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, May 28, 1963, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bopp
Mr. Clay
Mr. Irons
Mr. King
Mr. Mills
Mr. Mitchell
Mr. Scanlon
Mr. Shepardson

Messrs. Hickman, Wayne, Shuford, and Swan, Alternate Members of the Federal Open Market Committee

Messrs. Ellis and Bryan, Presidents of the Federal Reserve Banks of Boston and Atlanta, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Baughman, Eastburn, Furth, Garvy, Green, Koch, and Tow, 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. Rouse, Vice President and Senior Adviser, Federal Reserve Bank of New York
Messrs. Mann, Ratchford, Jones, Parsons, and Grove, Vice Presidents of the Federal Reserve Banks of Cleveland, Richmond, St. Louis, Minneapolis, and San Francisco, respectively
Mr. Brandt, Assistant Vice President, Federal Reserve Bank of Atlanta
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on May 7, 1963, were approved.

Under date of May 15, 1963, there had been distributed to the members of the Federal Open Market Committee copies of the report of audit of the System Open Market Account and of a report of audit of foreign currency transactions, both made by the Board's Division of Examinations as at the close of business January 25, 1963, and submitted by the Chief Federal Reserve Examiner under date of March 1, 1963. Copies of these reports have been placed in the files of the Committee.

Upon motion duly made and seconded, and by unanimous vote, the audit reports were accepted.

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 May 7 through May 22, 1963, together with a supplementary report covering the period May 23 through May 27, 1963. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs reviewed current and prospective developments in regard to the U. S. gold stock along with the results of recent gold pool operations. Continuing, he noted that the U. S. dollar was under increasing pressure against various Continental European currencies. As spelled out more fully in the written reports, there had been inflows of both short- and long-term capital funds into Continental money markets, attributable in some part to factors such as tight money market conditions, attractive possibilities for stock market as well as direct investments, and window-dressing operations by foreign commercial banks for midyear purposes. In addition, however, Mr. Coombs sensed some deterioration of sentiment abroad with respect to the U. S. dollar. The publication of the large first-quarter U. S. balance of payments deficit had attracted attention. There seemed to be a growing feeling in the money markets and in central banks that it might take several years before the U. S. got its international payments position into reasonable balance, which raised serious questions in the minds of foreigners as to how the problem would be handled in the meantime, and at this stage the announcement of even moderate gold losses caused an immediate market reaction. In the absence of the cooperative arrangements that had been built up by the U. S. Treasury and the Federal Reserve System over the past couple of years, the situation might now be rather dangerous. Drawings under System swap arrangements and

Treasury issues of bonds denominated in foreign currencies were absorbing the major impact of currency flows and were limiting gold losses.

After summarizing recent foreign exchange developments, including System and Treasury operations, again as spelled out in more detail in the distributed reports, Mr. Coombs noted that the total situation added up to a rather disturbing picture. Since early April the System had been drawing under several swap arrangements and operating in the market with the proceeds of the drawings on the assumption that the developments occasioning those operations would prove temporary. It was still too early, he thought, to conclude that more basic forces were responsible, and in his opinion the System would be well advised to continue to resist market pressures against the dollar through drawings on swap facilities. However, there was the risk of having to draw rather heavily, and the System might face difficulty in making repayment if the inflows of dollars into European capitals did not reverse themselves.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period May 7 through May 27, 1963, were approved, ratified, and confirmed.

Turning to recommendations for the Committee's consideration, Mr. Coombs called attention to a memorandum dated May 22, 1963, in which he had discussed the question relating to the periods of time for which drawings under System swap arrangements should be outstanding.

The preparation of such a memorandum had been suggested at the Committee meeting on May 7, 1963, in connection with a discussion of problems incident to the repayment of Swiss franc drawings under swap arrangements with the Swiss National Bank and the Bank for International Settlements. In his memorandum, Mr. Coombs suggested that the Committee establish a firm working rule (barring some unusual development in a given instance) of paying off any swap drawings outstanding if they had remained on the books for as long as a full year. In line with this suggestion, he recommended to the Committee a decision, subject to review in case of the development of critical circumstances, to repay in full the System's present $50 million drawing of Swiss francs under the Swiss National Bank swap arrangement on or before July 18, 1963, and similarly to repay the remaining $16 million drawing under the swap arrangement with the Bank for International Settlements on or before October 31, 1963. Mr. Coombs indicated that if the Committee accepted this recommendation he would negotiate with the Swiss National Bank and the U. S. Treasury on various aspects of the liquidation procedure. He stated that some of the problems involved, and possible solutions, would be outlined in a subsequent memorandum.

