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, December 18, 1962, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bryan
Mr. Deming
Mr. Ellis
Mr. Fulton
Mr. King1/
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Shepardson

Messrs. Bopp, Scanlon, Clay, and Irons, 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. Molony, Assistant to the Board of Governors
Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

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1/ Entered at point indicated in minutes.

Mr. Rouse, Vice President and Senior Adviser, Federal Reserve Bank of New York
Messrs. Sanford, Eastburn, Ratchford, Baughman, Jones, Tow, and Green, Vice Presidents of the Federal Reserve Banks of New York, Philadelphia, Richmond, Chicago, St. Louis, Kansas City, and Dallas, respectively
Mr. Eisenmenger, Acting Director of Research, Federal Reserve Bank of Boston
Mr. Cooper, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Runyon, Economist, Federal Reserve Bank of San Francisco

There had been distributed to the Committee preliminary and revised drafts of minutes of the meeting held on November 13, 1962. With reference to the revised draft, Chairman Martin stated that a suggestion had been made for amendment of a paragraph of the minutes (page 7 of the revised draft) covering the report on foreign exchange market developments by the Special Manager of the System Open Market Account. Chairman Martin then described the change that had been suggested, and it was agreed that the change would be appropriate.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on November 13, 1962, were approved.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account on open market operations in United States Government securities during the period December 4 through December 17, 1962. A copy of this report has been placed in the files of the Committee.

Mr. Stone commented as follows in supplementation of the written report:

The money market has come through the usual December period of liquidity needs without any serious strain emerging. Such pressures as did develop converged on the dealers, who had to take back a large volume of securities on maturing repurchase agreements. The refinancing of these securities was easily accomplished, however, with only a slight increase in dealers' borrowing costs and with relatively moderate bank borrowing from the Reserve Banks. Indeed, through most of the past two weeks, the market tended to be a little easier than it was just before the last meeting of the Committee, with money market banks making only modest net purchases of Federal funds, mainly at rates of 2-3/4 and 2-7/8 per cent. On the final two days of the period a firmer atmosphere developed and the effective rate for Federal funds moved to 3 per cent, but the market regarded this as merely a temporary churning around the tax date. There was no spill-over of this firmer feeling even into the Treasury bill market, not to mention the intermediate and longer term markets, which ended the period with prices moving upward.

The last several weeks' experience provided a particularly good illustration of the disparity that frequently develops between reserve statistics on the one hand and market conditions on the other. In the three weeks ended November 28, free reserves averaged about $465 million with the money market leaning to the firm side of its recent range of variation. Federal funds traded at 3 per cent during much of the time and member bank borrowings averaged about $110 million. In contrast, free reserves averaged about $300 million in the two weeks ended December 12, but with these lower reserve figures Federal funds were at or below 2-7/8 per cent most of the time. Moreover, borrowings from the Reserve Banks averaged slightly less during those two weeks than during the preceding three-week period. In the current week we are veering back to the earlier situation, with the liquidity needs associated with the tax date producing a firmer money market despite an apparent sharp increase in reserve availability.

Treasury bill rates have moved in a narrow range during the past two weeks--edging down for the first few days when some investment demand was augmented by System purchases, and then inching higher as dealers' financing needs were swollen by large awards in the December 10 auction and by the termination of maturing repurchase contracts on both the dividend and tax dates. However, there remains an expectation in the market that rates may again tend lower now that the tax date is passed, for evidence still suggests a continuing high degree of corporate liquidity.

Meanwhile, the entire capital market has been strengthened by the opposition that has been expressed by some in Congress to a quick tax cut and by the breakup of a log jam in new corporate and tax exempt issues as investors responded to slightly higher yields and moved to put accumulated funds to work. Prices of Treasury issues have risen almost steadily since December 6, and yields for most long-term issues are well below 4 per cent and are back near the relatively low levels they reached in early November.

In a discussion following Mr. Stone's comments, Mr. Mills inquired whether there was not in effect a conflict in managing the System Open Market Account between the part of the Committee's directive that called for attention to maintaining the color, tone, and feel of the market and the part that provided for encouraging a moderate expansion of bank credit. Mr. Stone replied that under some conditions it was entirely possible that there could be a conflict. However, such conditions had not prevailed during the past three weeks, or in his recollection for the past several weeks, perhaps months. In operating the Account according to the color, tone, and feel of the market, he explained, the Manager looked not only at interest rates but also at the reserve figures, watching, for example, the behavior of free reserves and the trend of total reserves as measured against the so-called growth guideline. During the past five weeks there had been a major shift in the distribution of free reserves. During November they were concentrated heavily in the country banks, and this was reflected in a relatively firm tone in the market to which the Account Management responded by letting free reserves move upward. If he had attempted to maintain free reserves at around $400-$425 million, the money market would have been substantially tighter than he understood the Committee intended. During the past two weeks, on the other hand, there had been a redistribution of reserves in favor of the banks in the money centers. In those circumstances, if free reserves had been maintained at $400-$425 million there would have been substantial downward pressure on short-term interest rates, more pressure than the Committee would have been willing to see. There was a choice, under conditions such as he had outlined, between maintaining relatively stable money market conditions and letting free reserves fall where they would as a residual factor, within the broad range that had developed over the past several months, or attempting to maintain a narrower range of free reserves and letting the money market move from extremes of tightness to ease. It had been the Manager's choice to be guided by market conditions.

Mr. Mills commented that he gathered the corporate dividend distribution date found money market banks holding large amounts of deposits, while the checks drawn against those deposits in the payment of dividends were not going to come back and be charged out of those accounts until about today's date. This might account, he suggested, for the rather distinct tightness that was experienced yesterday in the form of heavy dealer requirements. There could be a lag between the ease that money market banks experienced and the kick-back of tightness they would feel when the dividend checks were cleared. If the Account Management was too engrossed with the tone and feel of the market, he would be fearful that there could be a subsequent rather unsatisfactory tightening. Mr. Stone replied that he thought the lags tended to be relatively short. Even if they were longer and would result in the kind of kick-back to which Mr. Mills referred, in operating according to market conditions the Account Manager would respond to any undue tightening that emerged by providing more reserves irrespective of the free reserve figure.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period December 4 through December 17, 1962, were approved, ratified, and confirmed.

Before this meeting there had been distributed to the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period December 4 through December 12, 1962, together with a supplementary report covering the period December 13 through December 17, 1962. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Sanford noted that it should be possible to reach the end of the current calendar year without a further reduction in the U. S. gold stock. There was no assurance, however, that gold losses would not recur in the first quarter of next year unless there should be a marked change in the balance of payments situation.

Mr. Sanford then discussed recent developments in the London gold market, which had been relatively quiet recently, and went on to say that interest in the foreign exchange markets had tended to center in the Swiss franc and the German mark, in part due to year-end window-dressing operations by Swiss and German banks together with the approach of a December 20 tax date in Germany. These operations involved repatriations of funds through the exchanges, but had not, in his belief, included any significant volume of swap transactions. The matter of refraining from such swap transactions had been the subject of a cable to foreign central banks from the Federal Reserve Bank of New York, and subsequent requests from the foreign central banks to their commercial banks importantly engaged in international business. Nevertheless, the price of the German mark had advanced and was approaching the point at which the New York Reserve Bank would operate for the German Federal Bank's account to restrain the rise. The Federal Reserve had not intervened for its own account since the third of December, and after the turn of the year it was expected that the current movement would reverse itself. The firmness of the Swiss franc was influenced by the activities of German, Italian, and French banks, which reportedly had been selling U. S. dollars in Switzerland in order to meet Swiss franc commitments arising from earlier undertakings in the Euro-Swiss franc market that were now falling due. The Netherlands guilder had advanced slightly during the past two weeks, while the Italian lira and the French franc had at one time eased very slightly from their ceiling levels. The pound sterling had tended on the whole to rise a bit, and the Canadian dollar was generally firm. A relatively small amount of short-term U. S. funds reportedly had flowed into hire purchase in London and into commercial and finance company paper in Canada.

Mr. Sanford noted that transactions for the System Open Market Account consummated during the past two weeks included the delivery of $17 million German marks sold in the previous period and renewal for another three months of the $50 million swap agreement with the Netherlands Bank, under which the System had an outstanding drawing of $10 million equivalent of guilders due on January 2, 1963. Also, the standby swap agreement with the Bank of Italy was increased from $50 million to $150 million. The Bank of Sweden had not yet taken steps to enter into the swap arrangement that the Open Market Committee authorized to be negotiated at its December 4 meeting.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period December 4-17, 1962, were approved, ratified, and confirmed.

Mr. Sanford then presented several recommendations for the consideration of the Open Market Committee.

First, he recommended that the $50 million swap arrangement with the National Bank of Belgium, which would mature December 20, 1962, be renewed for a further six-month period. He noted that drawings under the swap arrangement had been used on three different occasions to absorb dollars in the hands of the Belgians and that four times the National Bank had sold francs to the Federal Reserve to obtain dollars, the most recent occasion having been only yesterday. As a result of those operations, the System now held $35 million equivalent of Belgian francs. In reply to a question raised as a matter of information, Mr. Sanford said there had been a slight profit on the foreign currency operations undertaken thus far in Belgian francs.

Thereupon, extension for six months of the $50 million swap agreement with the National Bank of Belgium, as recommended by Mr. Sanford, was authorized, with the understanding that the $50 million drawing thereunder also would be renewed.

Mr. Sanford then recommended that the drawing of $10 million equivalent of guilders under the swap arrangement with the Netherlands Bank, which drawing would mature January 2, 1963, be renewed.

The renewal of the $10 million drawing, as recommended by Mr. Sanford, was noted without objection.

Mr. Sanford referred next to the $250 million swap arrangement with the Bank of Canada that would mature December 26, 1962, and recommended that it be renewed for a three-month period. He indicated that it appeared likely that the Bank of Canada would pay off on the December 26 maturity date the $75 million drawing that remained outstanding under the swap agreement. In the event, however, that this drawing was not paid off, he would recommend renewal for a three-month period.

Question was raised by Mr. Mitchell whether it would not be advantageous from the standpoint of the U. S. balance of payments if the Bank of Canada renewed the $75 million drawing, on the theory that this might be an alternative to further Canadian borrowing in the U. S. capital market.

Mr. Sanford replied that in January the Canadians were going to receive half of the proceeds of a $250 million Government of Canada issue that had been floated some time ago. He anticipated that the Bank of Canada would repay the $75 million drawing unless Canada was subject to unexpected heavy reserve losses this week. It was true that the Canadians had tapped the U. S. capital market heavily in the past; with a free and open capital market in this country, it might be expected that this would continue.

Mr. Hayes expressed the opinion that the Bank of Canada would not want to continue very long to hold reserves on a short-term borrowed basis. Instead, they would want to borrow long in a substantial amount to offset their current account deficit to this country. They regarded that as a perfectly legitimate operation. Since the Canadians ran a larger current account deficit with this country than the offsetting capital borrowings, he saw no valid basis on which resistance could be indicated to their borrowing long-term funds in this market.

Mr. Mitchell noted that this country had substantial balance of payments problems and expressed the view that first consideration should be given to those problems. The swap arrangement was originally entered into with the Canadians principally as an accommodation to them. They had made good use of it; since the date of the agreement, their reserves had increased substantially. At the moment, certainly, the U. S. position was somewhat precarious, and he wondered whether there might not be some advantage in suggesting to the Bank of Canada that repayment of the $75 million drawing be deferred for at least two or three months.

In further discussion of this point, Mr. Hayes commented that the paying off of the drawing would not, per se, have any effect on the balance of payments. Long-term Canadian borrowing in the U. S. market did affect the balance of payments, but he did not believe that such borrowing would be affected by the repayment of the drawing.

Mr. Young noted that the repayment of the drawing, if it occurred this year, would result in the whole operation becoming a wash transaction, since it would have been entered into and paid off during the same year. Mr. Balderston referred to the fact that the Committee, when it originally authorized entering into the program of foreign currency operations, had indicated that such operations should be undertaken to moderate short-term variations and not to paper over long-term difficulties. Mr. Hayes suggested that a paying off of the drawing would be of advantage in the sense of maintaining the principle of liquidity in swap operations, to which Mr. Mitchell replied that this would seem to him to be a secondary consideration. Mr. Robertson commented that it seemed to him the fundamental issue here was whether the Canadians could be persuaded to defer entry in the U. S. market for the purpose of long-term borrowing, and he did not think that that question was going to be affected by whatever was done in respect to the $75 million drawing. Chairman Martin indicated that he agreed with this comment.

After further discussion along these lines, renewal for three months of the $250 million swap arrangement with the Bank of Canada was authorized, along with extension of the $75 million drawing thereunder if such drawing was not paid off on or before the present maturity date of the swap arrangement.

Mr. Sanford then referred to the distribution to the Committee under date of December 14, 1962, of a draft of proposed agreement on swap arrangements between the Federal Reserve System and the Swiss National Bank. This grew out of a recent understanding between the Swiss National Bank and International Monetary Fund under which the Swiss undertook to supply supplementary resources similar to those provided for in the International Monetary Fund agreement of January 5, 1962. With this in mind, the Swiss had proposed a formalization of existing swap arrangements between that bank and the Federal Reserve, plus certain other arrangements relating to monetary cooperation, substantially according to the distributed draft agreement.

Mr. Sanford recommended that the Committee approve the draft agreement in principle as a basis for future negotiation. He described it, in summary, as a recapitulation of the swap arrangements that had been entered into heretofore with the Swiss National Bank. However, the agreement would place no limit on the amount of short-term swaps that might be concluded now or in the future. It also provided, under certain conditions, for up to $200 million equivalent of medium-term swaps, if and when the International Monetary Fund standby arrangement of January 5, 1962, should come into use. It would also include other arrangements of a general nature relating to monetary cooperation between the Swiss National Bank and the Federal Reserve System.

Mr. Sanford also called attention to, and explained, a minor change in the draft agreement that was thought to be appropriate. He added that the Swiss National Bank would be pleased to obtain some indication of agreement in principle with a draft agreement of this type before proceeding with certain steps, including legislation, that apparently would be necessary in Switzerland.

Chairman Martin noted that the draft agreement was being put forward as a basis for negotiation, not as a final document, and that the Committee would have a further opportunity to review the matter before any final action was taken. However, the Swiss National Bank did not want to proceed with further steps in Switzerland in the absence of some indication that the draft agreement was regarded by the Federal Reserve as an appropriate basis of negotiation.

There followed discussion of the possible need for editorial clarification of one part of the draft agreement, during the course of which the Committee's General Counsel advised that he had reviewed the draft agreement and had discussed it with the legal staff of the Federal Reserve Bank of New York.

In reply to a question, Mr. Young commented that Switzerland was not a member of the International Monetary Fund but had been a participant in the negotiations that led to the arrangement to provide broadened Fund standby resources. It had been the hope that at some point the Swiss could be brought into the picture, and the draft agreement reflected a means of implementing that hope. In view of the fact that any drawings under the special Fund arrangement could have a maturity up to five years, the Swiss had incorporated an equivalent arrangement in the draft agreement.

