

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, February 12, 1963, at 9:30 a.m.

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

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

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

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

Mr. Molony, Assistant to the Board of Governors  
Mr. 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

Mr. Heflin, First Vice President, Federal Reserve Bank of Richmond

Messrs. Eastburn, Ratchford, Baughman, Jones, Tow, Green, and Grove, Vice Presidents of the Federal Reserve Banks of Philadelphia, Richmond, Chicago, St. Louis, Kansas City, Dallas, and San Francisco, respectively

2/12/63

-2-

Mr. Litterer, Assistant Vice President, Federal Reserve Bank of Minneapolis  
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York  
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston  
Mr. Mann, Senior Economist, Federal Reserve Bank of Cleveland

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on January 8, 1963, were approved.

Before this meeting there had been distributed to the members of the Committee a report covering open market operations in U. S. Government securities for the period January 29 through February 11, 1963. A copy of the report has been placed in the files of the Committee.

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

The past two weeks have witnessed little change in the money market or the Government securities market. In the securities market there was an excellent response to the Treasury's February refunding, with the public taking about \$2.5 billion 3-3/4 per cent bonds of August 1968 and \$2.8 billion 3-1/4 per cent one-year certificates. Only about \$200 million of maturing issues were not turned in--a remarkably low attrition rate of just a little over 3 per cent. The turn-in for the bond was large enough to accomplish some useful debt extension, yet not so large as to denude the short-term area (as happened in the Treasury's exchange operation last November).

The market is now awaiting the second phase of the three-stage program that the Treasury indicated with the announcement of the February refunding--namely a "junior" advance refunding which may be announced on or about February 20. The third phase is to be a second competitive auction of long-term bonds early in April; the amount of the issue and the date will be announced on March 13, and the coupon or coupons on March 27, according to present plans.

Price changes during the recent period for the most part consisted of small adjustments to the Treasury's current and prospective financings. Issues maturing out to 1966 recorded

small gains on the expectation of reduced supplies because of advance refunding; some of these issues were up more sharply where the market anticipated possible rights value. At the same time, prices of issues surrounding the new 5-1/2 year bonds moved a little lower and most longer term issues were also lower because of prospective increases in supply as a result of the advance refunding and the long-term bond auction.

The Treasury bill market has also been very steady, with rates on three-month bills varying only between 2.93 and 2.96 per cent. There was a considerable reduction in dealers' bill positions during the period, however, as good bank and nonbank demand has continued to be attracted by current rate levels. In turn, this may lead to increasing downward pressures on rates in the weeks ahead, particularly if there is any substantial movement out of rights in the advance refunding and into bills. A prospective sale of another \$1 - \$1.5 billion of June tax anticipation bills on March 6 should help to restrain such downward pressures.

Underlying the steady bill rate in the past two weeks has been a very steady money market, in which Federal funds traded consistently at 2-7/8 to 3 per cent--mainly the latter. In turn, the steady money market reflected a relatively even day-to-day climate of reserve availability, in which supplies of Federal funds tended to fall a little short of demand so that a moderate part of the member banks' reserve needs had to be met at the discount window.

In working toward this result, the System put in reserves gingerly during the period, relying on the condition of the market to indicate the extent of reserve needs and then moving to meet only the more pressing part of those needs. Thus reserves were supplied in good part through repurchase agreements, although the total size and duration of reserve needs also made it necessary to make sizable outright purchases on several days. These were largely in the form of Treasury bill purchases, either in the market or directly from foreign accounts. In addition, a modest amount of coupon issues was purchased in the market, avoiding by a margin of 2-1/2 years and more the issues involved in the Treasury's current refunding. These purchases served the additional purpose of demonstrating our continuing adherence to a policy of flexibility in the conduct of open market operations.

In the discussion that ensued, Mr. Stone was asked for further comment on the purchases for System Account of \$31.5 million of coupon issues during the past two-week period. Of these purchases, \$5 million

2/12/63

-4-

were in the one to five-year maturity area and \$26.5 million were in the over five-year area.

Mr. Stone replied that it had been necessary to supply some reserves on an outright basis. Most of these reserves were supplied through bill purchases, but advantage also was taken of the opportunity to supply some of the reserves through purchases of coupon issues. In making these purchases, the Account Management avoided by a margin of 2-1/2 years and more the issues involved in the Treasury refunding. There had been some market speculation, Mr. Stone noted, that the Open Market Committee had abandoned the tool of operations in coupon issues, and as he looked ahead he saw relatively few opportunities for engaging in transactions in coupon issues to head off this kind of speculation. No such operations had been undertaken since early December, and it seemed to him that the Manager had an obligation to keep the Committee's tools in good repair.

Further, if coupon issues were purchased at a time when there was not a real need for such purchases, an expectational reaction would be engendered that would defeat the effects sought to be achieved. Under these circumstances, he had considered it desirable to make some modest purchases of coupon issues. Obviously, they had no impact on the outcome of the Treasury financing; neither the amount of attrition nor the split between the two issues offered by the Treasury in the refunding was affected.

Mr. Robertson indicated that although he appreciated the points made by Mr. Stone, he had some question about the recent transactions from the standpoint of timing. In his opinion, the Account Manager should be able to

2/12/63

-5-

find some opportunities to use the tool other than at a time when the Treasury was engaged in a refunding operation. When coupon purchases were made in such circumstances, there were likely to be accusations that the System was simply endeavoring to help the Treasury.

Chairman Martin agreed that this was a point to be borne in mind. He had received a number of comments to the effect that the coupon issues had been purchased out of interest on the part of the System in helping the Treasury. While he thought Mr. Stone was correct in his comments, the possibility of market misinterpretation should not be ignored. Mr. Stone had referred to one kind of market misinterpretation, but the possibility of misinterpretation must be watched in both directions.

Mr. Hayes agreed that this possibility should not be disregarded. He questioned, however, whether the Committee should abandon the idea of engaging in any transactions in coupon issues during every period of Treasury financing. Such a broad self-denial could at times work against the interests of the System. There were a lot of periods during the year, he observed, when the Treasury was operating in the market.

Mr. Stone commented that the Treasury had already conducted one bond auction and was planning another in April. It might develop that the Treasury would work toward quarterly auctions of this kind. If so, and if the Committee denied itself the use of the tool of coupon issue operations during all periods of Treasury financing, such operations would be precluded for substantial periods each year, including periods as long as three weeks before and after each bond auction. He would feel more

2/12/63

-6-

constrained to avoid coupon issue operations in maturities beyond five years--or perhaps seven or eight years--during the period surrounding a bond auction than he would from engaging in operations such as conducted within the past two-week period, which were small, selective operations entered into during a refunding operation. Mr. Stone concluded by saying that he recognized the point to which Chairman Martin had referred.

Turning to another point, Mr. Swan noted the rather large volume of repurchase agreements entered into in early February and the fact that withdrawals before maturity were substantial. He inquired whether the repurchase agreements went out faster than anticipated.

Mr. Stone replied in the negative, stating that the repurchase agreements went out about as anticipated. It had been anticipated that there would be substantial withdrawals before maturity; he had had in mind that about \$50 million per day might be withdrawn, because the demand for bills had been very good. The repurchase agreements did not go out because dealers found cheaper financing elsewhere, but rather because of the good demand for bills.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities during the period January 29 through February 11, 1963, were approved, ratified, and confirmed.

Mr. Stone then presented the following statement:

It has come to my attention that we require the special approval of the Committee of the action we took on January 15, 1963, in connection with reallocating the System Open Market Account in order to bring the reserve ratio of the Federal Reserve Bank of Boston up from the low level to which it had

fallen the preceding day. The reason we require special approval is that that action was taken to resolve a problem that had not been contemplated in the rules governing reallocations.

At around 3 o'clock on the afternoon of January 15 it was learned that the Boston Bank's reserve ratio had fallen to 25.7 per cent the previous day. Mr. Marsh, acting for me in my absence, immediately contacted Mr. Latham of the Boston Bank and it was agreed that, in accordance with paragraph 3 of the rules governing reallocations, we would undertake a reallocation to raise that Bank's reserve ratio to avoid the possibility of the ratio slipping below 25 per cent, especially since we were so close to the end of a statement week. The rules say that the ratio of the Bank concerned shall be raised to the System average, which was 32.2 per cent at that time. This meant that \$152 million of securities would have to be taken from the Boston Bank. The difficulty was, however, that that Bank had only \$74.9 million of unpledged securities--a situation not provided for in the rules governing reallocation. A further complication was present. We had sold securities to absorb reserves that day, and it was quite possible that we might have to make additional sales the following day. If so, and if we had reallocated all of Boston's unpledged securities, it appeared that we might have been unable to make delivery of all of the securities sold, since the Federal Reserve Agent would not have been able to release any of the Boston Bank's remaining securities, all of which would then have been pledged. Under these circumstances, Mr. Marsh and Mr. Latham agreed that of the \$74.9 million unpledged securities held by Boston, \$70 million would be reallocated to another Bank or Banks, thus raising Boston's ratio to 28.4 per cent; and that \$4.9 million would be left untouched in order to have at least that many securities available for delivery in case it should prove necessary to sell to absorb reserves the following day. Leaving the Boston Bank with \$4.9 million allowed room for about \$100 million in sales. After agreeing to this action with Mr. Latham, Mr. Marsh contacted the Board staff and talked with Mr. Conkling, who also agreed that such action was appropriate. Thus \$70 million in securities was taken from the Boston Bank and \$4.9 million was left untouched.