Following comments by Mr. Coombs regarding his memorandum and the recommendations contained therein, there was a discussion during which members of the Committee expressed general agreement with the proposed establishment of a working rule that swap drawings be paid off if they had remained on the books for as long as a full year.

While concurring in the proposal that such a working rule be established, Mr. Shepardson raised a question with regard to its application to the repayment of the drawings under the swap arrangement with the Bank for International Settlements. He noted that there had been originally a drawing of $60 million equivalent in July 1962 to help absorb a heavy flow of speculative funds to Switzerland after the U. S. stock market break, that repayments of $25 million had been made by late October, that the System then made a new drawing of $20 million to help absorb another heavy flow of speculative money into Switzerland following announcement by the President of the United States of the Cuban quarantine operation, and that $16 million remained unpaid. His question was whether, under the proposed working rule, the remaining $16 million should not be repaid by July 1963. Otherwise, he foresaw the possibility of overlapping or leapfrogging operations, so that even under the one-year rule swap drawings would never have to be fully repaid.

Mr. Mills made the observation that while the swap arrangements had served a good purpose up to this point, it would be wishful thinking to feel that they constituted progress toward a fundamental solution of this country's balance of payments problem. He wondered if more positive actions must not be considered on the part of the U. S. Treasury, with the Federal Reserve System taking only a secondary position.

Mr. Coombs concurred in the view that a solution to the balance of payments problem required more fundamental measures. He did not think, however, that the foreign central banks concerned would be unhappy about a procedure such as proposed in his memorandum. The possibility of leapfrogging, as referred to by Mr. Shepardson, had not occurred to him. In the case of the drawings under the swap arrangement with the Bank for International Settlements, it seemed to him that there had been clearly two separate drawings occasioned by speculative flows of funds into Switzerland associated with with two major disturbing events. The drawing in July had been paid off entirely, and the sum of $16 million remained to be paid off against the drawing that had been made at the end of October 1962. As he saw it, repayment of the remaining $16 million at or before the end of October 1963 would be consistent with the terms of the proposed working rule.

In further discussion of this point, Chairman Martin suggested that if Mr. Coombs' recommendations were adopted, such action be taken with the understanding that leapfrogging operations, in the sense referred to by Mr. Shepardson, were not contemplated and that the Open Market Committee would not favor them.

> Subject to this understanding, the recommendations of Mr. Coombs as set forth in his May 23 memorandum, including the establishment of the proposed working rule and the repayment of the Swiss franc drawings according to the suggested time schedule,

were approved unanimously. Reflecting the adoption of the working rule, unanimous approval also was given to the amendment of the Guidelines on System Foreign Currency Operations, as reaffirmed by the Committee on March 5, 1963, to insert the following paragraph after the third paragraph of Section 2 of the Guidelines:

Drawings made by either party under a reciprocal arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

Mr. Shepardson stated that while he would not vote against adoption of the recommendations, in principle he felt that under the working rule the remaining drawing outstanding under the swap arrangement with the Bank for International Settlements should not be allowed to run until October and instead should be paid off not later than July.

Mr. Coombs referred next to a memorandum of May 23, 1963, in which he had discussed means of effecting liquidation of the drawings of Swiss francs under the swap arrangements with the Swiss National Bank and the Bank for International Settlements. With specific regard to liquidation of the $50 million drawing from the Swiss National Bank maturing on July 18, 1963, the memorandum noted that it might be possible to acquire through small weekly purchases roughly $15 million of Swiss francs, and to reduce the System's drawing correspondingly. As to the remainder, the System could sell spot to the Bank for