Mr. Mitchell inquired whether it seemed desirable to continue to limit Federal Reserve swap arrangements with other central banks to three-month or six-month periods.

Mr. Sanford replied that, as Mr. Young had indicated, the draft agreement provided a way for Switzerland, which was not a member of the International Monetary Fund, to extend intermediate-term financial assistance. The other principal countries were providing such intermediate-term help through the contribution of funds in connection with their membership in the International Monetary Fund.

Mr. Mitchell then inquired why, if the other System standby swap arrangements were on a short-term basis, subject to renewal, the agreement with the Swiss National Bank should not also be subject to renewal on a similar basis.

Mr. Young replied that it was always possible to convert a swap into a drawing from the Monetary Fund if circumstances should necessitate. The provisions of the draft agreement with the Swiss National Bank had been set up with a view to providing an alternative to Swiss membership in the Monetary Fund. In particular circumstances, it was conceivable that something might be worked out with other countries that would involve provisions similar to the Swiss arrangement.

Mr. Hayes commented that it was his understanding that this arrangement was sui generis. It was not likely to be a precedent for similar arrangements with other countries. It was an effort to accommodate the peculiar set of circumstances whereby Switzerland was not a member of the Monetary Fund, yet would like to enter into arrangements that gave it an opportunity to offer assistance along the same general lines as the pattern within which the Fund program would operate.

Mr. Mitchell indicated that the purpose of his questions was primarily to inquire whether surplus countries might not be persuaded to lend to the United States on an intermediate or long basis, and Mr. Young noted that certain efforts along those lines were being undertaken by the Treasury.

After further discussion, it was understood that the Committee would be agreeable to indicating to the Swiss National Bank that the draft agreement distributed under date of December 14, 1962, would be a satisfactory basis for further negotiations.

Mr. Sanford commented that in a day or two the New York Reserve Bank would send a telegram to all Federal Reserve Banks concerning the year-end valuation of Federal Reserve foreign currency accounts and a procedure whereby distribution of profits and losses hereafter would be made on a quarterly basis. Provision would also be made for quarterly distribution of commissions earned on bankers acceptances, commitment charges on foreign loan arrangements, and Foreign Department expenses.

These procedures had been the subject of study by the Federal Reserve Bank and the Board's staff in recent months.

Mr. King joined the meeting during the foregoing discussion of foreign currency operations.

The Chairman then inquired whether there were further questions or comments on Federal Reserve foreign currency operations. There being none, he called for the staff reports on economic and financial developments.

Mr. Koch presented the following statement on economic developments:

Although only two weeks have passed since the Committee's previous meeting, some new information on recent domestic economic developments has become available in the interim. In a word, this information continues to be of mixed significance for an evaluation of the likely future course of economic activity. Although the feeling of greater optimism regarding business prospects persists, this optimism still is based more on expectations than on tangible economic evidence.

On the favorable side of the economic news, one would include higher retail sales, particularly of autos; larger steel output; an increase in the average workweek in manufacturing; and the mildly better performance of the leading business indicators considered as a group. Preliminary indications are that orders for nonelectrical machinery rose further in November.

Sales of new domestically produced autos in November were at a seasonally adjusted annual rate of 7.5 million units, as compared with 8.1 million in October. In the first 10 days of December, auto sales were down somewhat, but they were still a record for the period. Stocks of new cars have risen little, and on December 10 were only about 790,000 units. Christmas buying early in December was disappointing, but it is still too early to predict retail sales for the month as a whole.

A further increase in the gross national product of perhaps $7 billion is indicated for the current quarter. This would bring it to a level around $562-$563 billion, about 4-1/2 per cent above that of the fourth quarter a year ago and 11 per cent above the preceding cyclical peak 2-1/2 years ago. Most of the recent increase has come from increased spending by consumers on autos and services. Government spending is also up. Business inventory accumulation is expected to be up a little, reflecting an end to the liquidation of steel stocks, but accumulation is still likely to be at a low rate.

On the unfavorable side of the news is the rise in the seasonally adjusted unemployment rate back to the August-September rate of 5.8 per cent of the labor force, the lack of increase in the November industrial production index, the somewhat disappointing recent surveys of anticipated business capital spending, and the greater recognition of the probable obstacles to an early tax cut.

I interpret the higher November unemployment rate and the stable production index as continuing evidences of the lack of vigor and dynamism in the current economic expansion. Indeed, the labor force, the level of employment, and the number of the unemployed were all at about the same levels last month as at midyear. The industrial production index has now shown no real change, either up or down, for four months. The record recent demand for autos has not been reflected in the production index because auto assemblies have been at virtual capacity.

Prices also continue to show little change, with the wholesale index of industrial commodities at about the year-ago level, and with the combined wholesale index remaining at essentially the same level that has prevailed since early 1958. Productivity in manufacturing is also apparently continuing to increase faster than wages, including fringe benefits. Labor costs per unit of output are still tending downward, although not as much as during the early stages of recovery when output was increasing rapidly.

As for business spending, current indications are that this area of the economy is not likely to contribute significantly to a sharp upswing in the near future. Inventory/sales ratios of business enterprises have been quite stable over the past year and are low by historical standards. They are not so low, however, when one takes into account the longer run downward trend in the ratio that has been developing over the past decade. Purchasing agents claim that inventories are conservative but adequate in view not only of the volume of business they are currently experiencing, but also the volume they expect in the foreseeable future.

Business spending on fixed capital for the year 1962 as a whole is now estimated at about $37-1/2 billion, 9 per cent higher than last year and 1 per cent more than the previous record in 1957. The latest McGraw-Hill survey indicates only a modest increase, if any, for 1963 over the current level. The more recent Commerce-SEC survey indicates a small decline in spending in the first quarter of next year.

Estimates for 1963 spending are, of course, based on preliminary plans and are subject to revision. I suspect they do not yet adequately take into account the effects of recent changes in allowable depreciation rates and in the new investment tax credit. Nevertheless, it seems quite clear that at least no great upswing is likely to occur in business capital spending in the months immediately ahead.

In conclusion, swings in business sentiment strike me as having been much larger over the past year than were warranted by the unfolding economic facts. Last summer and early fall's talk of recession proved to be wrong. One hears much less of it now. The evidence we have on hand today, it seems to me, remains most consistent with the view that economic conditions are likely to continue to improve early next year, but still at quite a plodding and unsatisfactory pace. Whatever happens eventually to the tax proposals, the first half of 1963 still poses many uncertainties.

Mr. Holland presented the following statement on financial developments:

Our financial system now stands almost precisely at the crest of its seasonal pressures. We must wait for one or more additional reporting dates to see the full dimension of the seasonal movements in our statistics, but already we can judge that the fall credit expansion has been substantial. Our first figures from city banks suggested some slowing of increases in bank loans to nonfinancial borrowers in November and prior to the tax date in December, but nonfinancial loan expansion in country banks appears to be continuing fairly strong. Meanwhile, bank financial loans, after declining in November, turned up strongly as the December pressures moved Government securities dealers and others into the banks. In addition, banks added to their holdings of both Government and non-Government securities.

Reflecting these bank asset increases, bank deposits continued to grow more than seasonally. Required reserves behind private deposits have mounted to over $100 million above the standard set down in the staff memorandum. The money supply was up an estimated $300 million further in the first half of December, showing an annual growth rate of almost 6 per cent from its trough in August. Furthermore, this added money supply appears to have been relatively well utilized by the economy, with demand deposit turnover advancing during the fall to an October-November rate 9 per cent above a year ago. Time deposits have continued to grow and, along with other deposit-type savings outlets, are completing a year of record increases.

This took place in an environment in which free reserves worked down to the lowest average in two years. These low free reserve figures were of relatively short duration, but they did not appear to have any tightening influence in the central money markets. Funds were flowing in and short-term interest rates held more or less stable during the period since the last meeting. Member bank borrowing, however, continued at close to or above the $100 million level that it had moved up to in November, suggesting some combination of either slightly greater reserve tension, greater bank credit demand, and/or some differing distribution of reserves around the country.

Money and capital markets during December were active, as investors and dealers adjusted their holdings to changing expectations as to the outlook and a tax cut. Attention to underlying seasonal influences also was in transition as mid-December tax and dividend dates passed without strain and the months of seasonal downward pressure on rates approached.

In particular, seasonal influences are converging upon the 3-month Treasury bill rate. Data for past years indicate that the bill rate ordinarily reaches its seasonal peak in the week before Christmas. Seasonal influences, taken by themselves, then tend to soften rates in the final week of December and the first week of January, and for some five months thereafter, with the softness ordinarily concentrated in the weeks around the turn of each month. These seasonal influences can be overridden by cyclical influences, as often happened in the 1950's, or they can be "ironed out" by official action, as occurred in 1961 and 1962. One key contributor to seasonal strength in the bill market, however--nonbank buying--seems likely to enter the market this year with more vigor than in the previous two years, since investible cash flow appears larger and the supplies of alternative money market instruments, such as commercial and finance company paper and negotiable time certificates of deposit, are likely to increase more slowly. (Banks, on the other hand, are likely to be much smaller short-term buyers than in 1961--perhaps no more than in 1962.) Dealers may help to slow any rate declines this year by unloading their current near-record holdings of bills, but the fact that they have been prepared to build up their inventories so far indicates their expectation of a strong bill market ahead.

The biggest influence countering any bill rate decline for the next month or so will undoubtedly be the Treasury's intended marketing of additional bills. The planned total involves a $200 million increase in 6-month bills on January 3 and January 10, a $500 million increase in one-year bills in mid-January, and $2 billion June tax bills, in perhaps one or two separate offerings in later January or early February. The market weight of these Treasury bill offerings, however, could develop too late to offset some immediate post-Christmas downward pressure on bill rates. Market attention will be attracted by the imminent succession of announcements concerning the Treasury's $250 million bond offering to underwriters, currently expected to begin this Thursday, but the extent to which such an influence will pervade the various maturity sectors of the market is problematical.

It should also be noted that any need for sizable System open market sales purely to absorb reserves is probably two to three weeks off. The reserve effects of changes in float, currency, and required reserves seem likely to about balance out until after the next meeting of the Committee.

Absent any special System actions or unforeseen market influences, the near-term prospects appear to be for some downward rate pressures to materialize in the intervals between Treasury financings and other official selling operations. Judgments will vary as to the concern to attach to this development.

In point of fact, the financial environment of the moment appears to suggest a rather narrow range within which policy could be flexed. The growth of bank credit and money, even with the recent somewhat higher borrowing and reduced free reserve figures, hints at the possibility that the banking system does not need quite as much nurture in the way of reserve availability as it did earlier in the year in order to keep growing. On the other hand, the low covered bill yield spread and reported lack of substantial short-term fund flows between New York and London--the only other major money market of the world--suggests that a slight seasonal easing of bill rate might not trigger much in the way of net additional short-term outflows.

A third factor, the prospective Treasury financing schedule, covers much of the time from this Thursday almost to the end of January during which, other things being equal, an "even keel" policy would presumably be desirable.

It seems to me conceivable that a gradual drift of free reserves back down in the direction of the first-half December level might still sustain some monetary expansion, might moderate money market rate declines somewhat, and yet might not do violence to the "even keel" concept, provided that the free reserve downdrift were tempered as necessary to offset any spurts of market pressures that might otherwise tend to push short-term interest rates back above their early December levels. Within this operating framework, market forces themselves could be left to do the rest of the job of balancing reserve availability and money market trends.

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

Preliminary figures for November confirm the tentative estimate of the U. S. balance of payments position reported at the last meeting. According to the officially adjusted figures, net transfers of gold, foreign currencies, and dollars were negligible; if the recent statistical adjustments are disregarded, there has been a net transfer to foreigners of $200 million.

Tentative figures for the first two weeks of December indicate a small surplus according to the official calculation, and a small deficit if recent statistical adjustments are disregarded.

As the second half of December tends to be seasonally favorable, especially if a repetition of last year's large window-dressing operations is avoided, the U. S. payments deficit for the year may not be very different from that for the first 11 months of the year. In this case, it would be about $2-1/4 billion according to the official statistics, or nearly $3-1/2 billion if debt prepayments are deducted from U. S. receipts and the recent statistical adjustments are disregarded. According to the official calculation, the deficit would be slightly smaller than last year (although much larger than forecast by the Treasury last summer), but on the basis of the conventional calculation it would be slightly larger than last year.

Economic conditions abroad have not changed much, except that optimism about further economic growth in Europe seems to have risen further. If this optimism proves justified, our exports next year may well surpass this year's total.

The Department of Commerce has prepared a tentative and confidential projection of next year's deficit which, assuming no further debt prepayments or statistical adjustments, envisages a deficit of nearly $3-1/4 billion, hardly smaller than this year's deficit. The projection is based on a decline of $900 million in commercial exports (exports not financed by Government funds) and an increase in imports of goods and services of $800 million, offset by an increase in investment income of $200 million and a decline in the net outflow of long-term capital of $600 million and of short-term capital of $300 million, as well as a decline in net untied Government expenditures (disregarding prepayments and statistical adjustments) of $600 million.

The most disturbing part of that projection is the expected decline in commercial exports. The projection assumes that U. S. exports, especially those to other industrial countries, are determined more by trends in foreign investment than by changes in foreign national income, because U. S. nonagricultural exports consist mainly of capital goods rather than of consumer goods. Thus, if investment in Europe did not increase, U. S. exports would tend to decline even if national income in Europe continued to rise. Although this assumption is derived from statistical correlations, its validity seems doubtful. Moreover, if present optimistic expectations about economic conditions in Europe were fulfilled, investment as well as consumption might continue to rise, and U. S. exports of capital goods could be expected to increase or at least not to decline even if the alleged statistical correlations were valid.

Past experience has shown that the net outflow of investment capital from the U. S. tends to change in the same direction as our trade surplus. Thus, if the projections of our trade surplus proved too low, the projections of our capital outflow also might have to be raised--unless our economy generated meanwhile a substantially greater demand for domestic investment funds.

If, however, an increase in our exports coincided with a revival in our domestic economy, and if the projections of a decline in our net Government expenditures abroad proved correct, our payments position might well change for the better next year. But even under these optimistic assumptions it would still be far from equilibrium.

At this point Chairman Martin noted that Mr. Young had just returned from a meeting in Paris of Working Party 3 of the Organization for Economic Cooperation and Development. In the circumstances, he felt that it would be helpful if Mr. Young were to comment on the meeting. He mentioned, in this connection, that under yesterday's date Mr. Young had distributed to the Committee certain documentation with respect to the meeting.

In his comments, Mr. Young said that at the meeting of the Working Party the U. S. participants were exposed to searching and critical questioning about U. S. debt management and monetary policies, with particular reference to adaptations that might be expected in the light of the Administration's proposed tax cut. The questioning was probably motivated in part by a feeling that the OECD Economic Policy Committee, in responding favorably to a U. S. solicitation of endorsement of the Administration's proposed tax reduction, may have given a blank check in the form of assurance of European cooperation in financing any enlarged U. S. balance of payments deficit that might result from stimulation of the economy. In other words, the Europeans may have felt that they had failed, through inadvertence, to exact a compensating U. S. commitment that its monetary policy would now begin to carry a larger burden in combating the persisting balance of payments deficit.

