GNP suggests that corporate funds available for liquid asset accumulation in the fourth quarter of the year would be even greater than in the third. Savings flows to institutions, moreover, which have shown no signs of abating, would likely continue to grow at least at the pace of recent months. With the availability of corporate funds and institutional saving so large, and prospective increases in credit demands so moderate, it seems likely that downward pressure on the rate structure would have intensified.

There is no point in pursuing "would-have-beens" while the international situation and the economy's response is in such doubt. Nevertheless, it is important to keep in mind that the economy entered this latest crisis period with ample liquidity and ample unused productive capacity, and with no inflationary psychology evident in either goods or financial markets. We may be confronted with a temporary senseless stampede for goods or for currency, and either could be accompanied by disorderly conditions in markets for U.S. Government securities. We must also continue to be prepared for a situation that seems happier only in contract, namely, an economy moving ahead very slowly in a more or less orderly fashion toward an upper turning point in domestic activity, with its balance of payments problem far from resolved.

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

Our balance of payments has become more and more disappointing, and recent international developments are unlikely to improve it. Transfers of gold and convertible currencies to foreigners were lower in September than in August, but increased greatly during the first half of October.

Even in the absence of further unfavorable developments, total transfers in 1962, adjusted for extraordinary receipts, may well exceed the similarly adjusted 1961 figure of \$3 billion, although statistical manipulations will probably bring the officially announced figure below the official 1961 figure of \$2-1/2 billion.

Net gold sales were small in September, and as Mr. Coombs has reported, will probably remain so in October; but only, first, because a very large part of our deficit has been with Canada, which traditionally keeps a large part of its reserves in dollars rather than in gold; and second, because of the Treasury and Federal Reserve operations mentioned by Mr. Coombs. These operations, of course, serve to delay the depletion of our gold stock but will not avert it unless present trends are soon reversed.

The reason for our disappointed payments balance may be found primarily in two factors:

First, our exports have declined, contrary to expectations, so that our export surplus now is probably at its lowest level since early 1960.

Second, the flow of funds to Canada has not only continued but increased. The rise in Canadian reserves during the first three weeks of October (nearly \$300 million) was larger than for any entire month since the stabilization of the Canadian dollar. But \$125 million of that sum represents a Canadian government debt transaction, and another \$100 million the share transaction of a large oil company. Moreover, no further outflow to Canada has been reported for the past few days.

As to developments abroad, there is growing concern about prospects for continuing boom in Europe. This concern has been reflected in a serious decline in German stock prices and weakness on other Continental European exchanges. If this concern should prove justified, the development would threaten our exports not only to Europe but also to less developed areas, whose foreign exchange receipts largely depend on their trade with Europe. Our exports to Japan and Canada, which have declined recently, will probably recover, in line with the stabilization of the foreign exchange situation of these countries. But this increase would certainly be insufficient to compensate for any serious drop in our exports to the rest of the world.

There is little chance of any significant reduction in our aid expenditures and, particularly under present circumstances, no certainty, to say the least, that we shall be able to negotiate further substantial reductions in the net burden of our military expenditures abroad.

Our main hope of improvement in our balance of payments in the foreseeable future--now less foreseeable than ever--must rest on a decline in our net capital outflow. In recent

months, there has been neither a significant movement of money market funds nor any exceptionally large bank lending to, or market issues of, foreigners. But outflows of investment funds, especially to Europe, have apparently continued at a high level, and outflows to Canada have resumed.

It is true that the end of the boom in Europe would tend to diminish the outflow to that area, but we cannot be certain that even in a favorable international climate market forces by themselves will work rapidly enough to make for a significant improvement in our total balance in 1963.

The highly complicated provisions of the tax reform bill just enacted may have removed some of the tax incentives for investment abroad. Also, the bill abolishing interest ceilings on time deposits of foreign monetary authorities is supposed to attract some foreign funds. The First National City Bank has just announced the rates it intends to pay for such funds; they range from 2-3/4 per cent for 30 days to 3-3/8 per cent for one year. The rates for deposits up to six months are higher but those for longer terms remain lower than the rates permissible under Regulation Q, and all quotations are considerably below prevailing rates for Euro-dollar deposits. It is unlikely that significant amounts of foreign funds will be attracted in this way.

Mr. Hayes presented the following statement of his views on the economic situation and monetary policy:

My thoughts as to policy for the next three weeks had pretty well crystallized before the President had spoken and the general outlines of the current national crisis had become visible. However, I see no reason to change my comments materially, as I had arrived at the conclusion that the status quo which this Committee advocated at the last meeting should still be our objective. The possible ramifications and long-run consequences of our new national policy with respect to Cuba are far too nebulous and unpredictable today to justify any probing conclusions. We must, I believe, simply wait and see, preserving maximum flexibility to reduce or increase the existing degree of monetary ease in the light of future developments.

The evidence available in the past three weeks suggests nothing better than a sidewise movement in the domestic economy. This is at best only a slight

improvement over the downward tilt implied by August indicators. The fact that another month has dragged by with no suggestion of renewed strength is probably more a reason for pessimism than for optimism, especially in view of the longer run employment problems reflecting the growing population. But although it is natural to find that questions are arising more and more frequently as to whether the economy is on the verge of a downturn, there is as yet little positive evidence in support of such a prospect for the near future.