International Settlements perhaps $13 million equivalent of sterling in exchange for an equivalent amount of Swiss francs. Simultaneously the System would undertake to repurchase such sterling with Swiss francs at the same rate of exchange 90 days hence, with the possibility of renewal. The Bank for International Settlements would acquire the Swiss francs by taking in deposits from the Swiss commercial banks and would invest in British Treasury bills the sterling acquired from the Federal Reserve System. This procedure would enable the Swiss National Bank to avoid purchasing gold, while also absorbing the additional liquidity injected into the Swiss market as a result of paying off the swap. Mr. Coombs believed the U. S. Treasury would be prepared to execute a similar swap of perhaps $13 million equivalent of its sterling holdings against Swiss francs and simultaneously sell outright to the System the Swiss francs so acquired at the prevailing market rate. The remaining $9 million required to pay off completely the $50 million swap drawing could be readily obtained by a direct System purchase of Swiss francs against dollars from the Swiss National Bank, which might then choose to hold the dollars temporarily or purchase a moderate amount of gold from the U. S. Treasury.

Mr. Coombs pointed out in his memorandum that utilization of the technique of swapping sterling for Swiss francs to liquidate the System's swap drawing would provide a useful additional experiment in System exchange operations. He noted that foreign countries can readily offset surpluses with one country against deficits with another simply by transferring the dollars acquired from the deficit country to the surplus country. The United States, however, faced serious technical difficulties in effecting transfers from one foreign currency to another, and the swap procedure suggested in the memorandum would provide a temporary solution to the problem of transferability. In effect the System would be employing a sterling asset to pay off a Swiss franc debt. While it would simultaneously incur a Swiss franc liability payable three months hence, it would retain an equivalent sterling claim.

Following comments in amplification of his memorandum, Mr. Coombs confirmed his recommendation that liquidation of the $50 million Swiss franc drawing under the reciprocal currency agreement with the Swiss National Bank be undertaken according to the procedure outlined in the memorandum, and that he be authorized to enter into negotiations with a view to liquidating the drawing in such manner.

Further, for reasons set forth in the memorandum, Mr. Coombs felt that utilization of the technique outlined therein, involving the swapping of System-held foreign currency assets to meet obligations in other currencies, was likely to be found useful in other instances. He suggested, therefore, that the Special Manager be authorized to arrange such swaps of currencies as might seem desirable from time to time up to a total of $50 million.

There ensued a general discussion during which Mr. Coombs responded to a number of questions on the technicalities of the recommended procedure for liquidation of the Swiss franc drawing under the reciprocal currency arrangement with the Swiss National Bank and on the nature of the more general authorization that he had requested. He also stated, in response to a further question, that he did not presently contemplate additional drawings of Swiss francs. There might occur, of course, some unforeseen event comparable in gravity to the fairly critical circumstances that had occasioned the previous drawings.

Mr. Coombs brought out that the suggested procedure for liquidating the drawing under the reciprocal agreement with the Swiss National Bank would involve, among other things, a direct purchase by the System from the U. S. Treasury of perhaps $13 million equivalent of Swiss francs at the then prevailing market rate. He felt that a direct purchase would be preferable to an indirect arrangement having the same ultimate effect although an indirect arrangement might perhaps be worked out, along lines that he mentioned, if the Committee so desired.

Upon question by the Chairman, it was indicated that the members of the Committee would not object to the direct purchase of the Swiss francs from the U. S. Treasury subject to the understanding that the francs would be acquired from the Treasury at the market rate prevailing at the time of purchase.

Accordingly, the procedure recommended in Mr. Coombs' memorandum for liquidation of the $50 million Swiss franc drawing, to mature on July 18, 1963, under the swap arrangement with the Swiss National Bank was approved unanimously, and it was understood that Mr. Coombs would enter into negotiations looking toward the liquidation of the drawing in such manner.

In addition, the Special Manager was authorized by unanimous vote to execute swaps of System-held foreign currencies for other foreign currencies in connection with the liquidation of System obligations in the latter currencies to such extent as might seem desirable from time to time up to a total of $50 million at any one time. To reflect in the Guidelines on System Foreign Currency Operations, as reaffirmed by the Committee on March 5, 1963, not only this action but also an action taken by the Committee on March 5, 1963 (as included at that time in the continuing authority directive on foreign currency operations), unanimous approval was given to the amendment of the Guidelines to add the following two paragraphs to Section 4 of the Guidelines:

The New York Bank may also, where authorized, purchase currencies through forward transactions for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements.