Having thus resolved the problem, we immediately went to work exploring proposals that we might wish to place before the Committee to provide for such contingencies in the future, and I should note that in the course of these explorations we found that the Reserve Banks' 1943 plan covering the pledging of securities behind the note issue provides an "escape valve" for a situation in which a Reserve Bank (other than the New York Bank) has a shortage of unpledged securities. The study now under way will, of course, deal with the whole range of problems in connection with reallocating

2/12/63

-8-

the Account and the pledging of collateral behind the note issue. In the meantime, however, I should appreciate the Committee's approval of the January 15 action I have just outlined.

Upon motion duly made and seconded, and by unanimous vote, the action taken on January 15, 1963, as described by Mr. Stone, was 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 January 29 through February 6, 1963, together with a supplementary report covering the period February 7 through February 11, 1963. Copies of these reports have been placed in the files of the Committee.

In comments based on the written reports and supplementing them in certain respects, Mr. Coombs reviewed current and prospective information relative to the U. S. gold stock and discussed the situation in the London gold market. Turning to foreign exchange market developments, Mr. Coombs concentrated his remarks on recent sterling and Canadian dollar rate movements, with explanatory remarks on the contributing factors. In this connection, he reported that negotiations for an enlarged swap agreement between the Federal Reserve and the Bank of England, as previously authorized by the Committee, were still pending, partly due to technical complications. He was hopeful, however, that the matter would be brought to a successful conclusion before too long.



2/12/63

-9-

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period January 29 through February 11, 1963, were approved, ratified, and confirmed.

Mr. Coombs then presented certain recommendations, the first of which was that the present \$50 million swap arrangement between the Federal Reserve and the Bank of England, which would mature February 28, 1963, be renewed for another three months on the present terms and conditions, assuming that an enlarged swap arrangement was not concluded before that time.

Renewal of the \$50 million swap arrangement with the Bank of England, as recommended by Mr. Coombs, was authorized.

Mr. Coombs next recommended that authorization be given for negotiations looking toward an increase in the present \$50 million swap arrangement with the Bank of France to a maximum of \$200 million. In discussing the recommendation, he noted that such an enlargement of the swap arrangement with the Bank of France would be in accord with actions taken in certain other cases to place the respective swap facilities more in line with potential balance of payments swings. However, as long as the French payments position continued in such heavy surplus, apparently reflecting rather basic conditions, he would not anticipate drawing on the swap. In reply to a question, Mr. Coombs indicated that if negotiations for enlargement of the swap were authorized, it would be his intent to discuss the matter with the Treasury. It was suggested that some expression from the State Department might also be obtained.

2/12/63

-10-

There followed discussion of French balance of payments developments, from which it appeared that in 1962 there had been a small deficit on trade account but that French reserves had continued to rise about as fast in the second half of the year as in the first half, after taking into account debt repayments.

Thereupon, negotiations for an increase in the \$50 million swap arrangement with the Bank of France to a maximum of \$200 million, as recommended by Mr. Coombs, were authorized.

Proceeding to his third recommendation, Mr. Coombs expressed the view that from time to time useful opportunities might appear to cover the short position developed by the System by virtue of certain swap drawings by buying forward, at relatively favorable rates, the foreign currency concerned. Likewise, there was the possibility that useful opportunities might appear to restrain an outflow of short-term funds arising out of interest rate developments favoring a particular foreign currency by selling that currency forward. At present, he noted, the Guidelines for System Foreign Currency Operations provided that any proposals to initiate forward operations were to be submitted to the Open Market Committee for advance approval. However, transactions such as he had in mind would have to be executed immediately. His suggestion was that the Committee might want to grant authority to buy forward certain foreign currencies--any of the foreign currencies that the Federal Reserve Bank of New York was now authorized to hold--to a total of \$25 million, along with authority to sell such currencies forward up to a total of \$25 million. It was his thought that this degree of flexibility would permit useful experimentation.

2/12/63

-11-

During a discussion that followed, Mr. Coombs drew distinctions between the forward operations that had been engaged in by the Treasury and the kind of operations he would have in mind for System Account. In reply to a question, he indicated that the need for the granting of the requested authority did not appear to be particularly urgent. Accordingly, it was suggested that a memorandum on the subject be prepared so that the matter might be studied more carefully by the Committee before a decision was reached. There being agreement with this procedural suggestion, it was understood that a decision on Mr. Coombs' recommendation would be deferred pending the availability of such a memorandum.

This concluded the discussion of System foreign currency operations and related matters. Accordingly, the Chairman called for presentation of the usual staff economic and financial reports, and Mr. Noyes presented the following statement on economic developments:

The budget and the accompanying proposals for tax reduction and reform, appraisals of the longer run outlook for the economy, and political developments in Europe and Canada have attracted so much attention in recent weeks that a change in the current economic situation might well have escaped one's notice. With this thought in mind, I shall try to focus my review today on what appears to have happened to the economy in December and January to see if it shows any evidence of a fundamental change in the pace of economic activity.

Taking first some of the broad measures of economic performance, neither industrial production nor nonfarm employment have broken decisively out of the narrow range in which they have moved since the middle of last year. However, the industrial production index for January is estimated down to 119 even, and December was revised down to 119.2. Another broad measure of activity--retail sales--is now also estimated to be down a little from December. So we find these three important broad measures of economic activity--production, employment, and retail trade--all off fractionally from the November level. In the case of retail trade,

however, it should be mentioned that the rise since summer is still 2-1/2 per cent, an annual rate of increase for the five-month period as a whole of about 6 per cent.

Construction activity edged back up in January to a seasonally adjusted annual rate of \$62-1/2 billion, still below the record October rate. A notable aspect of this was the relative strength of private residential construction, which many observers had expected to decline from last summer's advanced levels.

Over the two months as a whole, the stock market has been a bullish factor, but it has shown some weakness more recently. This is also true of the growth in bank credit, and especially the improvement in business loan demand in December, which was followed by about a seasonal decline in January.

From the data thus far available, it seems fair to generalize that the December-January movement in the economy was largely horizontal and that, if anything, we seem to have lost some of the upward momentum displayed in the late fall and early winter. But the difference is very small--much smaller than one might attribute to the vagaries of the weather at this season, or to the effects of dock, transit, and newspaper strikes. Thus, I would conclude that there has been no significant change in the over-all economic situation in recent weeks, in one direction or the other.

Whether this, in itself, is a bearish or bullish factor is not so clear today as at this stage of earlier cycles. Since we have not yet experienced in this period of recovery and expansion the business investment bulge that normally comes at this stage of the cycle, it can be argued--as it is, for example, in this month's issue of Fortune magazine--that each month during which activity is maintained without the support of large scale inventory or plant equipment expenditures is like "money in the bank"--in that it leaves more investment to be carried out in the months ahead.

Others, especially those who follow closely the cyclical indicators of the National Bureau, conclude that the economy is balanced perilously close to a downturn, and that any loss of forward momentum may well touch off a recessionary spiral. These are logical possibilities, as they always are when the economy is in a relatively balanced position--but it seems to me that their proponents have to strain to convert them into realistic probabilities. This leaves me where I have found myself so often in recent months--with the conclusion that there is not only little change currently, but also that there is no basis in current developments for anticipating a dramatic improvement or deterioration in economic activity.

Technical factors should operate in the direction of some slight improvement in the broad measures of activity in February.

If this does not, in fact, materialize, we can expect a rather rapid deterioration in the improved business sentiment that has prevailed since early winter. Such a development, especially if it were accompanied by increasing doubts as to the likelihood of an early tax cut, might present a difficult problem for the Committee, as there can be little doubt that optimism with respect to the business outlook and expectation of an enlarged deficit have played an important role in maintaining the level of interest rates.

Let me add to this only one other observation, which will also have a familiar ring. There is no evidence whatsoever in the nonfinancial area to suggest the re-emergence of inflationary pressures. Overtime at factories declined further last month. Money wage rates showed the smallest rise from January to January in any nonrecessionary year since World War II. In no important area of production is there any evidence that current output is pressing against capacity. In some instances it is a little closer than it was a year ago--and there may be some investment incentive in the relationships that are developing--but generally markets for industrial products remain highly competitive, and both material and product prices are moving in a very narrow range, close to the recessionary lows of early 1961.

Mr. Ellis inquired whether it was more accurate to say that basically there were no inflationary pressures in the economy at present or to say that such pressures as existed were offset by other pressures, so that on balance there had been no increase in wholesale commodity prices.

Mr. Noyes, in reply, noted that he had referred in his comments only to the nonfinancial area. He had not examined the financial area with sufficient care to express a judgment. In the nonfinancial area, however, he saw nothing that he would describe as inflationary pressure. There had been some price increases and some price declines, as is always true in the economy, with these movements tending to offset one another. He thought it difficult to take the position that a 2 per cent rise in money wage rates from January to January was an inflationary factor. It was low by any standards of the postwar period.