In any event, however, the confrontation reflected sincere and honest doubts as to whether U. S. monetary policy was properly geared to the balance of payments problem. From this standpoint, the probing perhaps reflected the elements out of which that intangible thing called confidence is compounded.

The first step in the meeting, Mr. Young said, was an extended review of debt management. At European request, the Treasury presented its debt management chart show, especially adapted to this particular purpose and audience. The visual charts prompted many and varied questions, but the ones that stood out as recurrent related to the growth of the Treasury's short-term or unfunded debt, to the apparently chronic indisposition of the Treasury to tap directly both the longer side of the intermediate market and the longer term market, and to the handicaps to debt management of the interest ceiling. Behind these questions was a larger one that from time to time made its presence felt: namely, whether it would not be a good idea for the Treasury to finance its prospectively larger deficit by longer term offerings in order to put long-term rates under upward pressure and thus help to make the U. S. market a less attractive one to foreign borrowers.

The second step in the Working Party's discussion was a review of U. S. monetary policy, based on a Secretariat paper circulated just a few days before the meeting. The purport of the paper was merely to set European and U. S. viewpoints in a juxtaposition that would activate discussion. But the authors also seemed to entertain a hope of eliciting a confession that Federal Reserve monetary policy had been too easy and had made worse the balance of payments deficit, and further a profession of desire to mend our ways to help correct the deficit, at least now that tax reduction and a more stimulative fiscal policy were in sight. The Secretariat paper obviously called for a rejoinder that would endeavor to persuade the Europeans that the U. S. monetary authorities were aware of both the internal and external aspects of their monetary problem, had been pursuing a policy geared to both objectives, and would make adaptations in the light of both objectives in the future. At the same time, it had to avoid advance commitment as to the precise nature or timing of such adaptations. There had been mimeographed for the Committee's information, Mr. Young noted, both the Secretariat's paper and his rejoinder.

The details of the discussion on U. S. monetary policy would take unduly long to recite, Mr. Young said. Suffice it to report that after two and a half hours of debate there seemed to be a consensus that present System policy, giving special weight to domestic factors, was not inappropriate for the time being, but that if and when tax reduction was enacted and took effect the Federal Reserve would face another problem. While this was the consensus, there remained a skeptical minority. These representatives expressed themselves as believing that the balance of payments deficit was so urgent that monetary policy could no longer compromise between internal and external considerations, but had now to give the greater weight to the external.

Mr. Young concluded by saying that further Working Party consideration of U. S. debt management and monetary policies was not foreclosed by this particular discussion. In fact, the Chairman in expressing the meeting's consensus stated that in his view there were additional aspects of these policies in need of Working Party examination and that he was therefore placing U. S. financial policy on the agenda for the next meeting to be held late in January.

In a discussion based on Mr. Young's comments, Mr. Mills asked Mr. Young if he would develop briefly the reasoning of those Europeans who would prefer a tighter U. S. monetary policy and higher interest rates irrespective of the fact that the economic impact of that sort of development might be adverse to encouraging growth in the economy and the kind of strength that would provide a better U. S. market for foreign goods.

Mr. Young replied that this point of view reflected the emphasis they placed on capital outflow as a disequilibrating factor in the U. S. balance of payments, and the effects of such outflow on the U. S. reserve situation and on general confidence, as they saw it, in the dollar. This point of view was set forth in the memorandum of the Working Party Secretariat that had been distributed to the Committee. In fact, it was set out so strongly that he had felt it necessary to make a rather detailed rebuttal, in which he pointed out that U. S. interest rates had been at levels believed to be consistent with this country's economic position and that this country was experiencing capital outflows particularly because of a lack of other markets to which foreigners could turn at this time, even for short-term capital. This situation placed a special burden on the U. S. balance of payments that could only be alleviated gradually over a period of time.

Mr. Mitchell inquired whether it appeared that in the background of the European judgments represented in the Working Party there was the interest of foreign lenders who did not like to see their potential customers coming into the U. S. market.

Mr. Young replied that he could not say whether this was the case. However, the Europeans were protectionist minded in terms of the restrictions placed on foreign borrowing in their capital markets. The U. S. participants had been pressing in the Working Party discussions for a more enlightened and far-sighted view of this problem and the need to remove obstacles to foreign financing of capital requirements, particularly from the standpoint of longer run developments.

Mr. Robertson commented that the European view to which Mr. Young had referred in his remarks apparently would call for a U. S. monetary policy that would increase interest rates across the board rather than simply in the short-term area. However, the capital outflow, such as it was, existed principally in the longer term area.

Mr. Young agreed that this had been true this year. He added that the Europeans had urged at times a harness of capital controls. If the U. S. was unwilling, they felt that the only recourse was to take monetary actions that would permit interest rates to move higher across the board.

There followed a brief discussion of the role of U. S. military aid in the U. S. balance of payments during which Mr. Young commented that U. S. participants in the OECD and in Working Party 3 had been attempting without a great deal of success to broaden the range of discussion to give more attention to the subject.

The Chairman then called for the usual go-around of views and comments on economic developments and monetary policy.

Accordingly, Mr. Hayes began the go-around by presenting the following statement:

The improvement in the business situation continues to be more a matter of atmosphere and expectations than of solid achievement. Such figures as have become available recently do not throw much additional light on the outlook. Basically, both the current situation and the outlook remain unchanged, i.e., the evidence points merely to continuation of a relatively slow advance.

Optimistic business sentiment has been dampened a bit in the past week by second thoughts on the difficulties of getting early and effective tax legislation through Congress. While there is undoubtedly a strong ground swell of sentiment for tax reduction, both as a long-needed basic reform and as a means of attacking the immediate problem of inadequate use of resources, the uncertainties with respect to the trend of Federal spending have caused some doubt as to the extent to which tax reduction may be feasible and desirable. From the System's point of view, it seems to me of the utmost importance that these doubts be resolved and that appropriate tax action be taken both for its own sake and because of its effect in lessening the burden of monetary policy's responsibility for domestic economic conditions.

I believe we can take a great deal of encouragement in this respect from President Kennedy's address to the Economic Club in New York last Friday. His forthright statement that easy money has gone about as far as it can go without causing a hemorrhage in our balance of payments clearly shifts the main burden of stimulating economic activity to fiscal policy, while his emphasis on the need to restrain Federal expenditures outside the defense-related areas should provide assurance to those who have been deeply concerned, as I have been, with the problem of controlling the rise in Government spending. We should also be gratified by his expression of confidence in Chairman Martin and by his reliance on the Federal Reserve to use its monetary tools wisely. The tax bill still has a long hard road to travel, and it would be naive to expect perfection, as the President clearly recognized. I believe, however, that the speech cleared up a great many misapprehensions about the Administration's philosophy in advocating a tax cut at the present time when a substantial deficit is already in prospect, and put in good perspective the need for fiscal policy to share the burden of growth stimulation with monetary policy, and the role of monetary policy in defending the balance of payments. I might add that the President's presentation--particularly in the question and answer period--was most impressive and that the response from the business and financial leaders present was quite positive in character.

The balance of payments continues as discouraging as ever, despite the sharp drop in the over-all deficit from October to November. Much of the drop reflected a reversal of October window-dressing operations, and the November total was helped by special Government transactions in the amount of more than $100 million. Furthermore, the average deficit for the last three months--$416 million--was above the already high level for the same period a year earlier and the results for the full year 1962 are bound to cause much disappointment both here and abroad. The sharp export decline in October, explainable only in part in terms of anticipation of the longshoremen's strike, is disturbing in view of widespread hopes that an improving trade surplus may be one of the principal keys to ultimate equilibrium in our international payments. In contrast with these disturbing considerations with respect to the basic balance of payments, the gold and exchange markets remain generally calm, and we have been able to avoid a drop in the monetary gold stock for a good many weeks. While this is reassuring as evidence of lessened political tension, of effective international financial cooperation, and of a considerable degree of confidence in the dollar, there is always danger that the surface evidence may be mistaken for the reality and that this momentary calm may cause undue complacency on the whole balance of payments problem.

Bank credit continued to expand vigorously in November, with business loans increasing more than seasonally, although less rapidly than in the previous three months. Liquidity positions at New York City banks, which had declined sharply at the time of the refunding, have improved appreciably since then. The money supply has risen substantially for the second month in a row, and time deposits have continued their sharp advance. Whereas seasonal factors have for some weeks been helping our efforts to maintain a firm short-term interest rate structure, we are now at the time of year when these seasonal factors may soon be expected to work in the other direction.

It seems to me that the continuing uncertainties in the domestic outlook, together with the absence of any dramatic evidence of crisis in the international financial area, preclude at this time a decisive or overt move with respect to monetary policy. On the other hand, in view of the improvement in business sentiment and the continuing abundance of liquidity, I think we can afford to focus more attention on our objective of maintaining a firm short-term rate structure, with particular concern for the 90-day bill rate. In view of the seasonal factors now in prospect, maintenance of the bill rate around its current level will probably require some lessening in the degree of ease in the money market, as measured by such factors as the Federal funds rate, the level of bank borrowing, and the level of free reserves. I am quite prepared to advocate such a moderate lessening of ease with a view to maintaining a firm bill rate structure. A modest move of this kind would put the System in the posture of defending a range of short-term rates that has existed for some time. It would be less obtrusive than an effort to push rates upward at a time when seasonal factors were also working in that direction or were neutral. Our balance of payments position still needs vigorous defending, as the President pointed out last Friday, and this modest action appears the least that the System can do to help at this particular time. I would contemplate that the Federal funds rate would be more or less regularly at 3 per cent. Borrowing at the Federal Reserve Banks would probably be somewhat higher than it has been, and free reserves would probably have to be lower--perhaps in the $200-$400 million range rather than the $300-$500 million range we have seen now for many months.

Incidentally, I doubt that even keel considerations will be with us until the end of January, when we shall have to look ahead to the Treasury's February refunding. Any move toward somewhat less ease now would be fully digested by the time of the Treasury's bond offering, which is expected some time in the first part of January.

There would seem to be no reason to consider a discount rate change at this time, as I feel that any clearly overt action on our part should wait further clarification of the business and tax outlook as well as the appearance of more obvious balance of payments danger signals.

It would seem appropriate to modify the directive to some extent to take account of the modest change in policy I am suggesting. As I have looked over the directives for the past several months, I have been struck by the fact that, whereas we made a change in June, in the direction of a slightly firmer policy, the language embodying this change was abandoned for good reasons at the time of the Cuban crisis; but it has never been reinstated adequately, so that in effect our present directive is, in my judgment, a good bit weaker than the one adopted in June. I would suggest the directive might read approximately as follows:

> It is the current policy of the Federal Open Market Committee to accommodate moderate further

> increases in bank credit and the money supply, while aiming at money market conditions that would minimize capital outflows internationally. This policy takes into account the lack of any significant improvement in the United States balance of payments and the recent substantial increase in bank credit, but at the same time recognizes the unsatisfactory level of domestic activity, the continuing underutilization of resources, and the 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 offsetting the anticipated seasonal easing of Treasury bill rates, if necessary through maintaining a firmer tone in money markets.

Mr. Shuford said he had been impressed by the remarks on the international balance of payments situation at today's meeting. His earlier uncertainties about the appropriate course of monetary policy probably had been increased somewhat. However, as long as the Committee was watching closely both the domestic and the international situation, he was not yet ready to make any drastic change in his basic position on policy.

Turning to the Eighth District, Mr. Shuford said the data that had become available in the past couple of weeks reflected no significant changes. All recent data tended to confirm the earlier belief that District activity continued in November at about the levels established during the second and third quarters of the year.

Reverting to policy considerations, Mr. Shuford commented that he was aware that the Committee's decisions must recognize both the balance of payments problem and the domestic situation. As long as the balance of payments was so adverse, clearly that matter must be given much weight. At the same time, as long as the domestic economy continued static, as it had since the middle of the year, the Committee must be mindful of the need for doing what it could by way of encouragement. In the light of these two necessities, it seemed to him that the Committee had steered quite a good middle course. Now, with a period approaching when short-term rates normally might be expected to decline, there was some question whether it would be possible to maintain the level of those rates and at the same time continue to have some expansion of seasonally adjusted bank reserves and the money supply. It seemed to him that it would be desirable to avoid a stagnation of monetary reserves and the money supply such as occurred in the first part of 1962. He would suggest, therefore, that three means be considered, so far as they were practical and effective, to assure a continued expansion of bank reserves and the money supply, in a manner that would be compatible with short-term interest rate necessities. First, for the near-term future, the System might give more emphasis to increasing somewhat its holdings of longer-term securities. Second, again for the near-term future, Treasury debt management might continue to help maintain short-term rates, thereby permitting increased flexibility of System operations. Third, to the extent compatible with balance of payments necessities, short-term rates might be permitted to reflect some normal seasonal decline without the Committee becoming too disturbed.

His position, Mr. Shuford noted, was somewhat different from that advocated by Mr. Hayes. Nevertheless, in listening to the policy directive suggested by Mr. Hayes, he did not find himself differing too much with that formulation. His inclination would be to accept that directive, even though there might be a small deviation between his thinking and that of Mr. Hayes. In his opinion, the Committee could also work within the present directive, though it might not be stated too well in the light of existing circumstances. He would not change the discount rate at this time.

Mr. Bryan spoke of the record low temperatures that had prevailed in the Sixth District recently and went on to say that although the frost had done some damage, estimates of the eventual economic effect were not yet available. Obviously, a good deal of the early vegetable crop in Florida had been destroyed, but there was a question as to whether the trees in the citrus groves had been injured seriously. Otherwise, the District economy had shown about the same movements as the national figures. Retail sales apparently had been doing a little better than the national average and automobile sales were relatively stronger, but the District index of steel production was weaker.

Looking at the national picture, Mr. Bryan observed that certainly no robust expansion was occurring. He would be inclined to go along with the idea of no change in monetary policy. On the basis of the staff figures, the results of current policy seemed to have about met the target projection, which was based on a 3 per cent growth rate of required reserves behind private deposits. By the same token, he felt that the Account Manager--within a general directive of no change in policy--must be given considerable latitude to adapt to conditions in the money market.

Mr. Bryan also commented that the long period of time that had elapsed since a change last was made in the discount rate had occasioned some discussion recently by the Atlanta Bank's directors. However, he saw no basis for changing the discount rate at this time. On the matter of seasonal decline in short-term interest rates, he noted that the problem involved comparisons between seasonal fluctuations in this country and in other principal countries to which short-term funds might flow. Unless the situation in other countries was known, it seemed difficult to tell whether or not some seasonal decline in U. S. rates could safely be permitted. He assumed, Mr. Bryan added, that flows of funds were not merely a response to interest rates, but a response to total opportunities for capital investment. If the international situation had shifted against the United States, in that opportunities for capital investment were better in some other countries, this meant that the Open Market Committee's responsibility was probably much more complicated than it otherwise would be.