The New York Bank may further, where authorized, purchase and sell currencies through forward as well as spot transactions for the purpose of settling commitments denominated in one currency by means of utilizing the Bank's holdings of another currency.

Mr. Coombs recommended next that the Committee authorize renewal for a further three months of the $50 million swap arrangement with the Netherlands Bank maturing June 13, 1963, and renewal for a further six-month period of the $50 million swap arrangement with the National Bank of Belgium maturing June 20, 1963. He noted that the drawing of $50 million equivalent of Belgian francs under the swap arrangement with the National Bank of Belgium likewise would mature June 20, 1963, and expressed the view that it would be desirable to renew the drawing for six months.

> Renewal of the swap arrangements with the Netherlands Bank and the National Bank of Belgium, as recommended by Mr. Coombs, was authorized by unanimous vote, and the proposed renewal of the drawing under the swap arrangement with the National Bank of Belgium was noted without objection.

Chairman Martin then called for consideration of the proposal contained in a letter addressed to Mr. Hayes under date of May 10, 1963, by Lord Cromer, Governor of the Bank of England. For reasons stated, Lord Cromer suggested the execution of a swap facility in the amount of $500 million between the Bank of England and the Federal Reserve System. He proposed that the facility be initially for a period of 12 months and that, if it was availed of by either side, actual swaps be for three months with the right to a further three-month extension.

The Chairman recalled that several months ago the Open Market Committee had authorized negotiations with the Bank of England looking toward enlargement of the existing $50 million swap arrangement with the Bank to a figure as high as $250 million. The Bank of England had not heretofore expressed its willingness to enter into an enlarged swap facility, but after further consideration it had now submitted the proposal outlined in the letter from Lord Cromer, which seemed to warrant full consideration by the Committee.

Chairman Martin brought out that there had been distributed to the members of the Committee, along with copies of Lord Cromer's letter: (1) a memorandum from Mr. Young dated May 23, 1963, citing advantages and possible objections to the proposal, and expressing the opinion that an expansion of swap arrangements between the System and the Bank of England would be in the interest of the System and of the international financial position of the United States in general; (2) a memorandum from the staff of the Board's Division of International Finance dated May 22, 1963, discussing economic conditions in the United Kingdom; and (3) a memorandum from Mr. Coombs dated May 24, 1963, expressing the opinion that an increase in the swap arrangement with the Bank of England to $500 million would represent a major contribution to international financial stability.

For discussion of the matter, the Chairman turned first to Mr. Coombs, who explained and amplified the points in his memorandum arguing in favor of acceptance of the Bank of England's proposal. Mr. Coombs also identified two points in the proposal that would involve technical deviations from the terms of the swap arrangements heretofore entered into by the Federal Reserve System with foreign central banks.

With regard to the first of these, a suggestion by the Bank of England that the swap facility be initially on a twelve-month basis, he recommended acceptance of the suggestion by the Committee. In fact, he felt that it might be desirable over a period of time gradually to shift the swap arrangements with other central banks to a similar basis, thus obviating the necessity for renewals at three-month intervals. It was his impression that most of the central banks would react favorably to such a modification. Mr. Coombs brought out, as his second point, that the Bank of England's proposal contemplated that drawings under the swap facility would be limited to three months plus one three-month renewal. For reasons that he explained, Mr. Coombs was of the opinion that such a feature would introduce an unnecessary, and what in some circumstances could be an undesirable, degree of rigidity. He would prefer, therefore, to retain in this swap arrangement, as in the outstanding System swap arrangements, provision for three-month drawings renewable after consultation between the central banks concerned and upon mutual agreement. He had reason to believe that the Bank of England would be agreeable to the retention of such a provision in the proposed enlarged swap arrangement if it were indicated that this was favored by the Federal Reserve. Mr. Coombs added the comment that under the working rule adopted by the Committee earlier during this meeting with respect to repayment of drawings under swap arrangements, there would be an effective maximum limitation of three three-month renewals of an original three-month drawing.