2/12/63

-14-

Mr. Hayes expressed some concern that certain recent wage settlements, such as the dock strike settlement, were on the generous side, and Mr. Noyes replied that one might foresee with concern the impact of certain things that were taking place. However, the whole range of wage settlements had tended to become more moderate, with the passage of time, over the past three years. Mr. Hayes commented that in light of the balance of payments situation it was important that they be extremely moderate. Mr. Noyes agreed, but added that he found it difficult to read a broad inflationary impact on the economy into the wage statistics.

Mr. Shepardson said he could agree that wage settlements during the past few years had been less out of line than earlier, and consequently that they produced less inflationary pressure. However, he felt it was an overstatement to say that there were at present no inflationary pressures. He suggested that wage costs in terms of output must, in fact, go down to obtain improvement from the standpoint of the balance of payments.

Mr. Balderston commented that real estate and common stock prices had been rising in a manner somewhat reminiscent of developments prior to the stock market collapse in 1929, in response to which Mr. Noyes observed that stock market prices had been moving about sideways in the past couple of weeks, which suggested to him that the inflationary steam that had contributed to the recovery of the stock market in recent months may now have diminished. Mr. Balderston then commented that one often read that wholesale commodity prices were the best measure of the existence of inflationary

2/12/63

-15-

pressures. However, as he read the history of the second half of the 1920's, he had some doubt. Mr. Noyes noted that here Mr. Balderston was using a broader definition of inflationary pressures than he (Mr. Noyes) had intended to imply. He had been speaking in terms of the value of the dollar.

There followed a reference to the consumer dollar, and Mr. Noyes noted that the index of consumer prices had risen last year by about 2 per cent. However, the index went down in December. Mr. Mitchell expressed the opinion, in this connection, that the consumer price index had a built-in bias on the up side.

Mr. Koch then presented the following statement on financial developments:

Since the chart show presentation at our last meeting covered financial developments over the last few months, I shall focus my remarks this morning on very recent developments and particularly on those in the money and banking area that are most directly affected by open market operations.

Looking first at bank reserves, the volume of required reserves behind private deposits has declined in the last few weeks to a level about \$200 million above the guideline, using last June as a base. This compares with a level about \$400 million above the guideline in late December and early January, but is about equal to the average December level relative to the guideline.

Free reserves have been somewhat lower in recent weeks, averaging around \$315 million in the three weeks ending February 6 as compared with about \$375 million in the three preceding weeks. The tone of the money market has continued somewhat more taut, with the Federal funds rate generally at or just under the discount rate and with New York commercial bank lending rates to Government securities dealers varying from about 3 to 3-1/2 per cent.

The seasonally adjusted money supply, after having increased a billion dollars in the first half of January, decreased about a billion and a half in the last half of the month. On average, in January as a whole the money supply was about half a billion

dollars above the December average. Time and savings deposits at commercial banks increased in January at almost as rapid a pace as a year ago immediately following the revision of Regulation Q.

If I may digress a bit at this point, I am continually struck by the difficulty of interpreting the relevance of changes in liquidity to monetary policy formulation. The very concept of liquidity, and particularly its relevance to spending, is by no means clear and precise. Total liquid assets continue to rise sharply, but so also does private short-term debt. If one subtracts such debt from liquid assets, the recent rate of increase of what might be called net liquidity is by no means as obvious as that in gross liquidity.

For example, the short-term debt of business enterprises considered as a group may now be about \$3 billion larger than their liquid asset holdings, whereas a year ago business liquid assets exceeded short-term debt by about \$5 billion. Even in the case of consumers, the ratio of their net liquidity, that is, their liquid assets minus their short-term debt, to their spending probably has actually declined somewhat over the past year or so. Although these figures are only the roughest of estimates and although they gloss over completely the question of the distribution of both the liquidity and the debt within the broad sector groups, they do not suggest any great excess of business or consumer liquidity. Moreover, the adequacy or lack of adequacy of an economy's liquidity cannot be judged in a vacuum. It must be judged in terms of its contribution both to current spending and to potential future spending.

Turning back to recent financial developments, 3-month Treasury bill rates, apparently influenced greatly by Treasury and Federal Reserve actions and by dealer expectations based on such actions, have risen to just under the 3 per cent discount rate. Longer term rates declined a little further in the first half of January, but since then have firmed. The recent firmness has reflected some pickup in activity in the capital markets, particularly by State and local governments, as well as growing caution on the part of market professionals on the likely effect on interest rates of a prospective larger Federal deficit, continuing gold losses, and an acknowledged somewhat less easy monetary policy. Most recently, following the Treasury's announcement of a three-pronged operation to lengthen the maturity structure of the Federal debt, longer rates edged up further.

Throughout the first half of January, bank credit and monetary developments appeared to have been as expansionary as those in the latter months of last year. Commercial banks and Government securities dealers, for example, were apparently as eager to hold positions in securities as they were earlier. This was somewhat puzzling in view of the slightly firmer tone in money markets and the somewhat less easy bank reserve positions that prevailed in the period.



In the last three weeks, however, there are signs of less stimulative activity in banking and money markets. Bank reserves and money are declining and the bank credit expansion has apparently slackened somewhat. Price adjustments have been needed to move some of the new corporate and municipal security issues. This situation may be only a temporary phenomenon--three weeks is a very short period. Or it may reflect the emergence of more usual forces for this time of year. It is still too early to tell whether it reflects either a lessening in demands for bank financing or a market response to less easy monetary conditions, but it is a situation that merits close attention.

In the weeks immediately ahead, the Treasury financing calendar continues to be full, with the advance refunding and some additional cash financing in immediate prospect. This full calendar would again make a change in monetary policy difficult. Market factors affecting reserve availability over the next three weeks will be confined mainly to the usual intra-monthly swings in float and currency in circulation. These factors will provide about half a billion dollars of reserves to the banking system in the week ending February 20 and drain about a similar amount in the two following weeks. Maturing System repurchase agreements will absorb most of the reserve buildup expected next week. Thereafter, some additional System purchases of Government securities are likely to be needed to supply reserves, particularly in view of the expected Treasury cash financing in early March.

Mr. Furth presented the following statement with respect to U. S.

balance of payments:

Net transfers of gold, convertible foreign currencies, and liquid dollars to foreigners in January have been tentatively estimated at \$400 million. For purposes of analysis we should increase this figure by amounts reflecting a further rise in illiquid U. S. Government obligations and the reflux of funds borrowed over the year-end by foreign banks for window dressing. On the other hand, we should reduce it by amounts reflecting an unusual bunching of long-term capital outflows and the effects of the dock strike. Adjusting the figure accordingly, we may--even more tentatively--estimate the January payments deficit at about \$300 million, an amount about equal to the monthly average both of the fourth quarter and of the entire year 1962 (disregarding debt prepayments as well as the various statistical adjustments). Should this estimate prove approximately correct, it would mean that, contrary to the first impression conveyed by

the weekly figures, January did not show a serious further deterioration in our balance of payments, although it obviously did not show an improvement either.

The last week of January and the first week of February saw net transfers from abroad to the United States. But if these figures are again adjusted for extraordinary transactions and the probable effect of the cessation of the dock strike, there is still no conclusive evidence of any significant change to the better. Moreover, a reliable estimate of the influence of the dock strike on the deficit will have to wait for the trade figures for both January and February; until then, any assessment of the situation will remain guesswork.

In the longer run, our deficit may be decisively affected by the repercussions of recent political developments in Europe and Canada. The French veto of Britain's entry into the Common Market has obviously been a serious diplomatic blow to the United States and the free world in general. But from the purely economic point of view, it may well turn out to be a blessing in disguise.

Our exports to both Continental Europe and Britain will benefit as they will compete on more equal terms, in Britain with exports from Europe, and in Europe with exports from Britain. And our capital outflow to Continental Europe and Britain will probably decline as U. S. firms and investors revise their estimates of the long-run political and economic prospects of those areas.

More fundamentally, it is true that the French veto probably has aggravated Britain's economic problems, and that market apprehension about sterling might cause apprehension about the dollar. But at the same time the French veto may induce the United Kingdom to seek closer commercial and financial cooperation with the Western Hemisphere, as a substitute for such cooperation with Continental Europe. After all, the invigorating effects of increased import competition, which the British Government expected from a customs union with Continental Europe, could just as well come from the United States. And if pro-American forces win the forthcoming Canadian elections, Canada, too, may want closer economic ties with the United States. Unification of the two dollars and the pound sterling would have far-reaching effects on our payments balance. If flows of funds between New York and Montreal as well as between New York and London became domestic rather than international movements, our deficit on capital account would virtually disappear in the short-term sector, and be substantially reduced in the long-term sector.

The idea of monetary union between the United States, Britain, and Canada may be derided as utopian. But a few years ago the idea of economic and political union between France and Germany would have been considered even more ridiculous. To central bankers as well as to judges applies the word of Mr. Justice Brandeis: "If we would be guided by reason, we must let our minds be bold."