Mr. Bopp noted that the Philadelphia directors, like the Atlanta directors, had had some serious discussions of the discount rate recently, particularly in light of the long time that had elapsed since a change last was made. He went on to say that recent weeks had produced just enough evidence to encourage either optimistic or pessimistic views, depending on the extent to which one glossed over those facts that did not suit his hypothesis. Recent labor force information indicated no further worsening of employment status; output and construction awards appeared to be holding previous levels; and store sales were following a pattern not much different from comparable previous years. Yet manufacturing employment appeared to have peaked out about on schedule, following declines in manufacturing hours. Combined with the leveling off of employment and output totals, this could hardly be interpreted as signifying satisfactory progress.

Bank credit increased at reporting banks in the Third District in the past two weeks, Mr. Bopp said, this expansion being generally in line with a trend that began early in the year. Both loans and investments had increased over the period. There had been little change in pressure on bank reserves.

Mr. Bopp saw no reason to change policy significantly at the present time. As he had pointed out two weeks previously, the recent pickup did not change the basic fact that the major domestic problem was one of underemployment, which called for a continuation of monetary ease. On the other hand, this did not seem the appropriate time for a shift toward more ease. Nor did it seem necessary to him, for balance of payments reasons, to move toward less ease. In short, he would continue present policy and retain the directive without change.

Mr. Fulton commented that in the past two weeks the Fourth District had been beset by a newspaper strike and a substantial accumulation of snow. The latter occurrence had upset the trend of many business indicators. According to reports, numerous industries in northern Ohio had been operating recently at around 30 to 40 per cent of usual levels, with those employing substantial female labor being particularly hard hit. Thus, the statistics on hours worked would be depressed temporarily, with manufacturing production made up later as opportunities afforded.

Turning to the steel industry, Mr. Fulton reported a gradual trend upward in production, with orders thus far in December moderately better than in November. The present outlook was for a somewhat higher rate of production in the first quarter of 1963, but for possibly a diminishing rate in the second half of the year. Some steel men expected production to total about 94 to 98 million tons next year, which would represent no real improvement from the current year. A slight drop in the number of automobiles produced also was expected. Guesses as to the number of domestic cars sold next year ranged around 6.2 million, or around 200 thousand higher if there should be a tax cut. At present, sales in the District were down substantially due to weather conditions.

Insured unemployment had increased less than seasonally up through the first few days of December; after seasonal adjustment the figure was

5 per cent lower than for the preceding two weeks. Department store sales had been badly affected by weather conditions. For the year to date they were up one per cent from last year, but for the four weeks ended December 8 they were down 5 per cent.

Loan demand in the District was strong and interest rates were firm. Both business and real estate loans had increased substantially. The daily average of bank debits was up 5 per cent from a month ago.

Turning to policy, Mr. Fulton expressed agreement with the position advocated by Mr. Hayes. He felt that the contribution to the domestic economy already made by monetary policy had been substantial, and it seemed desirable to him that a firmer tone now prevail in the market. If the System was to be able to influence short-term interest rates to a degree after the turn of the year, this was the time to start laying the groundwork. The seasonal return flow of currency doubtless would be large, and softening rates could encourage the flow of funds abroad. In the circumstances, the Committee should take cognizance of the situation and start maintaining a little firmer posture.

Mr. Fulton said he would subscribe to the policy directive suggested by Mr. Hayes. He would not change the discount rate at this time.

Mr. Mitchell said he believed, as he had for some time, that the domestic economy was fundamentally in an equilibrium situation. The question was how the economy was going to break out of its high-level stagnation; that is, whether up or down. It probably would take some significant change in public policy for this to occur, at least on the up side. Nevertheless, while he recognized that what had been happening during the past couple of months reflected primarily a matter of psychology, he did not feel that the matter of psychology should be dismissed too lightly. Exogenous factors might start in motion a series of real actions that would cause the economy to improve. The likelihood of such actions taking place was relatively small, but he would not be disposed to dismiss the possibility entirely. On the other hand, in the absence of that possibility, it seemed to be up to the Federal Reserve to do whatever could be done, both domestically and from the standpoint of the balance of payments. Therefore, he had been thinking in terms of a policy based almost entirely on short-run considerations, considerations that would extend perhaps over only the next three weeks. Here it seemed to him that the System ought to have basically a policy of no change. In particular, he hoped that whatever the Open Market Committee did, it would not prevent the money supply from continuing to rise. Personally, he did not attach too much importance to what happened to the money supply, but many people did attach importance to it and the Federal Reserve could not be unmindful of its public relations posture.

Mr. Mitchell went on to say that the reasons for the rise in the money supply in the past few months seemed to represent a well-kept secret. Thus far, at least, he had not received satisfactory explanations. His own view was that something had happened to the economy, and he thought it was the change in psychology that had occurred. This was, of course, a kind of offhand comment, but it was as good an explanation as he had heard to date.

The balance of payments situation, Mr. Mitchell continued, was one that must be kept in mind, when thinking in terms of the next three weeks, because of the anticipated seasonal trend of short-term rates. However, such evidence as had been presented seemed to indicate uncertainty regarding seasonal trends. There had been differences from year to year, and it could be that not much of any trend would develop. Treasury participation in the market would, of course, tend in the direction of firming the level of short-term rates. Therefore, he felt that the System should not go into this period prepared to take strong actions to bolster the bill rate at some pre-ordained level. The primary criterion should be the covered differential in bill rates between New York and London, which in a sense would seem to measure the exposure of this country to outward flows of funds at this particular time. As long as the differential did not exceed one-half point, the situation would not seem too disturbing. If the bill rate eased to that point, he would not be too concerned. At the same time, he felt that some switching operations supporting the level of short-term rates would be appropriate in this period. In summary, Mr. Mitchell thought it would be desirable for the Federal Reserve to exhibit an attitude of confidence and not show alarm if there should be some changes in short rates.

Mr. Mitchell concluded by saying that he saw no need to change the present policy directive.

Mr. King noted that over the period of the past three Committee meetings he had experienced a steady growth in his feeling of confidence concerning the domestic economy. He had become more and more convinced that efforts aimed directly at developing confidence in the dollar abroad were missing the point, that confidence at home was the key to confidence abroad. In fact, if confidence was developed sufficiently at home, he felt that the question of confidence abroad would tend to become moot. The Committee must face the fact that some seasonal decline in short-term interest rates probably was ahead. This decline might be less than seasonal, but he thought it would be wise, in anticipation of the probable decline, to take up some of the slack in bank reserves, even though some drop in short-term rates of purely seasonal proportions might not be entirely inappropriate.

Mr. King expressed the view that the policy directive should be amended. In his opinion the directive should make a minimum play on international considerations, reflecting his belief that the key to the problem was the domestic situation. Continued dwelling on the international situation, beyond necessities, would amount to protesting too much, and it did little toward building confidence at home. As he had said, it was his view that if there was no confidence at home, none would be built abroad.

Mr. King then suggested the following directive:

> In view of the steady though slow economic advance of the past year, it is the current policy of the Federal Open Market Committee to permit only a slight increase in bank credit and the money supply, while avoiding money market conditions unduly favorable to capital flows internationally. (Optional: It is also the Committee's policy to cushion such unsettlement in money markets as may stem from international developments of an emergency or nonemergency character.)
>
> To implement this policy, operations for the System Open Market Account during the next three weeks shall be conducted with a view to reducing free reserves on balance over the next three weeks and to sustaining a firm tone in money markets.

In commenting on the proposed directive, Mr. King said it was his thought that the direction of open market policy should be altered slightly, within the general framework of even keel and without affecting the broad course of policy to any substantial degree. In his opinion, free reserves should trend toward the $250 million range, with steady progress made toward that goal prior to the next meeting of the Committee. This was with the reservation, however, that if at any time the bill rate should advance to approximately the 3 per cent level, that would constitute a relief valve and stop temporarily the plan to work toward the range of free reserves that he had mentioned. He understood that his general prescription for policy was similar to that which some people, both here and abroad, had been urging for some time. However, this was the first time it had appeared to him that the situation was such as to make such a policy feasible.

Later during the meeting, Mr. King supplemented his earlier comments by saying that he thought this was a good opportunity for the

Open Market Committee to give a hint, by which he referred to a slightly reduced reserve position and possibly a slight temporary rise in the bill rate preceding a likely seasonal decline. He had in mind that this was the last scheduled meeting of the Open Market Committee this year. Therefore, this was the last opportunity for an indication of the Committee's policy position to appear in the policy record that would be included in the Board's Annual Report. Assuming no change in the Committee's present procedure for reporting its policy actions, he would be inclined to take the opportunity not only to give a hint currently of a slightly less easy policy but to confirm it through the publication of the policy record in the Annual Report.

Mr. Shepardson said it did not seem necessary for him to comment on the data, economic and financial, that had been placed before the Committee. General views as to the import of that data seemed to be fairly well accepted. There were continuing problems of underemployment and underutilization of resources, but he continued to believe that these problems would have to be solved by means other than monetary policy. There was no evidence of any lack of availability of funds for growth or expansion. In view of the inextricable intertwining of domestic and international problems, it seemed necessary for the Committee to give considerable attention to the balance of payments problem, which certainly had not improved, if anything seemed to have worsened somewhat. For that reason, it appeared to him that it would be entirely appropriate to move along the lines suggested by Mr. Hayes. In view of anticipated seasonal developments after the turn of the year, this would be an opportunity to get in a little better position. He would concur in Mr. Hayes' suggested targets and in his suggested directive.

Mr. Robertson presented the following statement:

> The information available to the Committee today suggests to me that the pace of business activity is still undesirably slow, and that it could continue to benefit from a generally stimulative credit climate. Accordingly, I am glad to see that the rate of monetary expansion has held up in December, and that by and large no seasonal tightness was allowed to develop in the money market. I might say I was somewhat surprised to see this maintained with as low a level of free reserves as we had in the past two weeks--and I would be even more surprised if we could continue to have such salutary results if that low level of free reserves was maintained for very long. I appreciate, however, that there were some peculiar influences at work these past two weeks.
>
> It is my judgment that we should strive to maintain a free reserve level high enough to sustain a gradual monetary expansion, so long as our domestic and international situations are as they are, even if this should result in a lower bill rate. I think it would be a mistake to reduce reserve availability simply in order to hold a particular level of the bill rate. Whatever the need for shoring up our short-term interest rate structure when interest-arbitrage funds are moving abroad in size (which need, as the Committee knows, I believe to have been overemphasized in the past year), the facts at the present are that the covered yield differentials are moderate, and very little in the way of covered money market funds is said to be flowing out.
>
> Consequently, it seems to me that the Committee should continue a policy designed to provide for moderate net bank reserve expansion, over and above seasonal movements. I would hope that in no event would the Manager of the Account seek to develop a firmer tone in money markets between now and the next meeting of the Committee--especially in view of the imminent Treasury financing program.

In a concluding comment, Mr. Robertson said he would not concur in the change in the policy directive suggested by Mr. Hayes. In his opinion, it would be appropriate for the directive to be continued in its present form.

Mr. Mills said that after listening to the discussion around the table and after having read the written reports on economic and financial developments that had been made available to the Committee, he found no reason to change the position he had submitted to the Committee on previous occasions, or the philosophy underlying that position; namely, that domestic considerations should have a first call on the Committee's policy actions. Much had been said about the balance of payments problem. However, as he looked at that problem over a period of time it seemed to him that it was an international financial rather than an economic problem, and that it should be treated as such. If the situation should deteriorate seriously, the treatment should take the form of appropriate financial measures and financial disciplines. In no event, however, would he feel that the Committee should refrain from giving precedence to domestic considerations and exerting such influence as it could bring to bear toward encouraging economic expansion through the adequate availability of reserves. He was pleased to associate himself with Mr. Robertson's statement, with which he fully concurred.

There was one factor that had not been brought out completely, Mr. Mills continued, by those who argued for a considerable reduction in the level of free reserves. This was the psychological reaction that might be expected to that sort of development in financial markets and throughout the commercial banking system. It had been said, at least by the New York Reserve Bank, that the lower level of free reserves two weeks ago, and again in the following statement week, was attributable to unusual circumstances and did not reflect a change in the direction of System policy. If there should now be a very evident reduction in the level of free reserves, however, it would seem inevitable that the financial community would interpret this as a change in policy. Further, a time of year was at hand when banks and industries and commercial concerns were laying their plans for 1963. If there should appear to be a change in policy, reflected in a tightening of money market conditions or an apparent desire that the level of borrowings at Federal Reserve Banks should increase, he was fearful of the impact on the thinking of the financial community. Therefore, such a development could run contrary to the System objective of encouraging and fostering strong economic growth. Fortunately, over the period until the next meeting of the Committee, a considerable eddying in the movement of funds would not be apt to cause any great concern, whatever form System policy actions might take. He hoped they would not be in the direction of a restrictive change in the direction of policy, but fortunately he did not think much harm could be done even if that should be the case.

In conclusion, Mr. Mills said that he would make no change at this time in the policy directive or in the discount rate.

Mr. Wayne reported that the generally strong and steady pace of Fifth District business had not changed significantly during the past two weeks. The textile industry was still the biggest question mark as mill operators continued to report slight declines in orders, shipments, hours, and employment, and nominally higher inventories. Forward buying of cotton goods had been unusually light for several months, which had to a considerable extent deprived manufacturers of their customary guidelines for scheduling production. As a result, shortages of some fabrics and excess stocks of others had developed as buyers sought goods on short notice to meet changing current needs. This unusually cautious ordering of cotton goods was attributed to the belief that lower prices might soon result from Government action to eliminate the cotton price differential in favor of foreign buyers caused by subsidizing cotton exports. Other manufacturing industries had maintained high levels of activity. Furniture makers, busy all year but particularly since the fall market, reported a further increase in orders. Both gross farm receipts and farm expenses were up from 1961, so that net farm income would be about the same as last year. Next year was shaping up as an uncertain one for tobacco growers. The Department of Agriculture had reduced acreage allotments 5 per cent for flue-cured varieties and had indicated that it would take action through price support discounts in 1963 to force diversification of types planted and to discourage the use of the sucker control chemical MH-30, which increases yield but to some extent apparently at the expense of quality.

As he saw it, Mr. Wayne said, the national economy in the past two weeks had continued in the pattern set in November, with business sentiment reflecting somewhat more optimism than business developments. On balance, current business activity showed little net change and there was nothing on the horizon suggesting an early upsurge. At the same time, the hope for an early and substantial tax cut, one of the major factors sustaining business optimism, was encountering increasing controversy and uncertainty. Should the hope for tax reduction be postponed or fade away, there was likely to be a substantial lessening in business optimism, which could unsettle the present precarious balance. While there was a distinct chance of such unfavorable developments, there was little that monetary policy could do to guard against them other than to maintain a ready availability of reserves, as the System had been doing for many months.