As to the credit picture, data on total bank credit, and especially on business loans, looked surprisingly strong in September. While there has been no follow-through so far in October, we have found New York bank lending officers somewhat more optimistic on prospective loan volume than they were. One possible explanation may be that corporate borrowers are tending to borrow from the banks on a temporary basis instead of going to the capital markets, because of expectations of a downward trend of long-term interest rates. Certainly the recent tendencies in the capital markets might well lend support to such expectations. Both long-term and short-term rates are well below the levels of mid-summer; and I was interested to note the other day the compression that has been occurring in bill rates, with the one-year bill, for example, 37 basis points below the summer level, whereas the 90-day bill rate is down only 25 basis points. The 90-day and 6-month bill yields are now only about 9 basis points apart.

I was very favorably impressed by the recent exchange of well-thought-out memoranda between Mr. Koch and Mr. Sternlight on the extent to which we should ignore or take into account the recent unusually high level of U.S. Government deposits in appraising the trend of required reserves and the money supply. Regardless of the merits of their respective points of view, however, it looks as if actual reserves are now running close to the Board's guidelines for the first time in several months in spite of a further build-up of Government deposits. Our contacts with the financial community as well as various measures of bank and nonbank liquidity suggest to me that we need have no fear that the economy's liquidity is anything but adequate.

Meanwhile, we can find no comfort in the latest balance of payments data, which confirm a substantial deterioration in the third quarter, whether we consider the over-all deficit or the so-called "basic deficit" excluding special

transactions and short-term capital movements. Particularly disturbing is the evidence that a part of this deterioration is traceable to a shrunken balance of merchandise trade. The net capital outflow on private account continues large. Release of the third-quarter balance of payments figures, scheduled officially for mid-November, but subject perhaps to some earlier unofficial leaks, may well revive fears as to the dollar's position and may generate new pressures for gold outflow--especially if the world military and political situation should become even more strained than it is now.

With the Treasury expected to announce the terms of its refunding offer later this week, our determination of policy today must take this factor into consideration. But there is another very strong reason for advocating a status quo policy. The Board's action in reducing reserve requirements against time deposits was interpreted in many quarters as a policy move towards greater ease, even though a careful reading of the official press release should have made clear the real nature of the move. Fortunately, second thoughts in the press appear to be more cautious than the initial reaction--and from the longer term point of view the Board's action should of course be of considerable benefit by bringing about a more appropriate level of requirements for time deposits. It should also fulfill its purpose of helping our efforts this autumn to sustain the level of short-term rates by enabling us to avoid open market purchases that would otherwise have been required. But these benefits could be outweighed by the risks if the market is encouraged to interpret the requirement reduction as a significant change in monetary policy. And the best way to prevent such misinterpretation is simply to convince the market, through our open market performance, that there has been no change. Thus I would hope that the Committee would decide to preserve about the same feel of the market as prevailed from the time of the last meeting until last Thursday's announcement, with continued close attention to short-term rates. In the light of present high corporate liquidity and resulting heavy demands for short-term investments, it may well be that some moderate decline in free reserves will be needed to preserve a sufficiently firm money market atmosphere.

I would merely like to add one comment with respect to open market operations. The Committee has always been willing to give the Manager the reasonable leeway he needs to meet unpredictable changes in market atmosphere. I would

hope the Committee would be particularly charitable in this respect in the present very difficult set of circumstances.

While I can see no justification for a discount rate increase under present conditions, I also believe that any reduction should be considered out of the question. A reduction, by confirming all the rampant suspicions as to the policy implications of the recent reserve requirements move, might well trigger a serious loss of confidence in the dollar.

The directive should probably be amended to indicate recognition of the national emergency, but the basic policy embodied in the directive should be left untouched.

As I said at the last meeting, the present combination of domestic and international needs suggests strongly the wisdom of a vigorous stimulating move in the fiscal area in the form of a substantial balanced tax reduction as soon as this can be practically arranged, unless it is precluded by further critical developments in the international military and political situation. I am not qualified to suggest precisely how large it should be, or what form it should take; but our calculations would indicate that a gross tax cut of, say, \$7 billion, made up of a \$5 billion reduction in personal income taxes and a \$2 billion reduction in corporate taxes, both effective January 1, might increase the prospective Federal cash deficit in fiscal 1963 by only around \$2-1/2 billion--a cost which could be readily borne in view of our unused resources and would seem well worth paying, particularly when one reflects on the substantially improved position in which monetary policy would find itself if this were done.

Mr. Ellis said a variety of offsetting pluses and minuses in New England balanced out to suggest that the economic advance which had been slowing down over the past few months, had now come to a halt. The September index of retail sales was off a point from August, while department stores sales for the past four weeks were 2 per cent below the previous year. During the most recent three months, construction awards were down about 4 per cent in spite of

a 22 per cent gain in the public works component. Data on manufacturing output in September were not yet available, but available reports suggested less favorable order trends in that month.

Except for a two-week span in September, demand deposits of First District banks showed a declining trend since July. District banks were net borrowers of Federal funds over most of this period. Business loans had declined a little less than might be expected at this time of year. As a result, loan-deposit ratios held close to the recent peak.

Mr. Ellis noted that it was difficult to foresee at this time the impact on the economy of actions that might ensue from the announcement made last evening by the President. His first reaction, however, was to conclude that a tax reduction in 1963 was now improbable in view of the atmosphere that seemed likely to prevail. He agreed with the view that the Presidential announcement was likely to have offsetting psychological effects in terms of spending. Yet he would not be too surprised to see some trend develop, and he anticipated that it would be stimulating to business. In his judgment, the outlook for credit demands had been strengthened rather than weakened as a result of the announcement.