The Chairman then called for the go-around of comments and views with respect to economic conditions and monetary policy beginning with Mr. Hayes, who presented the following statement:

In the short interval since our last meeting there seems to have been no significant change in the business situation. Retail sales have shown continued strength, and the outlook for residential construction may be a shade better, but offsetting this, at least in the area of sentiment, is the considerable uncertainty arising from the poor reception accorded the Administration's tax proposals and the disturbing setbacks in Europe and Canada for the economic and military unity of the Free World. The sharp shrinkage in total bank credit and bank loans in the four weeks ending January 30 casts some doubt on the impression given by earlier data of a marked strengthening in underlying loan demand. Perhaps the behavior of the credit statistics around the year-end reflects in good part a change in the seasonal pattern. There has been no important change in most measures of over-all liquidity, and it is noteworthy that the total gain in the money supply since the business cycle trough is now greater than it was in either of the preceding business upswings.

On the international scene, the basic balance of payments outlook remains decidedly gloomy, with long-term capital outflows playing a major role in January and probably in the months to come. I find especially disturbing the almost fatalistic acceptance, apparent in some Government circles, of the prospect that equilibrium will not be reached until around 1965, if then. The recent estimate of the balance of payments outlook for 1963 made by the Department of Commerce indicates that, in the absence of a concerted effort vigorously pursued, the over-all deficit in 1963 may well be larger than in 1962. The probable foreign reaction to such a development is not pleasant to contemplate. Imports are expected to rise more rapidly than exports, and there will probably be fewer special Government transactions to soften the impact of this and other adverse factors. Admittedly, there is a good deal of uncertainty as to the effects on our balance of payments of the current economic and political difficulties of Canada and Britain--but while they may conceivably afford our own balance of payments some temporary relief, this is clearly a slender reed on which to lean.

As was true at our last meeting, the Treasury's financing program would seem to preclude any immediate change in monetary policy. From an "even-keel" standpoint there will be a brief period around mid-March when monetary policy decisions could be made without particular reference to Treasury financing.

Parenthetically, I might add that although the new long-term bond auction will probably be announced March 13, the terms will not be announced until two weeks later. Thus, it might be possible to make some monetary policy decisions in that period.

Looking beyond the next three weeks, it seems to me quite probable that we shall have to come more firmly to grips with the balance of payments problem. The question may well be raised whether the monetary policy of the last two years, which has made a brave and sincere effort to cope simultaneously with excessive slack in the domestic economy and with a persistent deficit in international payments, without being able to make a conclusive contribution in either area, may still be regarded as a viable policy. It seems to me that we are a good deal closer than we have been to a crisis on the international front. On the domestic front, the more pessimistic analysts do not seem to anticipate anything more serious than the continuation of a sluggish performance. For these reasons, I am inclined to think that a more determined attack than any that has yet been undertaken must be launched in an attempt to reach a decisive solution of the balance of payments deficit problem, which has in turn been casting a long shadow on the whole domestic situation. I can see no justification for delaying such a move until a crisis is actually upon us.

I am quite aware that a decisive move toward less monetary ease would carry some risks to the domestic economy and might invite severe criticism of the System. This of course highlights the vital need for a prompt and sizable tax cut to provide stronger incentives in the economy, even if the reform aspects would have to be deferred till another year. I am also aware that the magnitude of the balance of payments problem is much too great to be solved by monetary policy alone. Nevertheless, monetary policy can and should play an important part, and I would hope that it can do so simultaneously with a new, decisive, and well-publicized program on the part of the Administration to achieve equilibrium in our international payments, including a substantial net reduction in military and aid disbursements abroad and a firm policy toward greater discipline in the area of production costs.

For the time being, I should think the directive might appropriately be left substantially unchanged.

Mr. Ellis reported that there appeared to have been no material change in conditions in the New England area. The regional economy continued its sideways movement. The Reserve Bank had been looking at manufacturing activity as a sector where any distinct trend might show

2/12/63

-21-

up first. At the regional level, however, no evidence could be found of a trend having been established one way or the other. At the end of 1962, the New England production index was at a level identical with the end of the preceding year, as compared with a 4-point rise in the national index of industrial production. The man-hour index in the District was still 2 points below the year-earlier level, while manufacturing employment, seasonally adjusted, showed no change in December. The January survey of purchasing agents revealed some increase in the frequency of reports of an upturn in new orders, but orders received by manufacturers in Massachusetts in December showed a decline for the second consecutive month on a year-to-year basis.

First District weekly reporting banks continued to show a declining loan trend, with the drop since December now amounting to \$90 million. This was fairly close to the seasonal pattern. However, commercial and industrial loans were down about \$60 million, more than expected on a seasonal basis since December.

Mr. Ellis expressed himself as satisfied with the conduct of open market operations and said he endorsed the reasoning expressed earlier by Mr. Stone with regard to transactions in coupon issues. In general, the market appeared to continue to operate quite smoothly within the guidelines that had been in effect since the shift in December to a policy of slightly less ease. Required reserves behind private demand deposits were now around \$200 million, rather than \$400 million, above the so-called growth guideline, while bank reserves and the money supply expanded in January at a less rapid rate than in previous months.

2/12/63

-22-

With respect to the question whether the System should consider policy changes out of deference to the possibility of an international payments crisis, Mr. Ellis said his thought would be to wait because the immediate future trend of the economy was yet to be made clear. If the economy should break strongly on the up side, the case for policy moves in light of the international situation would be strong. On the other hand, if the economy should break on the down side, the seriousness of shifting to a less easy policy must be considered; in that event, the opportunity for the System to move aggressively might be lessened. In the present circumstances, therefore, he would counsel waiting. He continued to feel that the current posture of monetary policy was appropriate until some definite economic trend appeared.

Turning to the policy directive, Mr. Ellis said he would like to feel that the directive was flexible enough to permit recording changes in the economic and financial situation as they developed. As to the second paragraph of the present directive, he saw little real need for change at this time except to refer to the forthcoming three-week period instead of the forthcoming two-week period. As to the first paragraph, he noted that the current directive had been redrafted somewhat by the Committee staff to provide a basis for discussion at this meeting. First, the draft would refer to a policy of accommodating moderate growth in bank credit and the money supply (rather than a growth more moderate than in recent months), and this change seemed appropriate. Second, the draft

2/12/63

-23-

would eliminate the reference to the "recent deterioration" in the U. S. balance of payments and would substitute a reference to the "continuing adverse" balance of payments position. This change also seemed appropriate.

Mr. Ellis also noted that the reference in the current policy directive to an absence of inflationary pressures had not been changed in the draft suggested by the staff. He thought that in using this language the Committee had not meant to imply that no inflationary pressures could be found; instead, that they were in limited areas and were offset by other pressures to produce a stable level of wholesale commodity prices. He suggested that the phrase might be dropped from the directive, that the word "general" might be inserted ahead of inflationary pressures, or that the word "absence" might be modified.

With respect to the second paragraph of the directive, Mr. Ellis noted that it would call for open market operations to be conducted with a view to maintaining about the same degree of firmness in the money market "and to offsetting downward pressures on short-term interest rates," while providing for continued moderate reserve expansion. Question had been raised by the staff as to whether the Committee would feel that the quoted phrase should be retained or dropped. Mr. Ellis said he would be inclined to retain it, along with the remainder of the language now found in the second paragraph of the directive.

Mr. Irons reported that there had been only very moderate changes in Eleventh District economic conditions, with perhaps on balance a slight strengthening of activity. Admittedly, however, within narrow limits an

2/12/63

-24-

observer could read the signs almost any way he chose. In January, department store sales were up from the year-earlier level, but they were down from the December level. Industrial production in the District was down slightly. Employment figures had improved slightly, while unemployment was around 4.8 or 4.9 per cent of the labor force on an unadjusted basis. Construction activity continued strong, and the number of awards in December suggested further increases. In petroleum, production had improved and refining was up slightly. In agriculture, 1962 receipts were at a record level. Losses due to recent weather conditions were uncertain, but it did not appear that they were likely to be as serious as some had anticipated.

Mr. Irons said that District banking developments reflected mostly seasonal movements. Loans were down about seasonally, with most of the drop in commercial and industrial loans. Investments also were down; banks reduced their holdings of Treasury bills, but this was offset somewhat by increases in portfolios of State and local government issues. Demand deposits were off seasonally, while time deposits continued to increase. There had been some increase in net purchases of Federal funds by District banks during the past period. This reflected the activity of a very few banks on the buying side, since most of the reporting banks were net sellers. There was not much borrowing from the Reserve Bank. Banks claimed that they were seeking loans and were in a position to take care of them.



2/12/63

-25-

Mr. Irons expressed himself as satisfied with the implementation of monetary policy during the past two weeks. Interest rates were well placed, in his opinion, in relation to the discount rate, which might be looked upon as the basic central rate. Bill rates had been quite close to the discount rate, while the Federal funds rate had stayed around the discount rate, and he considered these relationships satisfactory. He did not see evidence of inadequate reserve availability in relation to credit demands. On the international side of the picture, the U. S. rate structure appeared quite good in relation to foreign rates, all things considered, particularly in light of the recent weakness in sterling and the Canadian dollar.