In the policy area, Mr. Wayne noted that recent operations seemed to have been appropriate despite some unusual movements in the level of free reserves. Despite sharp declines in free reserves since November 21, the average rate on Federal funds had declined only slightly, bill rates had been fluctuating within a range of only a few basis points, loans and discounts of city banks had been showing healthy increases, and the money supply continued to rise moderately. No doubt these apparent inconsistencies had resulted in large part from a shift in the distribution of free reserves which largely offset the swings in their totals, but they illustrated the difficulties of undue reliance on free reserves as a policy guide. All available evidence indicated that sufficient reserves had been provided to meet and even to exceed the seasonal needs of the economy, and the Manager had maintained a steady tone in the money market, as instructed by the Committee in its most recent directive. Since there had been no significant change in economic developments during the past two weeks, Mr. Wayne saw no reason why the Committee should not renew its current directive. He would not recommend changing the discount rate at this time.

Mr. Clay expressed the view that a continuation of current monetary policy until the next meeting of the Committee would appear to be in order. Any tightening of policy would not be in keeping with domestic economic needs, which probably would be better served by moving toward further ease. On the other hand, it was difficult for him to see how the international balance of payments problem would be aided by a slight firming of monetary policy. Recent economic developments supported the view that there had been no basic change in the domestic economy in recent weeks. Despite improved sentiment and pluses in some economic indicators, the recent record in employment, industrial production, construction, and business capital outlays did not produce a picture of an economy showing significant advancement and progress toward fuller utilization of resources.

Mr. Clay noted that the above-seasonal expansion in business loans at weekly reporting banks in recent months had attracted considerable attention. This interest had been heightened by the fact that the business loan expansion occurred during a period when the level of economic activity had shown little improvement. The appropriate interpretation was not readily apparent. One possible view was that the expansion constituted evidence that credit was generally available at banks and that banks were actively promoting the use of credit. If this view was valid, then it was precisely the kind of improvement in credit availability that monetary policy should hope to promote under current conditions. A second view might be that the growth of business loans reflected shifts of financing from other sources and not a growth of total credit. It would seem that this possibility also would be regarded as favorable in terms of monetary policy, since nonbank funds would press for investment and improve interest rates and availability for borrowers in other areas of the credit and capital markets.

Pursuit of the monetary policy suggested by Mr. Clay for the next three weeks would have as targets a 90-day Treasury bill rate of 2.80 to 2.85 per cent, a Federal funds rate of 2-3/4 to 3 per cent, and continued expansion of member bank reserves on a seasonally adjusted basis. Operations would be conducted in longer maturities to the extent necessary to avoid undue pressure on the Treasury bill rate.

In Mr. Clay's opinion, no change should be made in the Reserve Bank discount rate. Apart from a possible change in the general form of the directive, he felt that the wording of the directive could be left unchanged.

Mr. Scanlon reported that economic trends in the Seventh District continued to be largely seasonal, with no clear-cut evidence of rise or decline. Despite the absence of material changes in statistics, reports from businessmen continued to reflect a modest strengthening of optimism, or at least less inclination toward a decline. A representative of one of the major auto manufacturers, while noting that new car sales were declining in December, interpreted recent developments, over all, as providing reassurance that sales of 1963 model autos and trucks would both continue strong. He noted that used car prices had held up surprisingly well, that cash customers were relatively numerous even after allowing for seasonal effects, that the proportion of more expensive cars had risen, and that inventories were at favorable levels.

Demand for business loans at weekly reporting banks in the Seventh District, after showing considerable strength in the past two months, appeared to have leveled off somewhat in the past two or three weeks. Consumer loans had shown a marked rise, but the increase in District banks' acquisitions of real estate loans and securities other than U. S. Governments had slowed.

As to policy, it seemed to Mr. Scanlon that the directive as presently stated was still appropriate. However, it was doubtful that the moderately less easy reserve position of the past two weeks would sustain a rise in reserves and money supply unless credit demands strengthened further, and he saw no clear evidence of this happening. He believed that a reversal of long-term rates to higher levels would be premature if it reflected more than seasonal pressures.

Due to the uncertainties in the money market and usual difficulties of reserve projections in the period until the next meeting, it seemed to Mr. Scanlon that it would be appropriate to make every effort to maintain an even keel in the market. He recognized that maintaining an even keel during this period might present problems to the Account Manager, and he felt the Manager should be given ample latitude in which to operate, but he would not object to a slight decline in the bill rate. He proposed no change in the directive or the discount rate.

Mr. Deming reported that there had been no recent developments of such significance in the Ninth District as to change the trends already in existence. The Reserve Bank's most recent sounding of sentiment--primarily business sentiment--in mid-December showed no particular change in the level of optimism. He had rather thought that the degree of optimism might have improved somewhat, but the survey showed no change from six months ago.

As to monetary policy, Mr. Deming said he would advocate basically a policy of no change. He would favor renewing the policy directive as now written. From Mr. Young's comments, and others he had heard, he thought he detected a feeling that the problem with respect to capital flows and interest rates involved more a question of confidence than a question of real movements of funds. There did not seem to be much that the Federal Reserve could do at the moment to change the basic balance of payments picture, or even the capital flows part of the picture. He did think, however, in light of some of the comments that had been made, that it might be of more importance than he had thought two weeks ago to insure that the short-term rate did not drop appreciably. Therefore, within the context of the directive, he would have the Account Manager pay somewhat more attention to the short-term rate during the next three weeks than to the level of free reserves.

Mr. Swan reported that in the Twelfth District there was no change in November from the seasonally adjusted rate of unemployment in October. However, it was encouraging to note that initial claims for unemployment benefits on an average weekly basis dropped materially in November after small increases in each of the preceding two months. Construction and retail sales apparently continued strong, with some slight further improvement in November. Estimates of cotton production as of the first of December indicated record yields in California, which should provide strong support for farm income through the year end. The cancellation of the Skybolt missile program was viewed with some concern in southern California because of the impact on the operations of one of the large aircraft firms in that area.

The major District banks, after having been rather consistent net buyers of Federal funds through the first week of December, were about in balance last week, and if anything expected to be net sellers in the current week. They did not expect, as of last Thursday, to be faced with any large volume of midmonth borrowing for tax purposes. Many savings and loan associations in California had announced an increase from 4.75 to 4.8 per cent in the dividend rate on share accounts, thus meeting the competition of a few aggressive associations that had offered the higher rate since the first of this year.

Turning to policy, Mr. Swan said he saw nothing in recent developments affecting either the domestic or international situation that provided a reason to change policy for the next three weeks. Therefore, he would like to see present policy continued. He had been rather surprised to see free reserves drop as much as they did with so little effect on the bill rate, the Federal funds rate, or member bank borrowing. No doubt this was related to the distribution of reserves as between country and city banks, and much of the decline in free reserves was associated with a decline in float. Next week there would presumably be a rise in float, possibly with some reflux of reserves to country banks. Thus, a considerably higher level of free reserves than $275-$300 million would have to be maintained if the same monetary policy was continued. In his view a continuance of the same policy would also mean a continuance of the underlying growth trend in nonborrowed reserves. Presumably it would mean also that member bank borrowing would not run significantly above a daily average of $100 million or thereabouts, with the Federal funds rate at 2-3/4 to 3 per cent, perhaps most often at 2-7/8 per cent. He did not anticipate a great shift in the bill rate. As Mr. Mitchell had said, if there was some decline, that might not be too meaningful unless it was associated with a significant widening of the covered spread between the bill rate in this country and those in Britain and Canada.

Mr. Swan concluded by saying that he would continue the policy directive in its present form and that he would not advocate a change in the discount rate at this time.

Mr. Irons reported that there had been no significant developments in the Eleventh District. Therefore, he would not take time to spell out the slight plus and minus movements that had been recorded around a high level of activity.

As to policy, Mr, Irons said that he did not see any need for a significant change, particularly during the next three weeks. He found himself getting into such fine shadings that perhaps they became almost meaningless. Certainly, he would not advocate any overt action or pressure in one direction or the other. If market conditions should tend to record a bit more firmness, he would not undertake to offset it. Nor would he deliberately undertake to add to the degree of ease in the market, for he felt that the current degree of ease was adequate and the position of the banking system was adequately liquid. Consideration should be given to the level of short-term interest rates, but he would not be too much interested in maintaining any specific level. The objective of the Desk should be to minimize to the extent practicable the movement of funds abroad; therefore, such influencing of short-term rates as may be required to achieve that objective would represent the proper approach. He would not be too much concerned about where free reserves happened to fall in the next three weeks; there undoubtedly would be large fluctuations in float as seasonal influences began to take hold. In these circumstances, free reserves could swing considerably one way or the other in a nonpredictable way. The Account Manager would have to give close attention to the tone and feel of the market, trying to maintain conditions that would be appropriate to the Committee's basic objectives from the standpoint of both short-term rates and the adequacy of reserves.

Mr. Irons indicated that he would not favor changing the policy directive; what he advocated for the next three weeks could be accomplished within the framework of the present directive. He would not recommend changing the discount rate at this time.

Mr. Ellis noted that reports from downtown Boston department stores had been showing sales running behind year-ago levels by some 6 per cent. However, improvement was noted beginning last week. If it were to continue, the stores might come out even with last year, with the District as a whole up about 2 per cent on Christmas sales. In general, District data that had become available during the past two weeks seemed to indicate that business sentiment was stronger than the statistics. It also seemed that the demand for bank credit was stronger than the economy from which it emerged. While New England manufacturing output had declined for two months, seasonally adjusted figures for commercial and industrial loans were up 4 per cent on an annual rate.

In reviewing policy considerations, Mr. Ellis noted a lack of evidence that the economy was surging ahead. There continued to be a serious underutilization of resources and there was no present evidence of inflationary pressures. The burden of proof seemed to rest on those who advocated any change in the present policy of substantial monetary ease. At recent meetings, and again today, Mr. Hayes had urged a greater recognition of the balance of payments and flow of funds problems as the basis for some slight lessening in the degree of monetary ease. Mr. Ellis was inclined to agree, although he tended to feel that in present circumstances the Committee should be glad to settle for not losing ground in short-term rates in the face of the pressure that he thought would be forthcoming in the first part of next year. He was, however, prepared to suggest some slight movement in the direction of less ease for the following reasons also. The System had been able to maintain a substantial position of ease through 1962, with free reserves in excess of $400 million on average, largely because credit demands had been satisfied through available funds. But if the seasonal adjustments could be accepted, one must conclude that the underlying situation had changed after midsummer. Since August commercial and industrial loans had expanded at a 7 per cent annual rate, which impressed him as evidence of a strong underlying demand and an unsustainable longer-run rate of growth. Similarly, required reserves had increased at an 8.5 per cent annual rate and the money supply at a 6 per cent rate, or 10 per cent if time deposits were included. The earlier shortfall from the growth guideline for required reserves against private deposits had been eliminated. Each person must apply his own conclusions to these data, but his conclusion was that business and industry were taking more initiative in expanding the use of credit. If the same degree of monetary ease that had prevailed were continued, he felt that the sharp expansion of reserves would carry above a sustainable rate of growth. Therefore, he believed that the Committee should make a small move toward less ease. He would suggest $300 million as a free reserve target, with Federal funds usually at 3 per cent and the bill rate around the recent level of 2.8 per cent.

Mr. Ellis said he would not recommend changing the discount rate at this time. As to the directive, he felt that the suggestion of Mr. Hayes--with perhaps an addition to the second paragraph--would be an appropriate reflection of the thinking of those who wanted to move toward slightly less ease. It seemed to him that Mr. Hayes' draft emphasized support of the bill rate. He (Mr. Ellis) felt that basically the situation continued to call for providing a moderate expansion of reserves in the banking system. Therefore, he would suggest adding to the second paragraph the phrase: while continuing to provide moderate reserve expansion in the banking system.

Mr. Balderston said that he found himself allied with the position taken initially by Mr. Hayes and supported later by certain other members of the Committee. He recalled having observed at the two preceding meetings that he was a little disturbed about the posture of the System in the event an international payments crisis should develop. Therefore, he felt it appropriate today to set forth the outline of a policy that might provide a better posture.

Mr. Balderston noted that Chairman Martin had observed many times that this country's domestic and international problems should be considered inseparable. As Mr. Balderston saw it, these twin problems challenged monetary policy at two levels, fundamental and transitional, and the System's policy response must be structured accordingly. Domestic costs should be kept under control, in order gradually to restore the world-wide competitiveness of U. S. industries and forestall domestic inflation, while at the same time avoiding deflationary pressures. In this respect, he was heartened by the relative stability of unit labor costs and the price of goods during a period when the unit costs of this country's chief competitors were beginning to rise substantially. With five successive years of relative stability of U. S. prices and unit costs, continued success in this area seemed to be within grasp, but it might take several years more for the fundamental correction to be accomplished. In the interim, policy faced another challenge, that of helping to guard this country's gold reserves and the soundness of its credit against disequilibrating flows of funds. The point might be approaching where some further outflow would develop if bill rates were not sufficiently high.

Continuing, Mr. Balderston said that in view of the liquidity already made available to the domestic economy since the trough of recession, he would now suggest lowering free reserves experimentally to the point where commercial banks ceased to add to their investments but did not sell Governments in order to make loans. He would supply just enough reserves to take care of loan demand without adding to or subtracting from the liquidity of the commercial banks. This would represent a policy of moderately less ease. The question was, however: how much less ease? As a guide for the time being, he suggested watching two storm signals. On the one side, the most convenient guide might be reports of the transfer of hedged short-term funds. On the other side, the guide might be the trend of seasonally adjusted private deposits or an upward creep of loan-deposit ratios suggesting action by the banking system to accommodate loan demands by divesting investments. A policy such as he had sketched would keep Federal funds at the maximum rate and would keep the volume of member bank borrowing from the Federal Reserve Banks near the top of the range of discounting that had existed for about two years. For testing purposes, he would suggest a level of free reserves of $250-$300 million in the hope that this change would offset the seasonal downward pull on the bill rate. Feeling as he did about the fundamental policy position, he would favor a change in the directive such as Mr. Hayes had proposed.

Chairman Martin stated that he would cast his lot with those who favored slightly less monetary ease. In this connection, he added the comment that he did not consider the use of the word "tight" applicable at the present time. In his view it was not a case of the domestic economy suffering at the expense of increased attention to the balance of payments. As he had said many times, he believed the problems were inseparable, and he also believed that the domestic economy had been gotten into a sufficiently liquid position. For the past few months he had done his best to try to convince himself that additional monetary ease would alleviate unemployment and abet economic growth, but it was his conviction that additional ease would do just the reverse. In his judgment the balance of payments situation was the biggest single shadow over the domestic business picture. If it could be alleviated, he believed there would be a stronger and more confident domestic business outlook. For a number of months, he noted, attention had centered on the domestic situation almost to the exclusion of the balance of payments problem, but over the next several weeks there was likely to be a marked increase in the discussion of the balance of payments in view of the figures that would shortly be released. He could not believe that a slightly less easy monetary policy would in any sense collapse the domestic economy.

In fact, such a change in emphasis might lead to a strengthening of confidence and an improved attitude on the part of businesses and business investors.