When it came to the proper course of monetary policy in these circumstances, Mr. Ellis found that his sentiments were similar to those expressed by Mr. Hayes. While the economy had weakened recently, neither

the cause of that weakening nor the solution seemed to be found in monetary action. In fact, looking at the statistics, it appeared that the response to monetary policy had been quite satisfactory in recent weeks. According to preliminary data, the gain in the money supply in the first half of October seemed to have been quite substantial, while time and savings deposits continued to increase at an annual rate of around 15 per cent. In view of the apparent economic response to monetary policy in recent weeks, it occurred to him that the need for monetary action at this time was not urgent. By the same token, the costs of not acting did not seem pressing. There did not appear to be any extensive volume of unsatisfied credit needs that would be met if a policy of greater monetary ease were adopted. Further, the balance of payments data for the third quarter, when released, would not be reassuring. For this reason, he would delay any deliberate probing toward lower short-term interest rates, although a lowering of such rates might be forced to some modest degree by existing pressures.

In summary, Mr. Ellis concluded that the need for immediate monetary action was not urgent. The costs of inaction did not seem excessive, while the possible costs of a policy of greater ease were excessive. Accordingly, he would prefer to continue the current course of monetary policy. However, there might still be some question as to the measurement of the current course of policy. As a participant in

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the daily open market telephone calls during the past three weeks, he had been impressed that the level of free reserves was not an adequate measure of the impact of current policy. In his opinion the Desk should continue to emphasize the maintenance of prevailing market conditions in terms of tone, color, and feel. Nevertheless, some targets were needed. In order to let the market understand the System's desire to avoid any inadvertent tightness, he would stand ready to supply reserves along a 3 per cent growth guideline. He would like to see the bill rate and the Federal funds rate continue in the ranges that had recently prevailed, with infrequent borrowing at the Federal Reserve Banks and free reserves around \$400-\$450 million.

Mr. Ellis also expressed the view that it would seem appropriate to continue the present discount rate. He concurred in Mr. Hayes' suggestion that the policy directive should be modified to recognize the impact of the changed international situation. Also, if the directive were changed, he would renew the suggestion he had made at the October 2 meeting for a modification of the language of the first paragraph to eliminate what he considered the implication of a grudging attitude toward expansion of the supply of bank credit and money.

Mr. Irons reported that in the Eleventh District there had been a number of minor and mixed changes during the past three weeks. In the aggregate, however, they did not provide any indication of significant change in the economic trend or the level of activity. Department store sales were a bit better during the past three weeks than a

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month earlier. Employment was up and unemployment was off a bit. On an unadjusted basis, unemployment in Texas was at the rate of 4.7 per cent. Construction activity rose to a new record level in the past month, while conditions in agriculture looked quite good. For the year as a whole, cash receipts from farm marketings probably would be up satisfactorily.

Mixed figures also were found in the District banking situation, Mr. Irons said. Loans were down a bit, but investments and deposits were up. There had been a rather substantial decline in IPC deposits, but time deposits continued to rise. During the past three weeks there had been an increase in the margin of Federal funds purchased over Federal funds sold, but the purchases were concentrated in a few banks. Borrowings from the Federal Reserve Bank were nominal. Bankers claimed that their institutions were adequately liquid and that they were in a position to meet loan demands. However, a few officers of larger banks had complained about the type of loan demand, by which they referred to the prevalence of demand for longer-term and marginal-type loans.

Turning to policy considerations, Mr. Irons said that in view of unsettled world conditions, the forthcoming Treasury refinancing, and the recent reserve requirement reduction, this would seem to him the wrong time for any overt policy move. Within the framework of existing policy, however, he felt that considerable leeway should be

given to the Desk in terms of its judgment as to the tone, feel, and color of the market. He suggested that the Desk might be a little more reluctant to absorb excess reserves on a daily basis. In other words, within the framework of a status quo position, he would prefer to be reluctant to absorb reserves actively rather than to veer on the other side. This posture could be described as one of permitting deviations on the side of ease for a few days, as contrasted with soaking up reserves actively. This might be particularly important while the results of the recent reserve requirement change were working themselves out.

Mr. Irons went on to say that he did not have any statistical standards to suggest that he thought would be particularly valuable at this time. As he had said, he believed the Committee should give the Desk an opportunity to judge the tone of the market. Also, he would bear in mind the objectives that the Committee had been pursuing. These included trying to provide an adequate availability of reserves to meet whatever demands the economy might have for credit, while at the same time keeping an eye on the international situation and endeavoring to maintain a level of short-term rates that would discourage an outward flow of funds. He would not be concerned about the level of free reserves, whether \$400 million or \$500 million, as long as the tone of the market seemed to be consistent with the Committee's objectives. In short, for the period ahead, he came out

with more or less a maintenance of the status quo. This appeared to be required by the situation that had developed. If there were deviations, however, he would be inclined to go very moderately on the side of greater ease rather than on the other side. He would not recommend changing the discount rate at this time.

With regard to the policy directive, Mr. Irons indicated that he would not object too strongly if the Committee wanted to include some phrase in recognition of the international situation. Other than to identify that situation, however, he did not know what the Committee would accomplish. For the moment, therefore, his inclination would be to let the directive stand and see what occurred.