Comments by the Committee reflected agreement with the views expressed by Mr. Coombs concerning the technical points to which he had referred in connection with the proposed enlarged swap arrangement with the Bank of England.

There ensued a general discussion by the Committee of the broader aspects of the proposal submitted by the Bank of England, with reference to numerous facets thereof including, among others, the size of the proposed enlarged swap arrangement. In this connection, reference was made for purpose of comparability to the $250 million standby arrangement with the Bank of Canada as well as to the agreements with such institutions as the Swiss National Bank, the Bank for International Settlements, the German Federal Bank, and the Bank of Italy. It developed to be the consensus of the Committee that in the case of the Bank of England a swap arrangement of the magnitude proposed could be justified. In reply to a question along these lines, Mr. Coombs indicated that he saw no way of measuring precisely the appropriateness of relationships between the size of one swap arrangement and another; in his judgment, no more than rough approximations could be made. The existing relationships between the various swap lines had evolved out of actual experience, and he thought this was perhaps the best guide available.

During the discussion of the British proposal, reference also was made to the possible public reaction to, and psychological impact of, the announcement of a swap arrangement of such magnitude between the Federal Reserve and the Bank of England, along with the possible reaction on the part of other foreign central banks having swap arrangements outstanding with the Federal Reserve System. Consideration was given to the benefits that might accrue both to the Federal Reserve and the Bank of England from the existence of the enlarged swap arrangement under various assumed conditions. There was general concurrence in the view that swap arrangements of this kind offered no fundamental solution to the U. S. balance of payments problem; as a temporary holding action, however, merit was seen in the defenses provided from the network of swap arrangements.

Inquiry was made whether, in the event of a British payments deficit vis-a-vis the Continent, the proposed swap facility might not be drawn upon for the purpose of dealing with such deficit, thereby placing more dollars in the hands of Continental holders and leading eventually to the possibility of further demands on the U. S. gold stock. In commenting on this question, Mr. Coombs pointed out that the purpose of the proposed swap facility would be to provide resources to counteract payments swings between the United Kingdom and the United States, rather than between the United Kingdom and the Continent. Drawings under the swap facility, and renewals thereof, would be the subject of close consultation between the Bank of England and the Federal Reserve System. It would be hoped that it would never be necessary for either party to draw on the proposed swap facility to the full amount. However, the facility would provide additional standby protection.

At the conclusion of the discussion, enlargement from $50 million to $500 million of the reciprocal currency arrangement between the Federal Reserve System and the Bank of England was authorized by unanimous vote, subject to the understanding that a modification of the proposal submitted by the Bank of England would be sought in the one technical respect recommended earlier by Mr. Coombs.

Secretary's Note: There follows the text of a statement released to the press by the Federal Reserve on May 30, 1963:

The reciprocal currency arrangement between the Federal Reserve and the Bank of England has been raised from $50 million to $500 million (from about 18 million pounds to about 180 million pounds), the Federal Open Market Committee announced today. Like the original arrangement with the Bank of England of May 31, 1962, the new agreement provides that forward cover, for any amount drawn, will be furnished to each party.

The substantial increase in the British swap reflects the desirability of enlarging the facilities for dealing with temporary and reversible flows of funds between the two largest centers of world finance. This agreement, together with other recent examples of international cooperation among central banks and treasuries, provides a major reinforcement of the world payments system and of international liquidity by increasing the availability of foreign exchange in case of need.

The new agreement brings the total of Federal Reserve reciprocal currency arrangements to $1,550,000,000. These swap arrangements do not in themselves constitute outstanding liabilities, but like the new British arrangement represent reciprocal facilities on a standby basis that may be drawn upon by either party from time to time.

In all such arrangements the Federal Reserve Bank of New York acts on behalf of the 12 Federal Reserve Banks under the direction of the Federal Open Market Committee.

It was noted that the Committee's continuing authority directive to the Federal Reserve Bank of New York on System foreign currency operations contained a provision that total foreign currencies held at any one time were not to exceed $1.3 billion. In view of the authorization that had just been given for enlargement of the swap facility with the Bank of England from $50 million to $500 million, it was suggested that it would be appropriate to amend the provision in the continuing directive relating to total foreign currency holdings. This would be in addition to an amendment of the directive reflecting the action taken earlier at this meeting authorizing the use of System holdings of foreign currencies, within a specified limit, for the settlement of commitments denominated in other currencies.