The Chairman went on to say that if the Committee was going to shift in the direction of slightly less ease, the policy directive probably ought to be changed. At the two preceding Committee meetings, he recalled, the majority decision had been to make no change in policy. In the light of today's discussion, however, he proposed to poll the Committee on the basis of slightly less ease, after which the policy directive could be discussed. In this connection, the Chairman again referred--as he had at recent meetings--to the problem involved in the use of phrases such as "slightly less ease" or "moderately less ease." He was not sure how this problem might best be approached. He had found through experience that words had different meanings to different persons, according to each person's concept of what was involved. The discussion scheduled for this afternoon with regard to the formulation of the current economic policy directive might shed some light on how to deal better with this problem.

Accordingly, the Committee members were polled on the question of a shift in policy toward slightly, or moderately, less ease. Chairman Martin and Messrs. Hayes, Balderston, Ellis, Fulton, King, and Shepardson indicated that they would favor such a shift while Messrs. Bryan, Deming, Mills, Mitchell, and Robertson indicated that they would not.

In connection with the foregoing poll, Mr. Mills commented that if the level of free reserves were brought down to $250 million and there was a normal reaction to that level of free reserves, he felt that this would represent an important rather than a modest tightening. Chairman Martin noted that this again went into the area of interpretation, pointing up the problem he had mentioned in his earlier remarks. Mr. Hayes noted that he had suggested a range of free reserves from $200 million to $400 million, in the thought that considerable leeway would be desirable.

The discussion then turned to the policy directive, and it was suggested that there be put to the Committee for purposes of a vote the directive suggested by Mr. Hayes, as amended by the addition of a clause such as mentioned by Mr. Ellis, which would call for continuing to provide moderate reserve expansion in the banking system.

There ensued a discussion during which Mr. Hayes indicated that he would be agreeable to a modification of the kind Mr. Ellis had suggested. He had not included such a clause in his proposed directive because of uncertainty as to the seasonal movement, but that was something of a technical question. If it was understood that references of this kind were always intended to take into account seasonal adjustment, he would see no objection to including the clause Mr. Ellis had suggested.

Mr. King expressed the view that the directive he had proposed would accomplish basically the same purpose as the directive proposed by

Mr. Hayes. The only question he would have with regard to the wording of the directive suggested by Mr. Hayes was whether it might not indicate that the Committee was acting out of a sense of trepidation by stressing unduly the international situation.

Mr. Hayes commented that perhaps some indication of trepidation would be prudent under present circumstances, and Chairman Martin said he would be inclined to share that view.

There followed a reading of the directive proposed by Mr. Hayes, as modified by the suggestion of Mr. Ellis, after which Mr. Bryan inquired whether "continuing to provide moderate reserve expansion" was intended to suggest that the Committee would endeavor to continue to follow the 3 per cent growth guideline in required reserves against private deposits. Mr. Ellis noted that similar language was found in recent directives, during which period staff projections had included the 3 per cent growth guideline. Mr. Mitchell suggested that this objective might be incompatible with the rest of the proposed policy directive, and Mr. King pointed out that he had referred in his proposed directive to providing for a "slight" rather than a "moderate" continued expansion of bank reserves. He went on to say, however, that he was not inclined to press for such a change.

Upon request the wording of the directive proposed by Mr. King was then read to the Committee, and after further discussion Mr. Hayes suggested that the Account Manager be asked for his opinion as to whether the directive that he (Mr. Hayes) had suggested would be workable if there was included in it the phrase calling for continued moderate reserve expansion in the banking system.

Mr. Stone said he would interpret this phrase to refer to seasonally adjusted figures. If that was the interpretation, he thought the directive would be workable, and he would see no incompatibility with the other parts of the directive. He considered it possible to obtain an expansion of bank credit along with firmer money market conditions. In any event, he noted that the Committee would be meeting again in three weeks, at which time the question could be reviewed. Mr. Stone also stated that in his opinion the directives proposed by Mr. Hayes and Mr. King were fairly close together. He observed that this was a particularly difficult time of year, due to the likelihood of wide swings in market positions, to try to draw fine distinctions.

In further discussion of the respective proposals, Mr. Hayes suggested that the setting of a principal target in terms of free reserves in the present period might create difficulties. Therefore, he would be inclined to place more emphasis on the short-term rate, letting free reserves fall where they would.

Mr. King commented, in respect to the phrase proposed by Mr. Ellis, that he believed a close reading of the Committee's directives over a period of time would reveal that references to bank reserves were intended to take into account seasonal adjustments. He also noted that over the past few months there had been a substantial monetary expansion while the Committee's directives called for a moderately firm tone in money markets. He was inclined to feel that the 3 per cent growth guideline would not necessarily be incompatible with a directive in terms such as Messrs. Hayes and Ellis had suggested. He added that he would be agreeable to accepting such a directive, noting, however, that in his opinion it would not go quite as far in the direction of lesser ease as the directive that he (Mr. King) had suggested.

Thereupon, upon motion duly made and seconded, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Open Market Account in accordance with the current economic policy directive:

It is the current policy of the Federal Open Market Committee to accommodate moderate further increases in bank credit and the money supply, while aiming at money market conditions that would minimize capital outflows internationally. This policy takes into account the lack of any significant improvement in the United States balance of payments and the recent substantial increase in bank credit, but at the same time recognizes the unsatisfactory level of domestic activity, the continuing underutilization of resources, and the 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 offsetting the anticipated seasonal easing of Treasury bill rates, if necessary through maintaining a firmer tone in money markets, while continuing to provide moderate reserve expansion in the banking system.

Votes for this action: Messrs. Martin, Hayes, Balderston, Ellis, Fulton, King, and Shepardson. Votes against this action: Messrs. Bryan, Deming, Mills, Mitchell, and Robertson.

In a footnote comment to the preceding discussion, Mr. Hayes noted that several of those who spoke today had seemed to suggest watching the covered bill rate spread almost to the exclusion of other rate considerations. He noted that a representative of the New York Reserve Bank, Mr. Klopstock, had testified recently before a subcommittee of the Joint Economic Committee on the sensitivity of short-term capital flows to interest rate movements. The comments of Mr. Klopstock had been distributed to the Committee, and Mr. Hayes felt that they would be of interest. Covered bill rate spreads admittedly were important, but they did not provide the whole picture.

The meeting then recessed and reconvened at 1:50 p.m. with the same attendance except that Messrs. Rouse, Sanford, and Williams were not present.

This afternoon's session of the Open Market Committee had as its purpose a discussion of the current economic policy directive and its formulation. There had been distributed to the Committee, under date of November 2, 1962, sample directives for several Committee meetings in a form suggested by Mr. Knipe, former Consultant to the Chairman of the Board of Governors, together with a memorandum from Mr. Knipe dated October 10, 1962, entitled "Writing a Directive." In preparation for today's discussion, there had also been distributed to the Committee for convenient reference excerpts from the minutes of the Committee meeting on December 19, 1961, and copies of the directives issued by the Committee since that date.

In introductory comments, Chairman Martin expressed the view that regardless of what might come out of this meeting, the Committee should undertake a review of this kind periodically. After referring to the material that had been distributed, he noted the practices that had been followed during the past year in drafting the current policy directive. He went on to say that Mr. Knipe had given considerable thought to the subject, particularly with a view to trying to develop a type of directive that would make a readable presentation of Committee policy. The question was whether the Committee would be able to reach agreement on any formulation along lines such as Mr. Knipe had suggested and, if so, whether that would be desirable. The Chairman also noted that Mr. Bryan, in particular, had over a period of time done considerable work looking toward the possibility of using quantitative guides in the directive. The thought of using such guides admittedly had an appeal. At the same time, on occasions when he had visited the Trading Desk he had been impressed by the difficulties involved in actual practice in attempting to conform to a target such as a given level of free reserves. A related problem involved the question of public interpretation. Sometimes, for example, it might be assumed that there had been a shift in policy because of a change in the level of free reserves when actually there had been no such shift.

The Chairman then suggested that there be expressions of views around the table on the subject of the formulation of the current economic policy directive and related matters.

Mr. Hayes, who was called upon first, noted that Mr. Knipe had provided a stimulating paper which focused attention on a problem that had faced the Committee for a number of years. However, Mr. Hayes did not share Mr. Knipe's dissatisfaction with the kind of directive being used at the present time. Looking back over the directives that had been used during the past year, Mr. Hayes found recorded in them about the degree of emphasis intended and almost every major factor to which the Committee had given attention in reaching its policy decisions. Among other things the directives recorded concern about the utilization of resources, dissatisfaction about the rate of economic growth, recognition of the desirability of monetary and credit expansion, concern about the short-term interest rate, and concern about capital flows and the balance of payments. Also, when appropriate the directives included statements on special factors such as Treasury financing, the stock market break, and the Cuban crisis. On the whole, therefore, he felt that the directives provided a fairly intelligible record of the things looked at by the Committee and the way the Committee felt. He would not want to say that the directive could not be improved, but he doubted whether the type of directive suggested by Mr. Knipe was in the right direction. He considered the present form of directive a major improvement over the old "clause (b)." Furthermore, only one example of the present type of directive had yet been published. Unless the Committee was convinced that there was some substantial defect in the present form of directive, it seemed to him that it would be advisable at least to await the reaction when the record of policy actions for 1962 was published in the Board's Annual Report.

Turning more specifically to the suggestions of Mr. Knipe, Mr. Hayes said he was quite concerned about what he would regard as too much emphasis on free reserve statistics and too little emphasis on the tone and feel of the market. The free reserve figures tended to jump around in a most unpredictable way, especially at certain times of the year, and any effort to pinpoint a free reserve target might produce difficulties. On the bill rate, he again felt that Mr. Knipe tended to set up too binding a formula. Mr. Hayes went on to say that when the Committee suggested that the Desk be guided by the tone, color, and feel of the market, he did not regard that as an abdication of the Committee's responsibilities, which seemed to be the interpretation of Mr. Knipe's memorandum. Instead, Mr. Hayes believed that the Committee should take advantage of the Account Manager's judgment based on the full range of market developments each day. With the broad range of indicators that were available, the Manager could not only provide whatever general level of free reserves the Committee regarded as appropriate but adjust up or down according to the way the economy and the banking system were responding. This was continually reflected in the behavior of the market indicators, and he felt the Committee's objectives were helped substantially by permitting the Manager a degree of flexibility. He had been impressed over the years by the tendency of many members of the Committee to stress the need for flexibility, and he was not sure that the kind of directive suggested by Mr. Knipe would permit it. Mr. Hayes pointed out that the Manager's judgments and actions were subject to criticism and review at Committee meetings, in addition to which any member could raise questions on the basis of the daily telephone conference or the written reports. He would caution especially against using quantitative guides or targets in the way suggested by Mr. Knipe. Certainly the Committee wanted to give appropriate instruction, but in the go-around at Committee meetings the Manager was given about the kind of guidance he needed. If numerical guides and targets were included in the directive, the Committee would run a severe risk of limiting the necessary flexibility.

As to Mr. Knipe's proposal to show in the directive background economic factors that were considered, Mr. Hayes said he was doubtful as to the value of that device to convey the atmosphere in which the Committee's directives were issued. The sample directives enumerated certain background facts but did not evaluate them or indicate how they were related one to the other. Further, the omission of certain facts might raise questions. For instance, he found no reference to the international position of the dollar or to balance of payments figures. A listing of facts might help someone to know what kinds of statistics were available to the Committee, but it would not disclose how much emphasis was placed upon them.

Mr. Hayes went on to say in reviewing the discussion on December 19, 1961, he noted that several Committee members had pointed out two problems. The first was the problem of conveying to the Manager an indication of what the Committee wanted in sufficiently accurate form so that the Manager would know what the Committee intended and could act accordingly. This continued to be something of a problem, but he felt that there had been an improvement. The second problem was one of giving the Congress and others an adequate explanation of why the Committee had done what it did. Mr. Hayes felt that the Committee had gone quite a long way through the use of the first paragraph of the present form of directive in providing a statement of the factors it had considered. He was not sure that the Committee had gone far enough, however, and he would revert to the idea that perhaps an explanation of policy might be published quarterly in the Federal Reserve Bulletin to give more insight into what the Committee was doing.

Mr. Ellis suggested that the problem of the directive had three major aspects. First, there was the procedural technique used in creating the directive. Second, there was the content of the directive. Third, there was the question of providing a policy record for subsequent publication. To take up those questions in reverse, he felt that a quarterly publication after an appropriate time lag might serve a useful purpose in contributing to a better understanding of monetary policy. It would relieve the criticism of delay in the availability of information. Further, it would not appear to endanger the confidential character of monetary actions; the policy record for the fourth quarter of each year was already released after a lag of one quarter.

As to the content of the directive, it appeared to Mr. Ellis that the concern of the Committee went largely to the degree of exactness that should be sought in describing economic objectives and specifying how monetary actions were to be implemented by the Manager. The Committee's discussions in the past had revealed a wide range of opinions on how detailed and precise the directives should be. Some felt that too much detail would lead to substantial problems because the Manager would be too limited, or to criticism if the Manager failed to come close enough to the targets specified in the directive. Mr. Ellis felt that the Committee had a fundamental responsibility to provide the Manager with as clear and exact instructions as the Committee was able to produce as the result of its deliberative sessions. To do less would be to abdicate responsibility to the Manager. The Manager must be given latitude to exercise judgment in achieving short-run objectives, but the delegation of authority should not extend too far. The question was whether the Committee was doing as good a job of communication as it could in providing guidelines and instructions to the Manager. The question of writing a good directive for purposes of explanation seemed to him of secondary importance.

Because there was such a wide range of views about the degree of exactness in the directive that was feasible or desirable, Mr. Ellis found himself reconciled to the feeling that progress could be made only in small steps. The need, therefore, was for a procedure that would keep progress alive throughout the year and enable experimentation. He concurred in the view of Mr. Hayes that some progress had been made during the past year. The first paragraph of the directives covered in a timely way many of the events of the year. However, he felt there had been a tendency to make the directive shorter and use more general language, thus tending to get back to the old clause (b). This led him to make two recommendations for modest procedural changes. First, he felt that the Committee should have its staff members who presented statements on economic and financial developments extend their remarks to the point of suggesting a level of free reserves, a bill rate, and a Federal funds rate that would be consistent with their analysis of the effect that monetary policy should be exerting on the economy. This did not mean that the Committee would necessarily accept those figures or targets, but he believed it should have the benefit of hearing from its technicians what their analyses suggested in terms of immediate objectives. In that manner the Committee members would be provided with benchmarks on which to base policy recommendations. Also, this would introduce early in the discussion some of the current measures for expressing policy direction, and the members could indicate what emphasis they would place on the various measures. In this way, perhaps, it might be possible to move through experimentation toward more exactness in the directive.

The second recommendation of Mr. Ellis was that the Committee's Secretary be charged with presenting at each meeting at least two drafts of possible directives. In formulating them the Secretary could call on the Account Manager or other members of the staff to the extent he thought desirable. Broadly speaking, Mr. Ellis said, the Committee always had three policy alternatives: no change, less ease, or more ease. The first course would be covered by the existing directive, and the two alternatives would be covered by draft directives that would be available at the outset of the meeting. During the go-around any member who believed the directive should be amended could also suggest language of his own, preferably in written form so that it could be studied. In the alternative, a member might ask the staff to draft a directive that he could endorse.