Mr. Swan reported that Twelfth District figures for September showed little change from August. Generally speaking, there seemed to be a continuation of what was on the whole a favorable situation in the area. Total employment in the Pacific Coast States, on a seasonally adjusted basis, rose .3 of a point from August to September, this being the third successive month-to-month increase. However, the increase in employment was more than offset by a decline in unemployment of less than seasonal proportions. Accordingly, the unemployment rate, seasonally adjusted, increased .1 of a point from August to September. Construction contract awards rose from July to August. The only available September figures--those for heavy engineering construction contracts--showed a decline from August. Cash receipts from farm marketings

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through August were up slightly from the previous year, but the last quarter of the year would be important and what would happen remained to be seen. Inclement weather had had some adverse effect on harvesting, particularly of tomatoes, grapes, and rice, and floods in Arizona apparently were going to reduce the cotton crop rather significantly. In early August, there was a reduction of the price of steel mill products, averaging about \$12 a ton, which probably wiped out most of the regional price differential. Apparently, this resulted from the pressure of imports and the fact that Western steel mills had been operating at substantially less than capacity. The net result would be cheaper steel prices in southern California, and probably in the San Francisco area, but it was not clear exactly what kind of geographical pattern for the entire Western area would emerge. This uncertainty probably had contributed to a decline in steel production in the first two weeks of October.

In the three weeks ended October 10, Twelfth District reporting banks showed a decline in investments considerably larger than the moderate loan increase. The rate of increase in commercial and industrial loans slowed down during this period; in fact, there was a decline during the week ended October 10. The largest increase again appeared in real estate loans. Due to the heavy concentration of time and savings deposits at Twelfth District banks--running about 50 per cent of total deposits--there was marked interest in the

reduction of the reserve requirement against time deposits. Actually, District member banks held about 22 per cent of the total time deposits of member banks. In view of the branch banking systems prevalent in the District, over 85 per cent of the total reduction in reserve requirements would go to reserve city banks, against an over-all figure for the nation of around 55 per cent. This implied that the released reserves would be likely to come into the money market quite promptly if other avenues for their use did not appear.

Mr. Swan also reported that the major Twelfth District banks, as a group, were still net sellers of Federal funds. This reflected primarily the choice on the part of the largest District bank to use the Federal funds market in preference to the bill market.

With regard to policy, Mr. Swan expressed the view that the uncertainties presented by the international situation, and in particular the Cuban crisis, ruled out doing anything at the moment except to maintain as even a keel as possible. Also, it seemed to him that, apart from international considerations, this would be required in the immediate future because of the forthcoming Treasury refunding. In terms of the attitude of the Desk toward day-to-day reserve fluctuations, however, he agreed with Mr. Irons that it would be better not to try to absorb excess reserves completely than to lean too far in the other direction.

After stating that he would not recommend changing the discount rate at this time, Mr. Swan turned to the policy directive and suggested that for the moment it might be couched in terms of stating simply that in view of the uncertainties engendered by the international situation and the imminence of the Treasury refunding, the Open Market Committee would make no change in monetary policy, endeavoring to maintain an even keel while awaiting further developments. Then, if the situation should become clearer, the Committee would be in a position to start over again and consider how to build up a new directive.

Mr. Deming reported that a number of Ninth District statistics could be summed up as indicating that the District was continuing to operate closer to capacity levels than the nation. Also, the course of economic advance in the District continued to be somewhat stronger than throughout the nation generally. In September, city banks in the District recorded the strongest loan expansion that had occurred in any September since 1950; at country banks, the record was the strongest of any September since 1955. In October the trend did not seem to be quite as strong. At city banks, however, loans were up slightly whereas they usually decline during this period. The strength was not in business loans, but in loans to security dealers and loans to nonbank financial institutions. This indicated that Ninth District banks were in a strong--possibly excessive--liquidity position, and that they were looking hard for ways to put money out.

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As to policy, Mr. Deming said that for reasons stated by Mr. Hayes and others, he would favor continuation of the status quo. At the same time, he thought the policy directive should be changed radically in recognition of the current international situation. It was his suggestion that the directive might read along lines that in view of the tense international situation, the current policy of the Federal Open Market Committee was to hold, as steadily as possible, present conditions in the money and credit markets.

It was impossible to see far ahead at this time, Mr. Deming noted. However, he had asked himself whether, if the Cuban crisis should develop into active hostilities, there was anything in the current rate pattern that he would want to change before such hostilities began. It was his conclusion that the prevailing pattern was probably as good as any and that there was not much he would want to do to change it. In his view the Desk should be given as much latitude as it needed to maintain the prevailing situation. Obviously, he would not recommend changing the discount rate at this time.

Mr. Scanlon reported that economic activity in the Seventh District had not changed significantly since the previous meeting of the Committee. However, as of last week there had been a firming of expectations among businessmen and economists in the District that activity would soon begin a moderate, short-lived decline. Some

believed that such a movement had been under way since July. One factor that had contributed to the recent growth of bearish sentiment was the announcement of price reductions in such products as steel, aluminum, cement, and building materials. While these price reductions largely reflected official recognition of market softness, which had been evident for some time, they nevertheless indicated that hopes had faded for an uptrend in demand that might have validated existing "list" prices.

Officials of Seventh District steel firms were now estimating that production in 1962 would be below 100 million tons. The auto industry was said to be holding its orders below the rate that would be required to produce the projected 1.9 million cars in the fourth quarter. Disregarding any military buildup, unless auto industry orders picked up substantially, the steel ingot production rate would rise only moderately from the level of mid-October through year-end.