At the present time, Mr. Irons commented, there were a number of major uncertainties in the picture. In the domestic picture, for example, there was uncertainty as to what would happen to the Administration's proposals for tax reduction and reform; in the international sphere there was the uncertainty engendered by the French veto of British entry into the European Common Market. Altogether, this did not seem to be a time for any overt change in policy. At the moment, since he did not see that a payments crisis was immediately at hand, he would hesitate to make any change from present policy on that score. Following that line of reasoning, it would seem appropriate if the bill rate was around 2.80-2.90 per cent, with the Federal funds rate around the discount rate,

2/12/63

-26-

a reasonably low level of member bank borrowing--perhaps around \$100 million, and free reserves around \$300 million plus or minus.

Mr. Irons said that he would have no objection to minor changes in the policy directive. On the other hand, he would just as soon continue under the existing directive, which would provide for continuing the policy that had prevailed for the past several weeks. He would not change the discount rate at this time.

Mr. Swan said that the Twelfth District picture showed no appreciable change in the past two weeks. One comment in the area of price developments might be of some interest in view of the discussion earlier during this meeting. While petroleum production was off somewhat during January, there was an increase in gasoline stocks, and this had been translated almost immediately into price weakness at the retail level in most of the major marketing areas on the West Coast.

District weekly reporting banks showed a considerably smaller loan decline in January than in the same month of 1962 or 1961, and the decline was also considerably smaller, relatively speaking, than at all weekly reporting banks. The reason for this development was not entirely clear, although one obvious sustaining factor was the continuing rise in real estate loan portfolios.

It was Mr. Swan's impression from scattered indications that, since the statistics had not shown the improvement anticipated in the change in business sentiment that occurred a few months ago, business sentiment was beginning to back up to the statistics.

2/12/63

-27-

Turning to policy, Mr. Swan said it seemed to him that, with no appreciable change in the business situation, with a number of Treasury financing operations scheduled for the near future, and with the many uncertainties obscuring the picture both internationally and domestically, this was not a time for a change in monetary policy. He noted, however, that total reserves had dropped rather sharply after mid-January, even though they were still above the guideline, that member bank borrowing was up rather substantially in the week of February 6, and that bill rates had been edging up a few points. It seemed to him, therefore, that the "even keel" of the past two weeks had in it what might be referred to as a slight upward tilt. In terms of a two-week period, this was not too significant. Over a somewhat longer period, however, it seemed to him that the Committee could get into a situation somewhat different from what it had anticipated. Thus, when he said that he favored no change in policy at this time, he meant no change from conditions that existed three weeks or a month ago rather than from those that existed today. He recognized that the serious nature of the balance of payments problem precluded any significant reductions in interest rates. He was not sure, however, that a gradual edging up of the bill rate accomplished very much, or that much could be accomplished unless the System was prepared to see a significant upward shift in the whole interest rate structure. In his opinion, this was not the point at which the Committee would want to consider such a move, in light of either the domestic situation or the immediate international situation.

As to the policy directive, Mr. Swan said he would be quite willing to accept the changes contemplated by the staff draft.

Mr. Deming commented that relatively little new information about the Ninth District had become available during the past two weeks. Preliminary January figures on nonagricultural employment indicated a slight improvement (on a seasonally adjusted basis) from December--about 1 per cent, and about 3 per cent over January 1962. While the number of people drawing unemployment compensation in January was some 14 per cent below the year-ago level, new claims were a bit higher than in January 1962. Both total unemployed and newly unemployed in January increased by about the normal seasonal amount. Department store sales in January were 3 per cent ahead of the same month in 1962, but they were down 3 per cent (seasonally adjusted) from December.

With regard to District banking developments, Mr. Deming said that January saw substantially larger than seasonal deposit declines and loan decreases at city banks, with about normal deposit and loan developments at country banks. At both classes of banks, investment totals behaved about as usual. The performance of loans and deposits at city banks might be no more than a reaction to the exceptionally strong behavior of both loans and deposits throughout the last quarter of 1962. Although the city banks seemed to be a little less liquid than they had been, they were not borrowing from the Reserve Bank. However, they had been rather steady buyers of Federal funds in the past few weeks.

2/12/63

-29-

Mr. Deming expressed the view that the Desk had performed quite well in the past two weeks, although he shared Mr. Swan's view that the even keel perhaps had a slight upward tilt. He had some impression that the market was just a shade firmer than he would have liked to see it. However, he did not have too much in the way of solid facts to support this impression. One could not quibble over a rise of a couple of basis points in bill rates, and dealer loan rates had remained fairly constant. On the other hand, he saw no need to push bill rates higher at the present time, particularly with the covered bill yield differential running in favor of New York. Also, the forthcoming increase in the supply of bills probably would work in the direction of a firming of bill rates.

Looking ahead, Mr. Deming indicated that he felt a continuation of even keel policy would be appropriate for the next three weeks. He would not change policy during that period, nor would he change the discount rate. He had no particularly strong feeling about any of the suggestions with regard to the policy directive. On balance, he would be inclined to leave in the second paragraph the phrase that called for offsetting downward pressures on short-term interest rates, if it should be the decision of the Committee to make no change in policy at this time, even though from a technical point of view it might be argued that there would be no need to offset downward pressures in the next three weeks and the phrase therefore did not need to be in the directive.

2/12/63

-30-

On the longer run situation, Mr. Deming indicated that he shared the concern expressed by Mr. Hayes regarding the balance of payments situation, but that he also shared the point of view expressed by Messrs. Ellis and Swan. It seemed to him, as apparently it did to some others, that System policy had been about as good as could have been expected over the past year and that it had accomplished about what the Committee hoped to do. He viewed the short-term rate policy followed during this period as rather passive and defensive rather than a strong influence. This was as he thought it should be, in light of the current and prospective economic situation. He did not see a great deal that monetary policy could do, short of a crisis situation, in the balance of payments area. The problem seemed to center fundamentally in the trade balance and in the area of long-term capital outflow, and any monetary policy action that was strong enough to be effective in regard to long-term capital outflow would be out of line with current and prospective domestic economic developments. In short, he did not see how the System could do much more than it was doing at present. He doubted the desirability of any further jacking up of short-term rates from present levels.

Mr. Scanlon reported that Seventh District business conditions had shown no significant change in recent weeks. Retail sales continued in good volume, steel production remained fairly stable, and production of automobiles was expected to continue at the current daily rate through the first quarter. It was now expected that any accumulation of steel

2/12/63

-31-

inventories would remain moderate, at least until March. Little reason was seen to expect early improvement in employment. The construction outlook, judging by contract awards, continued less promising in the District than in the nation.

As to banking developments, Mr. Scanlon said that the decline in total loans at District weekly reporting banks was about normal for January. Reserve positions of the large District banks had shown fairly large week-to-week swings recently, but on the whole had been somewhat tighter than in early January. Chicago banks had started their usual seasonal accumulation of bills preliminary to the April 1 assessment of personal property for tax purposes. Borrowing at the discount window had increased since mid-January, and in the latter half of the month Seventh District banks accounted for over 40 per cent of the U. S. total. Time deposits had continued to rise rapidly, with the major expansion in the "other time" category, largely certificates of deposit. The volume of certificates of deposit with September maturities offered by dealers suggested that banks were actively competing with Treasury bills and dealer repurchase agreements for short-term corporate funds accumulated for payment of Federal income taxes.

Turning to policy, Mr. Scanlon expressed the feeling that as long as rates were high enough to prevent a significant outflow of short-term funds the Committee should continue to provide reserves

2/12/63

-32-

to meet additional demands for credit and money. Some moderation in the rate of growth of bank credit had already taken place, and the money market had firmed. Meanwhile the business outlook was still uncertain, and further expansion of activities seemed desirable.

Mr. Scanlon agreed with those who felt that there should be no change in policy at this time. He would not change the discount rate. He had not come prepared to propose any changes in the directive, but he would have no objection to the technical changes that had been suggested.

Mr. Clay commented that it was apparent that the level of domestic economic activity was increasing very slowly. In fact, the measures of employment and output continued to show no change or small downward movements. The strength of consumer spending in recent months, notably in automobiles, was an encouraging development, but evidence of a pronounced upward movement in the economy still was lacking. At the same time the international balance of payments problem remained very difficult. The Committee was faced not only with the question as to what monetary policy could do about the problem but also the question as to what effect such monetary policy action would have on the domestic economy.

Mr. Clay said it was difficult for him to see how anything less than a sharp change in monetary policy could have much effect on the international flow of funds. The size of the U. S. capital



2/12/63

-33-

market, the state of domestic credit availability, and the marked spread between U. S. interest rates and those on relevant credit instruments in foreign markets supported such a view. In contemplating the desirability of such a policy, it would seem that the Committee must be mindful of the fact that policies that discourage domestic investment may make foreign investment more attractive for domestic capital. Apart from such considerations, the domestic economy continued to need the sustaining force of expansionary monetary policy.

Accordingly, Mr. Clay suggested that essentially the same policy as agreed upon at the January 29 Committee meeting be continued, along with a continuation of the same Reserve Bank discount rate. Presumably the sense of the policy directive also could remain unchanged.