In short, Mr. Ellis felt that the Committee had not fully utilized the drafting capabilities of its staff. If his two recommendations were adopted, Mr. Ellis believed that the Committee at least would start each meeting with a common benchmark and with possible targets summarized. He hoped that the Reserve Bank Presidents might consider shortening their regional summaries and devoting more attention to policy objectives and to their choice among the policy alternatives. More discussion of the directive should help to harmonize viewpoints and help in the adoption of the directive at the end of the meeting. The directive, of course, should be decided upon before the Committee adjourned.

Mr. Irons said it seemed to him there were a number of issues involved. First, there was the purpose of the directive: for whom it was being written. The Manager of the Account or an alternate would always be at Committee meetings and would know how the Committee arrived at the directive. Also, a directive of the kind now used was better, in his opinion, than those that had been used in the past. Considering this improvement, along with the fact that the Manager was in attendance at the meeting, he thought in most instances the Manager was in a position to carry out the directive about as accurately as could be hoped. If the Manager was not clear, he could request clarification at the meeting.

However, Mr. Irons noted that there had been other criticisms of the directive, including criticism from members of the Congress. Therefore, there was the question of making the directive clear to the public, in order to help answer such criticisms. But the more things that were introduced in the directive, the more difficulties would be involved. There was the question, for instance, whether the Committee should attempt to show how it arrived at the directive. Some of that thinking was found in the suggestions of Mr. Knipe, who talked about background facts that were considered by the Committee. The trouble was that the Committee did not reach its conclusions simply by examining such things as the production index, the number of unemployed, and the price level. The Committee members obtained from the staff of the Board, from the Federal Reserve Bank of New York, and from others within the System a wealth of material that was valuable, almost indispensable. This material was all read and studied by the Committee members in reaching their conclusions. Out of that whole package came the comments around the table at Committee meetings as to the direction in which policy should be moving and the means of attaining the desired objectives. It seemed to him that it would be difficult to state exactly how the Committee reached a conclusion without spelling out all of the basic facts in the materials that were put together. He had thought that something might be done by way of supplementing what was now included in the record of policy actions, but this would not be the same thing as supplementing the directive itself. For example, he would hesitate very much to say to the Manager that he was directed to keep free reserves at any particular figure over a period of three weeks; a severe snowstorm might invalidate such a directive immediately. Thus, such a directive would always be subject to question if it was not precisely achieved. He had thought at times about being more specific, but he had swung back to the feeling that a more general directive was preferable, although the directive should be meaningful and understandable. He felt that the directives in their current form did have meaning, although they could no doubt be improved somewhat. The directive should cite the main principles the Committee had in mind and the objectives the Committee was trying to reach. On the other hand, he did not think that the directive itself should attempt to make clear to every interested reader what the Committee did and how it used the available materials. He was also fearful of specific directives because he doubted whether it would be possible for a large number of people to reach agreement. Instead, he felt that some explanatory statement might be published along with the directives when they were released, but that would be separate from the directive. He was also fearful of trying to work with just two, three, or four guides and saying that this was what the Committee had agreed upon.

In summary, he would keep the directive in fairly general terms, pointing out the objectives that the Committee was trying to reach and instructing the Manager as to the direction in which the Committee was seeking to move.

Mr. Irons said he could understand that an outsider--even though fairly well informed, might have difficulty in getting a great deal of meaning out of the directive. However, he thought it should be possible for persons in the academic world to read the directive, use the available factual information, and understand reasonably well how the Committee arrived at the directive it gave to the Manager. He came back to the thought that the present form of directive was much better than the form of directive previously used. He would have some qualms about a directive being drafted in advance and submitted to the Committee early in the meeting as a directive that might be applicable. On the other hand, it would be appropriate for any Committee member--in a personal capacity--to bring in a proposed directive.

Chairman Martin commented at this point on certain views that had been expressed to him from time to time by thoughtful members of the Congress. He referred to one member of the Senate as having felt at one time that after each meeting the Open Market Committee should issue a statement as to what it was doing. However, this Senator subsequently changed his thinking and reverted to the position that perhaps it was best to follow the procedures that were established by the Congress in the Federal Reserve Act. This Senator also made the point, though, that there was a tendency to issue directives that were intelligible solely to the Open Market Committee, with amplification available only when a representative of the Federal Reserve System appeared before a Congressional Committee. Chairman Martin said he thought it would be generally agreed that within the context of the Committee discussions the directives were intelligible to the Committee itself. However, if the Annual Report included merely the directives that had been issued at the 18 Committee meetings this year, without further commentary, something could be said for the criticisms that had been made by members of the Congress and academicians. If on the other hand, the Annual Report included a full review of everything that went on in Open Market Committee discussions during the year, it would become a sizable document, considerably changed in character from the documents that had been issued. These were all facets of the broad problem of communication.

The go-around then resumed, and Mr. Swan said he saw two principal problems. First, there was the general question of communication in terms of explaining why the Committee did what it did. In this regard, he would favor further exploration of publishing some kind of quarterly article, either an expanded policy record or a separate article that would not duplicate the policy record. He would prefer the second alternative. However, this was apart from the question of the directive per se. There remained the question of what the Committee wanted to convey to the Manager and how it checked on what was done. He agreed with those who felt that the type of directive issued this year was much better than the old clause (b), although he had some question about the second paragraph of the directive. The first paragraph was a summary of general background, but when it came to the implementation of policy he thought the Committee could become more detailed and specific. It had been said that this was not necessary because the Manager was in attendance at the meetings. However, he did not think that was a complete answer, partly because other people read the directive at some point and partly because, as had been noted, the directive meant different things to different people. If so, the directive might mean something different to the Manager than to the other people around the table. Further, while he recognized the need for some degree of flexibility, he rather cringed at trying to defend the phrase "tone, feel, and color of the market" because he did not know exactly what it meant and he did not think anyone else did. The Manager had to translate this phrase into some kind of quantities; and if the Manager had to do so, it was really the job of the Committee to do the same thing. He said this with full regard, as he had indicated, to the need for maintaining some degree of flexibility, and this was where he would object to the emphasis placed by Mr. Knipe on free reserves. Instead, he thought it was a matter of trying to move toward a quantification of a number of factors, such as free reserves, total reserves, nonborrowed reserves, the Federal funds rate, the short-term rate, other rates, and member bank borrowing, so as to give some king of quantitative guidance in terms of several measures, with recognition also of the fact that there should be some indication of priorities. Granting the difficulties involved, he nevertheless would like to describe the boundaries of the problem in more quantitative terms. When the Committee issued a directive to the Manager it was supposed to direct him along certain lines, and to provide him appropriate guidance. Also, the directive should give an outsider the feeling that the Committee had given the Manager reasonably clear direction.

Chairman Martin commented that he thought Mr. Knipe, if present, would say that he had been trying to suggest exactly what Mr. Swan was advocating. Mr. Knipe had provided samples of possible Committee directives, but he had recognized that the Committee might use various kinds of specific guides. The difficulty was in trying to determine the things that might appropriately be quantified. Over a period of time, Mr. Knipe had experimented with many different types of directives; the samples that had been distributed constituted only a representative group of ideas.

Mr. Deming said he thought Mr. Knipe had made a notable contribution to the thinking on the directive. Mention had been made, he noted, of the difficulties of precise quantification. Due to the nature of movements of free reserves, it seemed almost impossible to use that alone as a meaningful guide to the Manager and to expect him to account for his actions. Borrowing from Mr. Knipe's classification of objectives--proximate, intermediate, and ultimate--and recognizing that the Committee could not reach from the proximate through to the intermediate, or certainly the ultimate, with any degree of precision, one possibility would be to attempt to make the first paragraph a statement in terms of the intermediate and ultimate objectives and conclude it with a statement that policy, in light of the background facts and these objectives, should be more stimulative, less stimulative, or about the same. That was in fact what the Committee did in arriving at a consensus; it would amount to putting the consensus into the directive. Then, the second paragraph could cite proximate objectives, in terms of such things as free reserves, interest rates, and the color, tone, and feel of the market. He tended to agree, incidentally, that there should be something more specific than just a reference to the color, tone, and feel of the market.

Mr. Deming expressed agreement with the view that it was difficult to write a directive for the general public. The directive had to be primarily an instruction to the Manager. It should be phrased precisely enough to make the Committee's position meaningful to the Manager, and to enable some appraisal of performance. He noted that the Committee members all went through the examination of a lot of indicators and applied judgments to a complex economic situation. This could not be presented in full detail in the directive. Probably the Committee could do a little better with its explanation in the policy record, although he had practiced writing some sample policy record entries and did not find himself too well satisfied.

Reverting to the type of directive that he had suggested in his comments, Mr. Deming read a form of directive that might have been issued at the December 4 meeting in conformity with such an outline.[1/] He noted that in substitution for setting forth as a matter of policy that the Committee wanted to encourage increases in the money supply and bank credit, the suggested form of directive would merely report that these were intermediate and ultimate objectives and then proceed to a general policy statement. He noted that a problem had existed this morning in using terms such as a moderately less easy or a slightly less easy policy, and he felt that some progress could be made in resolving this problem and enabling a meaningful determination of the consensus. In the second paragraph of the directive he would avoid specific figures, preferring to say, for example, that open market operations should continue to

1/ Appended to these minutes as Attachment A.

provide about the same degree of availability of reserves and a steady tone in the market, with particular attention to short-term rates, and that they should be consistent with maintaining the Federal funds rate close to the discount rate and a nominal level of member bank borrowing. Such a directive would be specific, but it would avoid the use of numbers, and it should permit the Committee to judge the performance of the Account Management in the ensuing weeks. It would avoid "pious hopes" and focus attention on things the Committee actually could do. The first paragraph, which would constitute principally a recital of major objectives, would form a springboard to the instruction to the Account Manager in terms of proximate goals. In Mr. Deming's view, the explanation of the Committee's directives had to be carried through by the policy record entries, by quarterly articles, or by testimony before Congressional committees. This could not be provided in the directive itself.

Mr. Scanlon said he had gone through much the same thinking process as others around the table. He had questioned the current type of directive and had tried to write a quantitative directive, but got into trouble. Thus, he had ended up with a type of directive similar to that described by Mr. Deming. The first thing to determine was the purpose of the directive, whether it was to provide a clear indication to the Manager of the wishes of the Committee or whether an attempt should be made to write a directive to answer outside critics.

In his opinion, the latter course would be futile, for the critics would never be satisfied. On the other hand, if it was felt that the general public was not getting all of the information it should have, a type of directive such as suggested by Mr. Deming should be helpful. Mr. Scanlon also commented that he would be in favor of considering some type of quarterly article.

Mr. Clay said he did not think the Committee could or should attempt to meet the criticism that the directive should be in such form as to be understood easily by outsiders, even by readers who were not knowledgable in the monetary field. To understand, people had to interest themselves in the subject. Further, he did not believe he could ever agree to a quantitative directive, nor did he think that such a directive would stand the Committee in good stead either in instructing the Manager or from the standpoint of external review. The same quantities would have varying impacts in money and financial markets according to the conditions that existed at particular times. This did not mean, of course, that the Committee should not continue to strive for improvement step by step from its present position. He noted that in many fields there were "words of art" that had definite meaning to those in the particular field. The Committee should keep trying to develop words that would best describe the impact of the directive on financial markets.

In reading the directives for the current year against the previous year's record, Mr. Clay felt that the Committee had been giving better directions to the Desk, and that was the essential purpose of the directive. Further, he felt that this year's record would be more readable to persons outside the System. He would object strenuously to requesting the staff to bring in alternative draft directives at the beginning of a meeting; in his opinion this was a Committee responsibility that should be accomplished at the meeting. He noted that it had been suggested last year that a period be provided within each meeting in which the staff could draft a directive after learning the thinking of the Committee, and he was not sure that this procedure had been experimented with sufficiently. Through this method, he suggested, it might be possible to develop "words of art" that had definite meaning in the monetary field.

Mr. Wayne commented that he had come to this meeting with a rather long memorandum, one that he now thought did not cover the subject as precisely as the comments of Mr. Deming. Therefore, he would simply express concurrence with Mr. Deming as to the type of directive that would come close to accomplishing what the Committee desired. The second paragraph of such a directive would not cite figures, and Mr. Wayne thought it would be unwise for the Committee to tie itself down to precise figures in the directive. Today's precision could be tomorrow's regret. As soon as the Committee put the directive in precise terms, it might find itself in an intolerable situation.

Mr. Wayne indicated that he would not be concerned about having the staff prepare alternative drafts of directives, for purposes of discussion, along the lines that Mr. Deming had suggested. Basically, there were only three alternatives: No change, more ease, or less ease; and he saw no reason why the staff should not suggest drafts that would accomplish those alternatives in order to provide a basis for discussion.

Mr. Wayne said he continued to feel strongly that the Committee should consider the publication of quarterly articles. He would entertain some reservations about having such articles include the directives and would prefer that they be directed toward longer-run objectives and how the Committee sought to achieve them. It might be better to reserve the publication of the directives for the Annual Report.

Chairman Martin commented at this point that if the practice of issuing quarterly reviews was started it could hardly be stopped, and there might be times when the situation was not such as to lend itself particularly well to explanation on a quarterly basis. Further, this method of reporting would go beyond the terms of the Federal Reserve Act, as the Act was now drawn, and he saw certain advantages in proceeding in accordance with the statute. If reviews were issued, the press would tend to look for them on particular dates, as the result of a procedure initiated voluntarily by the Federal Reserve and not called for by statute. The System might then be more vulnerable to suggestions for the publication of other material, including, for example, releases after each Committee meeting. These were all things that should be borne in mind.

Mr. Mills said he would continue to prefer going back to the clause (b) formula, with clause (b) an abbreviation of what now comprised one paragraph of the double-headed directive. Then, when the record of policy actions was published in the Annual Report, the explanation of the economic and financial situation should be sufficient to indicate reasons for the directives. Today's discussion pointed up his concern that the Committee was drifting into a position where it was giving more attention to the wording of the directive than to the development of policy. It was following the history and pitfalls of religions in which the observance of ritual became more important than devotion to faith.

Mr. Mills said he was not attracted to the idea of issuing a quarterly report because he believed that inevitably it would develop into a postmortem of what had transpired in operating the Account and a defense of what had been done, as contrasted with a clear-cut explanation of the policy actions themselves. He would be opposed to the development by the staff of alternative draft directives in advance of a Committee meeting because he felt that sooner or later this would result in less independent thinking on the part of members of the Committee.

Mr. Robertson commented that the directive should be drafted with such precision as to enable the Committee and the Manager to know what it meant. He did not care particularly whether that was done by using words or figures. How the directive was seen from the outside was also important, and he thought what was needed was the kind of statement suggested by Mr. Deming for the first paragraph. This type of statement could hardly be drafted around the table at Committee meetings. But it seemed to him that such a statement should precede the specific directive so that the latter could be read in the light of factors that had been considered by the Committee. This would make the directive more understandable.

Instead of publishing a separate quarterly article, Mr. Robertson was inclined to feel--although he was not sure--that it might be preferable to have a release of the policy record, perhaps augmented in some respects to show the kinds of facts the Committee had considered, with release on a quarterly basis after a three-month lag. He would also favor releasing all Committee minutes after an appropriate lapse of time.