The favorable reception of the 1963 model autos, as indicated by sales in early October, gave support to the view that low dealer inventories were primarily responsible for the drop in sales of auto dealers in August and September. This was an important factor in the decline in total retail sales in these months. Meanwhile, auto manufacturers were ordering materials and components very cautiously and were "firming up" production schedules only six weeks ahead instead of two to three months as in past years.

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Improved farm income in the Corn Belt in 1961 and 1962, and excellent prospects for 1963, had boosted land prices over the year-ago level by as much as 6 per cent in some localities, according to the Reserve Bank's recent survey of country bankers. Sales of farm machinery and household appliances also had increased in these areas. However, in the dairy states, where net farm income had declined as a result of lower support prices and less favorable crop conditions, farm land prices and sales of "hard goods" to farmers had declined this year. Bankers generally expected recent trends in land prices to continue next year.

During the past ten weeks, business loans at District reporting banks showed increases very similar to those of the comparable periods in 1958, 1959, and 1961, but well below the 1960 increase. This was less favorable than the experience of the nation as a whole. As elsewhere in the nation, loans on securities and, to a lesser extent, real estate loans, had risen at a rapid pace in recent weeks.

Mr. Scanlon said he was pleased to receive the recent memoranda of Messrs. Sternlight and Koch relative to reserve guides and Treasury deposits. While he was in agreement with what he took to be the basic proposition of both papers, namely, that no one guide (unless, possibly, a very complex one) could serve adequately under all circumstances, there was nevertheless need for landmarks to assure against moving too far off the desired course or for too long a time. As Mr. Koch noted,

the shortfall of reserves from the staff guideline could not be rationalized in terms of the unusually high Treasury balances since these balances were a part of deliberate policy to hold up short-term rates. Rather, it reflected simply that rate considerations did not permit a full offset to the reserves absorbed by these balances, and that the 3 per cent target growth rate was not compatible with a 2-3/4 per cent bill rate. Since he found the papers to be helpful, he hoped other similar papers would be forthcoming from the Committee's staff.

Mr. Scanlon found the current business situation extremely puzzling as it related to appropriate policy posture. Some knowledgeable businessmen whose judgment he respected thought the current forecasts of imminent decline in activity were premature. On the other hand, the forecasts provided specific evidence of weakening of expectations and would tend to reinforce and spread such expectations unless favorable business news was forthcoming soon. If the current "standard forecast" was to be realized, presumably expenditures for new plant and equipment, consumer durables, and inventories would decline. In this respect, the large cash flow to business corporations and the recent trend of business loans were of interest. Business loans had shown a fairly good rise during the past year and were showing at least seasonal strength even though inventories appeared to have

declined recently. Furthermore, internally generated funds of business corporations in 1962 might be slightly larger than the amount needed for capital expenditures and inventory accumulation combined, as was the case in 1961. This was an unusual situation in a year of business expansion. Some large Midwest business firms that reported plans to cut back capital outlays and inventories, when asked "what will you do with your money," stated that they would repay bank loans. But this seemed not to be happening. It was quite conceivable, therefore, that business would be better than indicated by many current forecasts.

Nevertheless, Mr. Scanlon said, the appropriate policy posture for the System would seem, as a minimum, to be that of achieving somewhat more than seasonal expansion of reserves; and to the extent that a greater expansion could be achieved within the framework of international restraints, the results should be beneficial. He would favor no change in the directive unless it was to recognize the seriousness of the international situation, as Mr. Hayes had suggested. He would not favor a change in the discount rate.

Mr. Clay commented that a pronounced element of uncertainty had been injected into the economic picture by the recent international developments centering around the Cuban situation. It was impossible to evaluate the impact of these developments and their significance for monetary policy even in the immediate future, to say nothing of the longer run implications. What this meant for the formulation of monetary policy would have to be determined as the course of events unfolded.

Mr. Clay also noted that the period immediately ahead involved a major Treasury financing operation. It would be important to avoid any policy action that would be disturbing to the success of that undertaking. Generally speaking, the Committee should endeavor to maintain essentially its present policy posture, although the specific actions taken in executing policy would be conditioned by the new market situation. The Reserve Bank discount rate should not be changed. The policy directive, in his opinion, should recognize the international situation.

Mr. Wayne said developments reported during the past three weeks seemed to indicate some easing in Fifth District business. Seasonally adjusted bank debits dropped 9 per cent in September to the lowest level since last December. The rise in department store sales in the first half of September apparently ended rather suddenly, and recent reports indicated a further decline in early October. The Reserve Bank's latest survey showed a worsening of general business sentiment for the first time since June. Manufacturers as a whole reported no change in factory shipments, but small declines in new orders, hours, and employment. Textile firms, hosiery mills in particular, continued to report weak demand accompanied in some instances by reduced employment and shorter hours. Flue-cured tobacco prices had been running lower than a year ago, but increased volume would probably hold total sales even with or above

last year's level. District weekly reporting banks continued to show strength in real estate loans, but seasonal declines in business loans.

On the national level, Mr. Wayne noted, the only sector of the economy that showed definite strength and progress seemed to be the automobile industry. Otherwise the economy was showing remarkable stability at a high level of activity--but a level some 3 or 4 per cent below what might be considered a fully satisfactory performance. The changes in production, employment, and incomes from July to August to September had been so small that they showed no trend. There had been some weakness in prices, especially for such commodities as aluminum, steel, and cement, and apparently inventory accumulation had almost, if not entirely, ceased. There was no evidence of any substantial relaxation in the long-term squeeze on profits. For almost three months there had been a slow and gradual but definite easing in long-term interest rates, while mortgage funds remained abundant with some shading of rates in certain areas. This easing of rates by the market itself would seem to indicate that funds were in sufficient supply to meet current demands.