Mr. Heflin reported that the Fifth District business outlook had not changed significantly in the past two weeks. The gradual declines in employment and hours that had characterized most manufacturing industries for several months appeared to be continuing. In contrast, employment in most nonmanufacturing areas had remained steady or achieved further small gains to record or near-record levels. Textile producers continued to operate under a dual handicap. First, they were paying \$42.50 more per bale for cotton than their foreign competitors. Second, forward planning remained hazardous, and orders at all levels continued to be based almost entirely on immediate needs. Action to eliminate or reduce the price differential

2/12/63

-34-

seemed assured, but how or when this would influence prices of cotton and cotton goods remained a mystery. Currently the most publicized plan called for subsidy payments equal to the foreign subsidy to be made in kind to domestic textile producers. The proposal faced numerous obstacles, however. Other plans called for: (1) a smaller subsidy to domestic users on the theory that transportation costs would offset the rest of the advantage currently enjoyed by foreign competitors; (2) elimination or reduction of the export subsidy; (3) an equalization fee on imports, an idea rejected last fall by the Tariff Commission. The equalization fee would leave foreign and domestic cotton prices unchanged but would raise the price of imported cotton goods to the extent of \$42.50 for each bale of cotton they contained.

Mr. Robertson presented the following statement:

The available evidence still suggests to me that the pace of business expansion is undesirably slow. The increase in market sales and gross national product does not seem to be much faster than the growth in our productive capacity, and we continue to have large numbers of unemployed men and machines. The fall business pick-up apparently was not enough to trigger any vigorous and broadly based upsurge.

With this thought in mind, I have become increasingly concerned as to the possible adverse consequences of the current less easy monetary policy. Interest rates have crept up counter-seasonally since the year-end. Early January figures on over-all bank credit and the money supply suggested a continuation into 1963 of the momentum of last fall's strong advance, but later figures show that the rise has been sharply

slowed, with reversals in key elements that may be going beyond a simple unwinding of the temporary December bulge. The money supply dropped off markedly in the last half of January. Reserve utilization by the banking system has slid back throughout January, with some of the sharper drops below seasonal patterns occurring in the latest weeks. Total bank credit growth slowed during January, and loan demand flattened out, in contrast to the vigor of demands by borrowers throughout the fall. I do not think we can sit idly by if this kind of trend continues. Nor do I believe we can comfortably assume that it is in no way related to our present less easy policy.

On the international financial side, interest rate differentials with the other major money markets are more favorable, and the nature of the political stresses that have developed in both Canada and Britain probably are going to dampen if not reverse capital flows in those directions for a time. This would seem to indicate that at the moment we have a little more leeway than before for using monetary policy flexibly.

Once again the Treasury financing schedule seems to preclude any significant move on our part before the next meeting. I would suggest, however, that in the time between now and March 5 we all pay particular attention to the flow of evidence regarding bank credit and monetary changes. If the apparent contractive tendency of recent weeks persists, then I believe we should come prepared to consider a policy of somewhat greater ease at our next session. In the meantime, I, for one, would like to see the Desk pursue the traditional "even keel," but with its day-to-day doubts resolved a little more on the side of ease than has been characteristic of recent weeks.

As to the policy directive, Mr. Robertson expressed concurrence with the draft that had been suggested by the staff. He would favor eliminating from the second paragraph the reference to offsetting downward pressures on short-term interest rates.

Mr. Shepardson expressed agreement with the view that the domestic economy did not seem to be moving ahead with any great

2/12/63

-36-

vigor at the present time. He felt, however, that the deterring factors were outside the scope of monetary policy and that they had to be dealt with by other means. Accordingly, he believed that the present posture of System policy was appropriate. He did not see any indication that monetary policy was exerting repressive or detrimental effects. Required reserves against private demand deposits had slackened from their end-of-year peak, but they seemed to have turned up in the past week or so, and they were still considerably above the so-called guideline.

Mr. Shepardson noted that the existing policy directive expressed a policy of accommodating growth in bank credit and the money supply more moderate than in recent months. It also called for open market operations with a view to providing for continued moderate reserve expansion. The point he wished to emphasize was that the directive called for continuing growth at a moderate rate, not restraint or cutting back. He had thought that such a directive was appropriate at the January 29 meeting, and he felt it was still appropriate, for he would like to see the rate of increase in required reserves move a little closer to the guideline than it had over the past several months.

Mr. Shepardson indicated that he would be inclined to agree with changes in the directive along the lines mentioned by Mr. Ellis. As at the January 29 meeting, however, he had a question about the appropriateness of a flat reference to an absence of inflationary

2/12/63

-37-

pressures. In his opinion, there were continuing inflationary pressures. For example, the terms of the dock strike settlement went beyond the Administration's so-called guidelines, and wage pressures were inherent in a number of present or pending strike activities. Also, there was a continuing rise in farm land prices. Those were only a few of the areas where he saw continuing inflationary pressures. They may not yet have resulted in significant wholesale commodity price increases, partly because of a continuing squeeze on profit margins, but they were reflected one way or another in agricultural and consumer prices. It had been suggested that a one or two per cent annual rate of increase in money wage costs was not significant, but when this country was trying to get in a more favorable competitive position vis-a-vis the rest of the world, any increase was on the wrong side. In his opinion, the reference in the directive to an absence of inflationary pressures should be eliminated or modified.

As to the course of monetary policy, Mr. Shepardson said he saw no alternative at the moment except to continue prevailing policy. He thought the terms of the policy directive had been implemented reasonably well by Desk operations during the past two-week period.

Mr. Mitchell referred to the comments that had been made about the effect of price changes on the competitive position of this country in world trade and asked the Committee to ponder for a moment what a 10, 15, or 20 per cent reduction in interest rates would do in terms

2/12/63

-38-

of stimulating the economy. He went on to express the view that the sustained program of maintaining the short-term rate had introduced abnormalities that would prove troublesome for the U. S. economy. Referring to the difficulties that were involved when the pegging of interest rates on Government securities was terminated in the early 1950's, he suggested that the System was again following a practice that could result in a substantial problem.

As to the immediate future, Mr. Mitchell said he could see no alternative except to continue prevailing policy and maintain an even keel. As to the directive, he was favorably inclined toward the draft suggested by the staff except in one respect. This related to the statement that it was the Committee's current policy to accommodate moderate growth in the money supply. He felt that the Committee really wanted to accommodate moderate growth in bank credit, but he was not so sure when it came to the money supply. He did not know precisely what was meant by the statement in the directive and therefore would suggest omitting it. However, in the second sentence, where the directive stated that the Committee's policy took into account, among other things, the substantial increase in demand deposits in recent months, he would substitute "money supply" for demand deposits. To him, this would be more in keeping with what he understood to be the Committee's thinking.

2/12/63

-39-

In a discussion based on Mr. Mitchell's comments regarding the directive, Mr. Deming indicated that he would concur fully in the changes Mr. Mitchell had suggested, these being in line with views he (Mr. Deming) had expressed at recent Committee meetings. Mr. Bopp noted that a decline of \$1.5 million in the money supply, seasonally adjusted, in the second half of January had been reported. It was his feeling, however, that the seasonal adjustments might not have been worked out too well. The Committee had been encouraged in recent years by end-of-year expansion, but then there had been reversals after the turn of the year. He was not at all sure about the longer run significance of the latest reported decline. Mr. Mitchell said he would be prepared to identify the period of growth in the money supply as October-December, and Mr. Young commented that the words "in recent months" had been included in the draft directive for the purpose of meeting that point.

Mr. Fulton stated that in the Fourth District automobile sales provided the only unblemished evidence of positive expansion in January. However, there were other elements of maintained strength for the month as a whole, and no serious setbacks. The general tone of business seemed good, without the usual January jitters.

Steel output faded somewhat as the month progressed but rebounded in the week ended February 9 to the highest level of the year.

2/12/63

-40-

New orders were reported to be showing substantial improvement, though they were smaller than had been hoped for earlier. Part of the increase in production in December had been attributable to the build-up of mill inventories, which were now being finished and shipped. Thus far, there was little evidence of a pronounced increase in customers' inventories of steel. Most buying was for current use.

Unemployment had edged upward on a seasonally adjusted basis, apparently reflecting primarily the effect of the continuance of severe cold weather. Construction had turned up in the fourth quarter of 1962 in all categories, with heavy engineering contracts especially strong. In the past week a permit for a \$20 million office building was issued in Cleveland, which would boost the figures substantially for February. Department store sales retreated slightly from the high December totals in the first five weeks of this year, with weather conditions undoubtedly playing a major part in the drop. Bank debits rose 4.6 per cent in January from the December total and stood about 10 per cent higher than the same month a year ago.

Earning assets at District reporting member banks declined in January. The decline in total loans was the largest for the period in the past four years. Business loans, seasonally adjusted, declined comparably to prior years, but loans on securities were in large volume.



2/12/63

-41-

Turning to policy considerations, Mr. Fulton said that perhaps he was a little more optimistic than some others who had spoken. He felt that this was a period of low visibility and that it would be desirable to wait for the economic outlook to become clearer before taking any overt action. It seemed to him, however, that there were signs of underlying strength in the economy, as evidenced by new orders for machine tools and the recent upturn in steel production. The dock strike had been terminated, with what was in his opinion a very bad settlement. There were tax proposals before the Congress that were unsettling, and the Cuban problem continued. Along with these factors, there had been bad weather conditions for some time. It was difficult to see how there could be clear economic visibility in those circumstances.