In response to a question as to how the explanatory material he envisaged in the policy record would differ from what was now included, Mr. Robertson indicated that he did not envisage that it would differ too much. The Committee simply should do the best job it could from the standpoint of making the policy actions understandable.

Mr. Shepardson expressed agreement with those who were fearful of using quantitative terms in the directive. He considered this impractical in view of the various factors that might be operating at any time in a number of directions, causing results that would not seem to jibe with the target figures. He noted that at Committee meetings the members talked of various quantitative levels to indicate a general result they were interested in achieving. But it was recognized that circumstances might develop whereby such targets would not be compatible with the desired result. The figures for the past several weeks provided an illustration. The figure that seemed of most long-term significance--and it was not necessarily appropriate for inclusion in the directive--was the reserve growth guideline that was aimed at over a period of time, with recognition that there would be temporary fluctuations. Other targets were subject to such wide fluctuations that they would seem to be of little use for purposes of the directive.

Mr. Shepardson felt that the kind of directive used this year had been more meaningful than the type of directive used previously and constituted a definite improvement. He considered it important that the writing of the policy record be kept on a current basis to avoid the risk that it would become an after-the-fact review. While improvements were possible, he thought the present type of directive was probably about as close as the Committee could come to what was desired. A Committee of this size could not operate on a day-to-day basis, any more than directors of a business. The directive should not be expanded indefinitely, although perhaps it could be made a little broader. It should be written primarily for the benefit of the Account Manager. However, if the interested student wanted to make use of the available economic and financial information and use it in checking against the directive, he should be able to interpret the kind of directive that the Committee was now using about as well as would seem feasible or desirable.

Mr. King expressed the view that use of a form of directive such as suggested by Mr. Knipe would inevitably lead to public confusion, or at least to more argument. Aside from that, he foresaw two problems in the use of such a directive. First, the Committee would impose upon itself a rather mechanical approach in trying to reduce the directive to precise numerical guides, as a result of which he thought the Committee would actually have less control over the Account than at present. Second, he noted that for the past three meetings the Committee members had had difficulty in arriving at a consensus as to policy, with differing views expressed. Therefore, he felt a general approach in the directive was the only one that held out hope for achieving a reasonable amount of agreement.

Mr. King went on to say that he had been attracted initially to Mr. Deming's suggestion regarding the form of the directive, particularly the second part, which to him appeared somewhat more general than the directive the Committee was now using. At the same time, he felt that the first part of the directive described by Mr. Deming tended to introduce material of the kind now contained in the policy record entries. He was not sure whether that would be desirable or undesirable, but he was inclined to have some doubt. There was also the question whether it was feasible to prepare such material on the day of each meeting or whether this task should be deferred until later when time was not so pressing. He was inclined to feel that

Mr. Deming's approach would, in a sense, tend to move back somewhat toward the clause (b) approach by adding the stress of compiling and approving such a directive on the day of each meeting.

Accordingly, Mr. King said, he came back to a point made earlier by Mr. Hayes, namely, that since the present form of directive had been used for only one year and, except in one case, the directives had not yet been published to determine the public reaction, it would be wise to continue for the time being in this pattern. As to the question of publishing a quarterly report, he was not sure that it would be advisable to initiate such a practice right now.

Mr. Mitchell expressed the view, in respect to communications to the Manager, that the only point in amplifying such communications was to remove potential inconsistencies. He also felt that the directive should be cast in terms of whatever changes the Committee wanted to make from the present status of policy. The Committee should not use words like "steady"; instead, the directive should lead from the present to some other point. The factor of concentrating on change was vitally important in the directive, for internal consumption and otherwise.

As to the preparation of the directive, Mr. Mitchell found it difficult to accept the idea of the staff drafting a directive before the Committee met, but he would agree with the staff drafting a directive following the Committee discussion. It was extremely difficult, he noted, for a large group to say that it agreed on something, and this tended to result in the directive becoming watered down, thus contributing to the difficulty of outsiders in understanding the Committee's actions. As an illustration of the public relations problem, he cited directives in the spring of this year that called for further expansion of the money supply, while the money supply in fact was declining.

As a possible means of improving the System's public relations posture, Mr. Mitchell said, he would suggest the issuance of an objectively prepared digest of the Committee's minutes. The reader who studied the digest could then trace the connection between the economic facts reported, the arguments made, and the policy adopted.

In conclusion, Mr. Mitchell said he did not think the Committee was doing too badly with its directives at present, although some small changes might improve the directives considerably.

Mr. Fulton expressed agreement with the view that the present form of directive was superior to the old clause (b), through the use of which the Committee had fallen into the habit of continuing the directive indefinitely without change despite changing conditions. One factor in the writing of directives about which he was apprehensive was the fact that fatigue toward the end of Committee meetings might create a tendency to employ broad language that could be used repeatedly. In his view, both paragraphs of the directive should be revised frequently. The language that stated the reasons for the policy that was adopted should be changed often; even if policy did not change, the factors contributing to it were subject to change. As to procedure, he would be inclined to reconvene after a luncheon recess for the purpose of refining the policy decision of the morning into a directive that would be, to a degree, along the lines Mr. Deming had suggested, with the idea of explaining the background factors plus the Committee's conclusion. As he had said, he would try to avoid renewing the same directive simply because policy had not been changed.

Mr. Fulton indicated that he continued to favor the idea of a quarterly release after a lag of a quarter. This release might focus on the economic situation. A student could then read such a release, with the directives alongside, and observe what had happened in terms of interest rates, free reserves, and other factors, thus finding out the results of monetary policy. A lag of one quarter in the issuance of such a release would be advisable, but the document should explain two things: the thrust of monetary policy and how successful that policy had been.

Mr. Bopp agreed with the view that there had been significant improvement in the past year in the form of the directive. He had always been skeptical of quantitative directives, yet that was primarily, he thought, because of a lack of full comprehension as to how the economic system functioned. An all-knowing economist presumably could write the directive in quantitative terms if he knew the direction in which the Committee wanted to move. If a person was in a sense all-knowing, he should be able to write any directive in quantitative terms because there was inherently an internal consistency between appropriate rates of interest and appropriate levels of reserves. This seemed to be the direction in which forces were moving not only in economics but in handling complex material in other fields. Although he was not too hopeful as to what might be achieved, even in terms of short-run developments, it might be worth while to have some computer technicians work on the variables and see where they came out.

Mr. Bopp went on to say that he had long felt that a quarterly review of policy actions, issued after a lag of one quarter, would be desirable. He had not given particular consideration to possible objections such as Chairman Martin mentioned at this meeting. He wondered, however, if they did not contain the possible implication of estopping any discussion of policy except in the Board's Annual Report. He would like to think this matter through before reaching a conclusion. In his view, it might also be appropriate after a lapse of about five years to publish the complete minutes of the Committee, or a digest that would eliminate some of the less important material.

Mr. Bryan said he considered Mr. Knipe's proposal an excellent effort at a quantitative approach to the directive. He felt, however, that Mr. Knipe fell into a difficulty that always tended to prejudice the problem of stating the directive in quantitative terms. This was when he suggested a central target for free reserves, plus or minus a few million dollars. It was the same sort of error that he (Mr. Bryan) had fallen into when he suggested a certain total reserve target, plus or minus a few million dollars. Both were inadequate to the facts of life with which the Manager was confronted in operating the Account. Thus, Mr. Bryan said, he was greatly interested this morning when Mr. Hayes proposed a range of free reserves from $200 to $400 million. Mr. Bryan believed it should be possible to use a quantitative directive if the Committee could agree to provide enough latitude to accommodate the Manager, and permit his accommodation in turn to prevailing money market conditions.

Mr. Bryan also believed it was important for the Committee always to consider whether any particular directive was one that the Manager could accomplish within the means at his disposal. There was some tendency to include in the directive a lot of things that related to the reasons for the Committee's actions, material that more properly should be included in the policy record entries. There was also a tendency to include in the directive certain propositions that the Manager could not control with the means at his disposal.

Mr. Shuford commented that the Committee had responsibilities that were required to be performed in the public interest. The

Committee also had a public relations responsibility, but the need to focus attention on basic responsibilities, as described in the Federal Reserve Act, made other considerations of secondary importance. The Federal Reserve Act specified the manner and timing of information required to be published. The requirement was for publication annually of a record of policy actions, and the types of information to be included were specified. Aside from possible consequences such as had been mentioned by Chairman Martin, it seemed to him that, without a change in the law, there was a substantial question about publishing more frequently than required by law types of information similar to that which the law required.

Mr. Shuford also said that from a review of the record, he thought the Committee had made progress with the directive since the days of clause (b). In his opinion, the present form of directive had worked well. Although he felt sure there was room for moderate improvement, perhaps along lines suggested at this meeting, it seemed doubtful to him whether the Committee could be a great deal more specific in terms of the use of quantitative expressions than it had to date. Actually, he thought this would be understood by reasonable persons outside the System because the same factors prevailed in other areas. In the check clearing process, to take an example, general policies were established and people were given the power and authority to carry out those policies. The same thing held true in the enactment of laws and the making of legal decisions. There must be an exercise of judgment by the people who were entrusted with the carrying out of policy. Within the Committee framework, he felt that this procedure had worked out well.

As to the preparation of the directive, Mr. Shuford expressed the view that it would be preferable not to have directives drafted in advance of Committee meetings. The drafting should be done after the fact, and he was inclined to feel that members of the staff who had participated in the meeting were in the best position to come up at that point with a proposed directive. In any event, it seemed advisable for the Committee to take as long as necessary to prepare and adopt a directive before the adjournment of each meeting.

Mr. Balderston said the approach he took was to ask himself what audiences the Committee was seeking to reach. First, there was the Desk, and he agreed with the view that communication between the Committee and the Desk was quite satisfactory. There were means of correcting any misinterpretation under which the Desk might be laboring at any given time. Because the function of communication with the Desk dealt with the future, it was difficult to quantify, as many members of the Committee had concluded over the years, and he would favor letting the communications between the Committee and the Desk continue as at present if they remained satisfactory. Another audience, however, was concerned with the proximate past.

That audience could not be satisfied, obviously, by providing information as to what had transpired at a Committee meeting just concluded, or probably even at recent meetings. However, he would suggest changing the nature of the report required to be provided annually by preparing an explanation that might be entitled "The Work of the Federal Open Market Committee in the Year____." This would be somewhat like the statements that the Bank of Canada had used occasionally in its annual reports, something like a leading article in the Federal Reserve Bulletin, devoted exclusively to the work of the Open Market Committee. It would relate the work of the Committee to the economic background that the Committee had to take into account, and the directives could be appended as footnote items.

A third audience mentioned by Mr. Balderston comprised those learned individuals who would like to delve more intensively into the work of the Open Market Committee. For that audience he would suggest publication of the Committee's minutes in their entirety after a suitable lapse of time. Such a project might be particularly appropriate to mark the fiftieth anniversary of the founding of the Federal Reserve System.

As to procedure for preparing the directive, Mr. Balderston said he would favor the preparation in advance of each meeting of two alternative drafts, which could be studied side by side with the directive adopted at the preceding meeting. Theoretically, he would suggest turning the drafting job over to a committee during a luncheon recess, but he felt sure this would not work satisfactorily in practice, partly because of the pressure of time. Therefore, he would be willing to run whatever risk was involved in having alternative drafts prepared for the Committee in advance.

Chairman Martin commented that he felt today's discussion had been distinctly worth while. If parties with a sincere interest in System affairs could have participated in the discussion and listened to the comments, he was inclined to think that many of their criticisms would have been answered. The difficult problem, however, was how to get this picture across. He shared the view that had been expressed by members of the Committee about the desirability of providing the public full information, and the Committee should continue to work on the problem of improving its communications. In his opinion, the System had not been doing the best job over the years in informing the public, particularly concerning the procedures by which policy decisions were reached. On the occasion of meetings of the Chairmen and Deputy Chairmen of the Federal Reserve Banks, there was brought home to him the amount of good will, and potential for building good will, that existed within the ranks of the System, but at the same time the System was the subject of severe criticism from academicians, based largely, he felt, on a lack of understanding of System procedures and how the System really worked. In his experience one of the best ways of getting across to parties outside the System was to discuss the means by which those in the System sat around the table and tried to reach the proper policy decisions.

The Chairman went on to say that in looking through much of the literature concerning the Federal Reserve System he was distressed by the content. It did not present a fair picture of what he regarded as one of the most interesting experiments in political science, an experiment that deserved to be fairly judged. One possibility of presenting the matter to the public might be the issuance of Committee minutes, after a suitable lapse of time, or the preparation of a digest of the minutes by two or three competent outside parties. In any event, however, the System must in some way communicate the picture of how policy decisions were arrived at, including the picture of how disagreements within the System's ranks involved honest differences of judgment on the part of persons who all held the same ultimate objectives. The average man with whom he talked had no conception of this situation; many false impressions were reflected in such conversations. This placed a real responsibility on the System to try to explain more effectively what it was doing, and work should be pursued on the subject continually.

Turning to the preparation of the Committee's policy directives, Chairman Martin commented that perhaps the Committee should experiment further with the procedure that was used for a rather brief period earlier this year whereby the directive was drafted during a recess in

Committee meetings after the Committee had arrived at a policy consensus. However, he felt that the Committee had already made a lot of progress with the directive. The very fact that today's discussion had been held was evidence of a spirit of progress. Possibly it was not feasible to do certain things, but he considered it essential to continue to work toward the achievement of a better public relations posture. The twelve Federal Reserve Banks were doing a lot of work along these lines, he realized, but the job of explaining the System adequately had not yet been resolved. He would like to see material made available that qualified persons could analyze in order to make knowledgeable judgments with regard to the institutional framework of the System.

This concluded the discussion of the formulation of the current economic policy directive and related matters.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, January 8, 1963, and it was understood that subsequent meetings would be scheduled tentatively for January 29, February 12, and March 5, 1963.

The meeting then adjourned.

Ralph A. Young

Secretary

Suggestion by Mr. Deming as to type of current economic policy directive that might have been issued at meeting of Open Market Committee on December 4, 1962

The domestic economy has shown little expansionary force recently and still is operating with a margin of underutilized resources and an absence of inflationary pressures. Bank credit has grown considerably during the past several months and the total credit supply seems to be quite adequate, with credit readily available. The liquidity level is fairly high and while the conventionally defined money supply has expanded relatively little, time deposit growth and that of near-money has been very strong. The U. S. balance of payments position is not satisfactory and while capital outflows have been moderate they bear continued concern. In the light of these circumstances, it is the policy of the Federal Open Market Committee to continue to pursue a moderately stimulative program, but to do so cautiously because of the potential problem of renewed large-scale capital outflows.

To implement this policy, operations for the System Open Market Account during the next two weeks shall be conducted so as to provide about the same degree of reserve availability as has prevailed recently and a steady tone in the money markets, with particular attention being paid to short-term rates. Consistent with this, member bank borrowing should be kept nominal and the Federal funds rate should be maintained at close to the discount rate.