As to policy, Mr. Wayne stated that he found himself in general agreement with what had already been said about making no change in current policy. He agreed almost completely with Mr. Deming, whose proposed directive was terse and to the point. In summary, he would favor no change in the posture of policy until the Committee could see more clearly the effects of the current crisis.

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Mr. Mills commented that Mr. Brill had made a point deserving of emphasis, namely, that skillful handling of the System Open Market Account had prevented a movement toward a lower interest rate structure. The correctness of that statement unfortunately was indicative of artificial interference in the U. S. Government securities market, with all of the problems that were inherent in what was tantamount to a pegging operation. This raised the over-all problem whether the System's monetary and credit policy should resist natural forces in the market or whether System policy should move with the tide. In Mr. Mills' opinion, it should move with the tide. He felt that it would be advisable to capitalize on the widespread reaction to the reduction of the reserve requirement on time and savings deposits and allow a very gingerly movement toward an enlarged supply of reserves and a modest lowering of interest rates.

If disorderly conditions should occur in the Government securities market, Mr. Mills said, they should be met promptly and vigorously. By the same token, if the difficult international situation provoked unusual outflows of gold and dollars the official response to that sort of situation should be sharp. The normal official response to that situation would be a sharp increase in the discount rate of the Federal Reserve Banks. However, since such a movement would stem out of what would amount to a panic condition, he doubted that an upward discount rate adjustmet would

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be effective, particularly when there were so many questions about deterioration in the economic situation abroad. Consequently, that kind of problem should be met through the Treasury rather than through the central bank.

Mr. Shepardson said that on the basis of the economic review given by the staff, it seemed to him entirely appropriate to maintain the policy that the Committee had been endeavoring to follow during the past several weeks. The new developments in the international situation only enhanced the necessity of maintaining the present position at this time. There was no telling how fast or how slowly the international situation might develop, or what direction it might take. With the passage of time the Committee might have better guidelines. At present, however, he felt it would be a mistake to make any shift in policy. In line with that view, he hoped the operations of the Desk would tend to counter any of the feeling that still seemed to exist in the market that the reduction in reserve requirements portended a policy of greater ease. He did not believe it was necessary to counter every shift in reserves, but within the range of the present tone of the market he hoped steps would be taken to counter any latent feeling of greater ease that began to appear.

Turning to the directive, Mr. Shepardson commented that two approaches seemed worthy of consideration: no change, or a change such as Mr. Deming had suggested. He would be inclined to favor the latter approach.

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Mr. King expressed the view that the present international situation was likely to provide a push to the domestic economy, at least in the short run. He did not believe that the American people were likely to start saving more money under present conditions. Instead, it seemed more likely that they would start buying things that they might need for the long pull.

In view of the probability that the commercial banks were going to go into short-term securities a little more heavily, Mr. King felt that this would be an ideal time more or less to condone a slight downdrift in the Treasury bill rate. He would not suggest forgetting about the bill rate completely. However, if it went to the range of 2.50 to 2.60 per cent, he would not be disturbed. In his opinion, the level of free reserves should remain fairly high, perhaps somewhere in the \$450-\$500 million range. A degree of reluctance to soak up temporary excess reserves might be appropriate. On the other hand, if the weekly average of free reserves got up to \$600 million, that might be regarded as confirming market guesses that the recent reduction in reserve requirements reflected a move toward an easier monetary policy. In all the circumstances, it appeared that the Desk might have a rather difficult three-week period ahead.

Mr. King expressed the view that in the absence of a change of policy at this time it would be a mistake to change the policy

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directive. Three weeks ago he had suggested a modification, but he would not change the directive today. He did not believe the Presidential announcement had changed the Committee's responsibilities in any respect. Therefore, he felt it would amount to overplaying the situation to change the directive.

Mr. Mitchell said that his basic position with respect to monetary policy had not changed. In fact, recent economic developments had tended to reinforce it. However, there remained the question of what should be done when the Cuban situation was taken into consideration. Taking that situation into account, he would be inclined to endorse a position such as outlined by Mr. Irons, which contained some suggestion of a slight potential drop in short-term interest rates. In his opinion, the Desk should not inform the market directly or indirectly regarding the meaning of the recent reserve requirement reduction. The Board's announcement spoke for itself, and no official interpretation should be added to it.

As to the directive, Mr. Mitchell did not think it should be changed at this time, for he had no idea of the situation with which the Open Market Committee might have to cope. There might, for example, be a run on currency or a hoarding of commodities. But no one could say whether such developments would occur, and there was no need for the Committee to imply that it knew what was going to develop. In

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his opinion, it was doubtful that the Cuban situation would result in any large military buildup. It might have an impact on business or consumer psychology, or it might quiet down without too much economic impact. Within a week or so it might be possible to make a better judgment on that score. One possibility, therefore, would be to hold another meeting of the Open Market Committee in about a week.

Mr. Fulton reported that except for a strong recovery of auto sales, the picture in the Fourth District was devoid of improvement thus far in October. Other indicators were showing either no change or slight decline. Steel production had leveled off, and the price change that had occurred in sheet and stainless steel would affect the earnings of the steel companies adversely. The machine tool industry had a favorable backlog, but orders were not increasing. The new depreciation schedules provided by Treasury Bulletin F were said to be having little effect in terms of new orders. Unemployment had increased in the steel centers and had shown no material improvement in the rest of the District. All in all, prospects appeared rather dismal.