In his opinion, Mr. Fulton said, the Desk had done a good job in the past two weeks. He was not displeased about the slight trend toward restriction of reserve availability. Aside from the fact that an even keel was called for by the Treasury financing program, he felt that the policy posture of the System was appropriate. As to the policy directive, he would agree with the suggestions made by Mr. Mitchell.

Mr. Bopp reported that business in the Third District had not improved in recent weeks. December indications had ranged from mediocre to unsatisfactory, and the sparse data for January showed

2/12/63

-42-

no trend. The labor force status was unhealthy; output decreased in December; and the demand for labor remained poor. The most dramatic recent event was a three-week transportation strike in Philadelphia. Central city department store sales were off more than 40 per cent during this period.

Seasonal factors had dominated Third District banking statistics over the past several weeks. Loans and investments at reporting banks and deposits at all member banks had followed the descending path typical around this time of year. Pressure on reserve positions had at the same time eased considerably.

Mr. Bopp remarked that, as the Committee was aware, he had tended for some time to favor an easier policy than that favored by the majority of the Open Market Committee. However, now that the Committee had moved toward a slightly less easy position, and now that this had become generally understood by the public, he would find it difficult to advocate a return to the former position. At present, therefore, he would recommend little change in policy, interpreting this to mean a continuation of about the same reserve positions and money rates, with no change in the discount rate. A directive along the lines proposed by the staff would appear satisfactory.

At the same time, Mr. Bopp added, he felt it was important to watch developments closely for signs that might call for greater

2/12/63

-43-

ease. With economic activity virtually on dead center for many months, it would be important to detect early signs of the direction in which the economy moved off the plateau.

Mr. Bryan commented that it was difficult to say that anything significant had happened in the Sixth District in the past several weeks. At the same time, he got an impression of a gradual weakening of the District economy, although the statistics undoubtedly were affected by the severe weather. December nonfarm employment was off in every State in the District. Manufacturing employment, personal income, and average weekly hours also were off, while insured unemployment was up. The net of these figures was a general impression of weakness. They might be counteracted by saying that department store sales have shown strength, a development that was confirmed by the broader measures of retail trade. Construction contracts had taken a spurt, but this was really attributable to one large public utility project. While he could agree with the view that visibility was not good at present, nevertheless he did not have the impression that the Sixth District economy was moving upward. As to the national economy, it appeared to be about on dead center. It might be that the national economy was in the process of making adjustments that would allow it to come off the plateau on the up side, but he was not at all certain that that would happen.

2/12/63

-44-

Mr. Bryan recalled that at the January 29 meeting he had expressed the view that the Committee ought to aim for total reserves on about the 3 per cent trend line, which came out to about \$19.6 billion, with ample latitude to the Desk for variations around that figure. The present figure was not too far from that goal, and he would have no quarrel with the result.

Mr. Bryan said he could not advocate a change in the discount rate at this time. He would like to associate himself with the view that the reference in the policy directive to an absence of inflationary pressures should be modified.

Mr. Shuford said that in the Eighth District there had been only minor pluses and minuses in the economic indicators. In his opinion, none of them was of such nature as to warrant special mention. In brief, economic conditions thus far in 1963 had, generally speaking, just about approximated conditions in the latter half of 1962.

Mr. Shuford recognized that there appeared to have been a moderation recently in some of the monetary indicators, such as the money supply and bank reserves. At the same time, he regarded the policy actions taken last year as having resulted in very stimulative conditions during the latter part of the year. Consequently, he was pleased with the operations that had taken place over the past eight weeks. He would favor a continuation of the policy that had been in existence during that time.

2/12/63

-45-

Mr. Shuford indicated that he would have no objection to any of the changes that had been suggested in the policy directive. Personally, however, he felt that the policy directive as it now stood would be a satisfactory directive for the forthcoming three-week period. He would agree, if technical changes were going to be made in the directive, that the reference to an "absence of inflationary pressures" might be modified.

Mr. Balderston expressed agreement with those who would like to modify the reference, in the first paragraph of the directive, to an absence of inflationary pressures. He would suggest that the clause be eliminated or that there be substituted language such as "the continued stability of the general level of commodity prices." In this connection, he referred to the buying of common stocks at price-earnings ratios that would have been looked upon as far out of line a number of years ago. If the stock market were to break at some point in the future, he felt that the Committee might appear to have been a little naive if it had repeatedly referred in the directive to an absence of inflationary pressures.

Mr. Balderston suggested the possibility of shortening the second paragraph of the directive so that it would call simply for open market operations with a view to maintaining about the same degree of firmness in the money market that had prevailed in recent weeks. Since the reference to offsetting downward pressures on short-term interest rates had originally been included in a

2/12/63

-46-

context of offsetting seasonal pressures, it would seem that this language might perhaps be eliminated. As to the reference to providing for continued moderate reserve expansion, he suggested that this part of the directive had not been followed recently. This comment was made without criticism of the Desk. However, the use of such language might lead a financial historian at some time in the future to make the observation that, despite the directive, total reserves and required reserves against demand deposits were lower than at the beginning of the year. There had been comments at recent Committee meetings, he recalled, to the effect that reserves had been rising at a rate in previous months that could not continue. It was the Committee consensus that an increase of 8 or 9 per cent, annual rate, was something that ought to be corrected. The charts would show that there had been a correction since the first of the year, but it had been a return to the longer-term trend. This was not what the words of the directive seemed to imply.

As to the forthcoming period, Mr. Balderston recommended no change in prevailing policy.

Mr. Mitchell commented at this point that the first sentence of the directive stated that it was the Committee's policy to accommodate moderate growth in bank credit. This could hardly be done, he noted, without reserve expansion. He suggested that Mr. Balderston's

2/12/63

-47-

point might be met by changing the concluding words of the directive to call for accommodating, rather than providing for, moderate reserve expansion. Chairman Martin commented that business sentiment appeared to be declining at the moment, as it always tended to do at this time of the year. It was surprising to him that business sentiment had stayed as vigorous as it had for such a long period, particularly in view of the severe winter weather. In all, it appeared that the January-February doldrums might have come a little later than usual this year.

The Chairman went on to say that he thought monetary policy, over all, had been quite good during 1962. He did not think one could have expected monetary policy to do much more than it had. The thing that concerned him very much was the fact that the degree of ease that had prevailed over the past two years had not been more successful in stimulating business activity generally. Also, it was his impression that the quality of credit was deteriorating seriously in some areas, and this worried him a great deal. He knew of nothing that would discredit monetary policy more than forced liquidation attributable to the compounding of easy credit on easy credit. In many places he saw clear indications of overbuilding; he thought there could be no question but that easy credit was being used to start office buildings, luxury apartments, and similar projects. It seemed to him that this would lead to trouble. He hoped that businessmen would not get into that type of thing on a large scale.

2/12/63

-48-

The Chairman went on to say that if the System had been derelict in 1962 it was probably in paying a minimum of attention to the balance of payments problem. He did not pretend to know the answer to that problem, and he was not sure that the System could take any effective action in advance of a payments crisis. However, although he was not attempting to predict at the moment whether such a crisis would come within the next three or six months, there was little question in his mind but that a crisis was approaching in the Western world. Such a situation, if it came, would require all of the wisdom and collective intelligence that could be brought to bear, but he feared that was what the System was facing in 1963. He might just be seeing ghosts, of course, but one could not ignore the basic problems involved, and he did not believe those problems showed signs of easing. The world situation involved such factors as the veto of British entry into the Common Market, the Canadian political crisis, and instability in Latin America. In one sense the United States was an island of strength, which placed great responsibility on U. S. authorities to maintain the strength of the principal reserve currency until a time when the rest of the world became more stable. The System should be careful about overt moves in either direction, but he believed the burden of proof was on those who maintained that the System had not been doing enough to stimulate the domestic economy.



2/12/63

-49-

Chairman Martin added that one must never lose sight of the fiasco of too much borrowed money and the forced liquidation that might emanate from it. One must bear in mind the speculative possibilities involved whenever money was as freely available as it was today. While he was not proposing that the current availability of money be curtailed, he was sure that many of the time deposits--not included in the money supply as conventionally defined--were in effect purely demand deposits. He had checked a number of sources that he considered reliable.

The foregoing were factors, then, that must be borne in mind, the Chairman said. In his opinion, the important thing for the System in 1963 was to be stable and not be pushed unduly in either direction. He was sympathetic to the objective of stimulation of the domestic economy, but Mr. Hayes had stated well this morning a point that he (Chairman Martin) had been expressing for some time; that is, that the greatest single shadow over the domestic economy at the present time was the balance of payments problem. This was the type of question with which the Committee would have to concern itself over the course of the year.

Turning to a summarization of today's meeting, Chairman Martin said he understood there was no disagreement on policy for the next three weeks. It appeared to be unanimously agreed that there should be no change in policy and that an even keel should be maintained.