Persons with whom the Reserve Bank maintained contact throughout the District were tending, by and large, to anticipate a downturn after the first of the year. Orders had been declining, or at least not increasing to the extent that had been expected on a seasonal basis. As to the possible effect of the Cuban situation, it did not appear that

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the steel mills would participate in any military buildup to the extent that they had on previous occasions due to the change in the nature of military hardware.

Turning to policy, Mr. Fulton said he would concur with those who felt that present policy should be continued. He would not like to see the money market become softer. Instead, he felt that the maintenance of a firm short-term market was desirable, with Federal funds continuing to trade within their recent range. Reserves should be made available as required for seasonal purposes, and the tone and feel of the market should be the major guide. The market should not be led to believe that System policy had been changed when in fact it had not been changed.

As to the policy directive, Mr. Fulton was inclined to feel that a change along the lines suggested by Mr. Deming would be appropriate in recognition of current international developments. This did not mean that the Committee had to be wedded to such a directive indefinitely. For the record, however, it would seem desirable to show that the Committee recognized the changed situation and had determined to continue the policy it had been following in the thought that it was suitable.

Mr. Bopp reported that business conditions in the Third District were sluggish. Reserve city banks were under some pressure and were buying Federal funds. The Reserve Bank had just completed its annual

survey of prospective business capital expenditures, which indicated that manufacturers in the Philadelphia metropolitan area expected to spend about 17 per cent less next year. In durables the survey indicated a drop of 25 per cent; in nondurables 11 per cent. Chemicals showed a sizable increase, but with this and one other exception the projections for a decline in expenditures were widespread. In other areas of the District, expectations ranged from a drop of 21 per cent in the Wilmington area to an increase of 16 per cent in the Lehigh Valley.

Mr. Bopp also said that at the two most recent meetings of the Philadelphia directors there had been a split vote on the retention of the present discount rate, reflecting some feeling that in light of the sluggish business situation the System should move toward greater ease. While this was a minority view thus far, the balance of opinion seemed to be shifting in that direction. Basically, Mr. Bopp said, he felt the same way himself. In view of overnight developments, however, he concluded that there should be no change in policy at this time. Like Mr. Mitchell, he believed that the Committee should keep on top of the situation. Thus, it might be appropriate to consider holding another meeting of the Committee before three weeks had passed.

Mr. Shuford indicated that he would prefer to refrain from commenting on policy at this meeting of the Committee, which was the first he had attended as a Reserve Bank President. The Eighth

District, he said, seemed to reflect about the same situation as outlined nationally. Figures for the third quarter showed no significant changes from those for the second quarter. The employment situation reflected no particular change, while department store sales fluctuated within narrow limits and bank debits remained relatively stable. Bank loans had increased, although only slightly. Deposits showed an increase in the third quarter, but this was related to time deposits. Demand deposits had been declining at a rate of about 2 per cent since January. The agricultural situation appeared satisfactory, with the prospect that output for the year would be about the same as in 1961. From conversations with businessmen and bankers around the District, it seemed fair to describe their attitude as reflecting the level of current economic activity. There seemed to be no feeling of strong optimism or strong pessimism.

Mr. Balderston indicated that he would favor a continuance of the status quo as far as policy was concerned, especially in view of the pending Treasury refunding. His main concern at the moment was that the Federal Reserve maintain a posture that would be a steadying influence on economy. In short, this nation should act like a good banker in its relations with the world. The Federal Reserve System and the commercial banking system should be prudent, stable, and careful in word and deed. For the Federal Reserve, this meant that it ought to be cautious about the actions it took because of the manner in which such actions might be construed.

Mr. Balderston also said that he would favor changing the policy directive to recognize what had developed yesterday. It seemed to him that these developments made the present directive an anachronism. Therefore, he would be inclined toward a directive such as suggested by Mr. Deming.

Chairman Martin began his comments by referring to the suggestions that had been made about the possibility of calling a special meeting of the Open Market Committee. In view of the pending Treasury refinancing, he questioned whether this would be too good a time to call a special meeting or meetings. For this and other reasons, if it became known that extraordinary meetings of the Open Market Committee were being held, that would create a certain amount of comment. If necessary, in the light of developments, the Committee could get together by conference telephone. In the absence of urgent considerations, however, his thought would be to proceed on a schedule whereby the next meeting would be held on November 13, 1962, with succeeding meetings on December 4 and December 18, and then on January 8, 1963.

As to policy, the Chairman noted that the consensus obviously favored maintenance of the status quo. With that in mind, the policy directive presented something of a problem. In this connection, he commented that Mr. Knipe (Consultant to the Chairman of the Board of Governors) was going to leave his post within the near future. Mr.

Knipe had given considerable thought to the Committee's policy directives, and the Chairman said he proposed to distribute to the Committee members directives in form suggested by Mr. Knipe for the past several meetings, in the thought that these might serve as a basis for further Committee discussion concerning the manner in which the directive might best be formulated.

As to the situation today, Chairman Martin indicated that he would have no strong objection to changing the present directive. He noted, however, that there appeared to be some sentiment within the Committee for leaving the directive unchanged. Mr. Deming had suggested one approach, if the Committee wished to change the directive, and Mr. Young was prepared to suggest a different formulation.

At the Chairman's request, Mr. Young then read the draft of directive that he had prepared.