**Secretary's Note:** There had been distributed to the Committee by the Secretary a background statement of the current economic position. As amended in the light of subsequent comments, the statement read as follows:

The domestic economic situation continued to show little change from other recent months. Inclement weather affected business activity, as did strikes, in some important localities. Industrial production, nonagricultural employment, unemployment, and wholesale prices in January were at levels little different from those in December, or in mid-1962. Retail sales, seasonally adjusted, were estimated to be fractionally lower in January than in December but considerably above last summer. Sales of new automobiles increased to high levels, but department store sales declined. Auto markets were particularly strong, with sales of domestic cars at a 7 million annual rate. Construction expenditures edged higher.

Manufacturing employment and the average length of work week declined further. Average hourly earnings of factory workers were unchanged in January and less than 2 per cent above a year earlier. Judging from reports issued so far, profits in manufacturing appear to have risen appreciably in the fourth quarter. New and unfilled orders for durable goods declined in December, extending for another month a decline that began in October.

The seasonally adjusted money supply declined more in the second half of January than it rose in the first half, although it averaged somewhat higher than in December. On the other hand, the rate of growth of time and savings deposits accelerated. Seasonally adjusted bank credit rose substantially further, but the rise was concentrated in security holdings. Total reserves and required reserves against private deposit expansion declined over the past three weeks. Free reserves also declined, reflecting mainly increased borrowings. The money market firmed a little in the past two weeks as Treasury 90-day bills, at around 2.95 per cent, were close to their 1962 highs.

Capital market financing for February was indicated to be somewhat above the moderate volume in January owing to a considerably larger volume of municipal financing. The Government securities market regarded the February Treasury refinancing as highly successful.

Stock market prices, which had risen further in January on active trading, showed little additional rise in early February. Yields on U. S. Government, municipal, and corporate bonds generally rose during the past few weeks as investor caution increased.

The over-all deficit in the U. S. balance of payments was estimated for the month of January at about \$400 million. About half of this large net deficit was the result of a near-record volume of new foreign bond issues and placements--nearly all Canadian issues. U. S. exports rose sharply in December from their rate in the preceding two months, while imports declined from their advanced level in October and November. Because of the 5-week dock strike, which ended January 25, trade data for December and the next two or three months will not provide a reliable basis for appraisal of trends. Gold and foreign exchange markets were generally quiet, but the pound sterling and the Canadian dollar weakened abruptly in late January and early February as a result of political developments.

With respect to the policy directive, Chairman Martin expressed the view that the suggestions made by the staff seemed generally satisfactory. He noted that certain other suggestions also had been made, including suggestions by Mr. Mitchell and Mr. Balderston.

In the discussion that ensued, consideration was given first to the reference in the directive to an absence of inflationary pressures. It was suggested, after discussion of this point, that reference be made instead to an absence of "general inflationary pressures," and agreement was expressed.

Consideration was given next to the concluding clause in the directive, which called for providing for continued moderate reserve expansion. Mr. Balderston reviewed the points that had caused him to

2/12/63

-52-

raise a question about this clause, following which a suggestion was made, and agreed upon, that the directive be changed to refer to open market operations with a view to "accommodating moderate reserve expansion."

Discussion then turned to the question of retaining in the second paragraph of the directive a reference to open market operations with a view to offsetting downward pressures on short-term interest rates. Mr. Hayes expressed the view that this language should be retained. Asked whether he anticipated a need for offsetting downward pressures within the next three weeks, Mr. Hayes commented that within the context of the very modest change in policy in December, the Desk would want to do something about downward pressures if it saw them developing. Mr. Robertson noted that it had consistently been his position that this created a tendency toward a "bill rate only" policy. He asked whether Mr. Hayes would not be satisfied if the directive simply called for maintaining about the same degree of firmness in money markets as in the past few weeks. Mr. Hayes replied that this might suggest a shift in policy that was not intended at this time. The statement with regard to offsetting downward pressures on short-term rates was just as applicable for the next three weeks as it had been for the past two weeks. There could be a surge in the demand for bills that would put bill rates under considerable downward pressure, yet there might be no indication of less firmness in general market conditions. The retention

2/12/63

-53-

of the clause under discussion would give the Desk a degree of flexibility that he considered desirable.

Mr. Mitchell indicated that if, as he recalled, this language was first inserted in the directive to take account of anticipated downward seasonal pressures, it would seem to him appropriate to eliminate the clause at this point. Speaking along somewhat the same lines, Mr. Swan commented that even though the Committee had subsequently removed the word "seasonal" from the reference to downward pressure on short-term rates, the Committee had at first had in mind seasonal pressures that presumably would be identifiable as such. If the directive called for maintaining about the same degree of firmness in the money market, this presumably would mean that the Desk would take offsetting action in the event of either upward or downward rate pressures. If the reference was only to offsetting downward pressures, this would seem to go beyond the Committee consensus, which called for continuation of the existing policy.

Mr. Hayes commented that at the time the language was included in the directive there was some recognition, he thought, of the difference between general firmness in the money market and pressure on bill rates. He felt that it would be desirable to have this language maintained in the directive as a guidepoint if downward pressure on short-term rates should develop. Mr. Deming indicated that he would be inclined to retain the clause simply on the ground

2/12/63

-54-

that the Committee was not changing policy at this time. Technically, the language might not be necessary at this stage.

Chairman Martin commented that he thought a case could be made for retaining the clause on the grounds stated by Mr. Deming. He felt that the Committee should focus at each meeting on whether there was to be a change of policy in either direction. At this meeting it was clear that the Committee did not intend to make any change in policy.

In further discussion, additional points were raised that suggested to those who presented them a preference for either retaining or omitting the clause under consideration.

Chairman Martin then commented that this discussion pointed up a recurring problem with regard to the formulation of the directive. As he had said on previous occasions, he doubted the efficacy of taking votes on questions of phraseology. Accordingly, he suggested that there might be simply an indication of preference on the part of the Committee members for or against the retention of the particular clause under discussion. The members of the Committee then expressed themselves on this question, and it developed that all but two of the Committee members would prefer to retain the clause.

Chairman Martin noted that he had suggested the foregoing procedure (an expression of preference) because of his feeling that different words mean different things to different people. In his view, the taking of formal votes on matters of this kind was not

2/12/63

-55-

particularly satisfactory. This did not mean, however, that if anyone felt strongly enough his position should not be recorded.

Mr. Robertson indicated that he felt an important question was involved in the retention or elimination of the clause relating to the offsetting of downward pressures on short-term interest rates. The Committee, he thought, was tending to label itself as a "bill rate only" group. The problem, as he saw it, involved whether the maintenance of the short-term rate should be regarded as a principal function of open market operations. To him, therefore, the question went beyond merely a matter of words. He would like to be recorded as voting for the directive, but as not favoring the inclusion of the clause in question. He also indicated that he would like to furnish, for inclusion in the record of this meeting, a statement of reasons in support of his position.

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 following current economic policy directive:

It is the Committee's current policy to accommodate moderate growth in bank credit, while aiming at money market conditions that would minimize capital outflows internationally. This policy takes into account the continuing adverse United States balance of payments position and the

substantial increases in bank credit, money supply, and the reserve base in recent months, but at the same time recognizes the limited progress of the domestic economy, the continuing underutilization of resources, and the absence of general inflationary pressures.

To implement this policy, and in view of the forthcoming Treasury financing, System open market operations during the next three weeks shall be conducted with a view to maintaining about the same degree of firmness in the money market that has prevailed in recent weeks and to offsetting downward pressures on short-term interest rates, while accommodating moderate reserve expansion.

Votes for this action: Messrs.  
Martin, Hayes, Balderston, Bryan,  
Deming, Ellis, Fulton, Mitchell,  
Robertson, and Shepardson. Votes  
against this action: None.

Secretary's Note: Mr. Robertson subsequently transmitted to the Secretary the following statement in amplification of his oral comments at the meeting regarding his position on the directive:

Although Mr. Robertson voted to approve this directive, he expressed disapproval of the retention of the clause in the last paragraph: "and to offsetting downward pressures on short-term interest rates." He felt that the retention of this clause, well beyond the period of strongest rate pressures, suggested Committee preoccupation with the maintenance of a particular level of bill rates rather than with the promotion of a general monetary atmosphere appropriate to the objectives of the Committee. Open market operations to offset any downward pressures of market forces on bill rates were not currently justified either by international rate relationships or by domestic considerations. In his view, the need for stable monetary conditions during the Treasury financing period over the next three weeks was adequately covered by the injunction, immediately preceding the clause in question, that the Manager should conduct operations "with the view of maintaining about the same degree of firmness in the money market that has prevailed in recent weeks."



2/12/63

-57-

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, March 5, 1963.

This concluded the discussion of matters before the Open Market Committee for consideration at this meeting.

At the invitation of the Chairman, Mr. Deming commented as a matter of information on the grand jury indictment returned recently against a number of Minnesota banks, a bank holding company, and a clearing house association, charging certain practices in violation of the antitrust statutes.

Mr. Mitchell then presented observations based on his attendance at the Conference on Inflation and Growth held in Brazil in the early part of January.

The meeting then adjourned.

  
Secretary