Mr. Hayes commented that he felt the changes proposed by Mr. Young could be interpreted as giving less attention to the international financial situation than at present. He added that he would urge the Committee to do one of two things, either adopt a directive along the lines suggested by Mr. Deming or simply insert in the present directive a clause indicating that the Committee was taking into account the potential effects of the Cuban situation. He would be inclined to prefer the latter alternative.

There followed a discussion during which Mr. King raised a question as to what would be accomplished by the inclusion of a clause such as Mr. Hayes had suggested, in response to which the latter pointed out that this would recognize a factor that seemed to dictate a policy of holding the line. Mr. Deming brought out that his proposed reformulation of the directive would not indicate that the Committee was going to do anything different. However, it seemed important to him that the Committee not seem to dismiss casually a Presidential announcement of consequence. Mr. Clay noted that his comments on policy this morning would have been different had it not been for the President's announcement yesterday evening. Mr. Swan commented that in view of the uncertainties of the moment he believed that current monetary policy should be continued. A directive such as Mr. Deming had suggested would provide flexibility because it would recognize a reason for which policy remained unchanged. Later, in the light of conditions that emerged, a new directive could be evolved.

Chairman Martin then commented that, as he read Mr. Young's proposed directive, it would attach at least as much importance to the international situation as the present directive. This pointed up the problem faced by the Committee in choosing words for the directive. In any event, however, the directive was not just a pro forma announcement. It should endeavor to reflect the manner in which the Committee wanted to instruct the Management of the Account. In his (Chairman Martin's) view, language along the lines suggested by

Mr. Young had merit because it went further than a mere observation with respect to the international situation that had developed.

The discussion today, Chairman Martin repeated, brought out the essence of the problem faced by the Committee with respect to its policy directives. It would be his suggestion that the Committee devote another round of discussions to the formulation of the policy directive, beginning with the next meeting, perhaps, and continuing over the remaining meetings this year in an attempt to determine whether a better form of directive could be found.

After further observations along these lines, Chairman Martin invited additional comments on the several proposals regarding the directive to be issued by the Committee today, and Mr. King presented the view that a formulation such as suggested by Mr. Deming might indicate that the Open Market Committee was fashioning policy on little other than the Presidential announcement. Actually, the Committee knew a good deal about the economy. Also, if Mr. Deming's suggestion were adopted, the Committee would face the question of what to do at its next meeting, for such a directive could not be continued indefinitely.

Mr. Hayes indicated that he had some sympathy with Mr. King's observation. At this juncture the Open Market Committee was just as interested as ever in the state of the economy and the balance of payments. However, there was a new element of uncertainty in the

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situation. A clause could be inserted in the directive to recognize that fact even though policy was left unchanged.

At the request of members of the Committee, the directives suggested by Mr. Deming and Mr. Young were then read again. Question was raised as to whether Mr. Deming's formulation implied that the bill rate should be maintained at precisely its present level, and Mr. Stone said he would not interpret the language to mean that every indicator would necessarily have to remain constant. Mr. Deming agreed.

Mr. Hayes inquired whether, if policy was to remain unchanged, the second paragraph of the present directive should not be left intact. When Mr. King asked whether it was not correct to say that a majority of the Committee would not object to a slight easing of the bill rate, particularly in view of the likelihood of increased bank demand for short-term securities, Mr. Hayes referred to the Chairman's consensus, as stated earlier, which had been in terms of maintaining the status quo.

After further discussion, Mr. Balderston moved the adoption of the policy directive suggested by Mr. Young, and this motion was seconded by Mr. Mills. A vote was taken and the motion was carried by unanimous vote.

Accordingly, 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 current economic policy directive:

It is the current policy of the Federal Open Market Committee to encourage moderate further increase in bank credit and the money supply, while avoiding money market conditions unduly favorable to capital outflows internationally. It is also the Committee's policy to cushion such unsettlement in money markets as may stem from international developments of an emergency or near emergency character. This policy takes into account the potential financial effects of the Government's quarantine on armament imports into Cuba, the imminence of a large Treasury refinancing, and the recent stability of economic activity, with a margin of underutilized resources and an absence of inflationary pressures.

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

Votes for this action: Messrs. Martin,
Hayes, Balderston, Deming, Ellis, Fulton,
King, Mills, Mitchell, Shepardson, and Irons.
Votes against this action: None.

In casting his vote on the directive, Mr. Mills said he sensed a growing sentiment within the Committee, with which he concurred, toward giving less attention to fluctuations in the supply of reserves resulting from natural influences and allowing the weight of such movements to fall in the direction of easier rather than tighter money market conditions. In his view the steady posture that had been maintained within the climate of status quo did a disservice to the Federal Reserve System's general belief that monetary and credit policy had a great virtue in being flexible. Instead of that, the System had moved, in words and actions, toward a rigidity that in business and academic circles could very possibly provoke criticism in the future.


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Mr. Hayes voted in favor of the directive with the understanding that his reservations would be recorded in the minutes. He noted that at past meetings there had been some advocacy of changing the word "permit" to "encourage" in the directive in describing the attitude of the Committee toward further expansion of the supply of bank credit and money. That type of change, which seemed to have significance to some Committee members, provided an indication of why he voted today with reluctance. He would have preferred to leave the directive unchanged, except for the insertion of a clause in recognition of the current international crisis.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, November 13, 1962, unless occasion arose to hold a meeting by conference telephone in the interim, and that subsequent meetings would be scheduled tentatively for December 4, 1962, December 18, 1962, and January 8, 1963.

The meeting then adjourned.


Secretary