Accordingly, upon motion duly made and seconded, and by unanimous vote, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions in the System Account in accordance with the following continuing authority directive on System foreign currency operations:

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines on System Foreign Currency Operations reaffirmed by the Federal Open Market Committee on March 5, 1963, as amended on May 28, 1963:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs
Belgian francs
Canadian dollars
Austrian schillings
Swedish kronor

The Federal Reserve Bank of New York is also authorized and directed to purchase, in accordance with the Guidelines and for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements, any or all of the foregoing currencies through forward transactions, up to a combined total of $25 million equivalent.

The Federal Reserve Bank of New York is further authorized and directed to purchase and sell, in accordance with the Guidelines and for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies, any or all of the foregoing currencies through forward as well as spot transactions, up to a combined total of $50 million equivalent.

Total foreign currencies held at any one time shall not exceed $1.75 billion.

Before this meeting there had been distributed to the members of the Committee a report covering open market operations in U. S. Government securities and bankers' acceptances for the period May 7 through May 22, 1963, and a supplementary report covering the period May 23 through May 27, 1963. Copies of these reports have been placed in the files of the Committee.

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

The money market remained generally firm during the first part of the period since the last meeting of the Committee and after mid-May a somewhat greater degree of firmness emerged as action was taken to implement the policy decision of May 7. Federal funds traded consistently at 3 per cent throughout the whole period and there were varying margins of unsatisfied demand for reserves to be met at the discount window, with those margins somewhat higher after May 15 than before.

As it worked out, the slight shift in the System's posture was accentuated because of the erratic behavior of market factors in the latter part of the week ended May 22; free reserves on May 22 alone fell some $300 million short of expectations and the effect of this, together with required reserve revisions carrying in from an earlier period, was that average free reserves turned out to be about $160 million in that week compared with an average level of about $220 million that had been projected on the 22nd. The related effect on member bank borrowing was a sharp bulge on May 21 and 22 and a rise in weekly average borrowing to $281 million as compared with levels largely ranging between $100 million and $200 million earlier this year. Average borrowing may be sizable again this week, if only because a number of banks saw fit to borrow in size relatively early in the reserve period and in some cases they apparently managed to build reserve excesses over the week end.

The decline in published free reserve figures to $160 million for the week ended May 22, of course, helped to make the point clear to the market that System policy was undergoing a shift. Coming on the heels of a period of consistent firmness in the money market, a continuation of fairly good news about the domestic economy, and not-so-good news about the balance of payments, and further underlined by the System's sales of bills in the market a week ago Friday and Monday, market observers and participants now seem pretty well convinced that there has been a change.

There is much less certainty as to how much of a change has been made, however, and as to what impact any particular change might have on short- and long-term interest rates. It is noteworthy, for example, that through May 22, despite persistent firmness in the money market, three-month bill rates had worked up only to 2.94 per cent from 2.90 per cent before the last meeting of the Committee. After news of the reserve figures had interacted with other indications of a firmer policy there was a further moderate rate increase--to about

2.97 per cent in yesterday's auction of three-month bills--but there was good bidding interest as a result of the higher rates that had emerged.

Thus far, the long-term market has reacted only mildly, in terms of price and rate changes, to the shift in System policy. In part this reflects, as in the bill area, a considerable measure of uncertainty as to how far the System intends to move. More particularly, however, the mild price reaction reflects the substantial purchase orders that have been executed at the Trading Desk on behalf of various Government investment accounts. These market purchases enable the Treasury to retire special issues held by the trust funds, or to refrain from issuing such special obligations, and thus to hold the over-all debt within the current legal limit. Since May 2, but mainly in the past week, a total of over $550 million coupon-bearing securities has been purchased for various Treasury investment accounts--including about $155 million of 5- to 10-year issues and $143 million of over-10-year maturities. And yesterday we tendered for $100 million six-month bills for Treasury account--also to deal with the problem of the debt limit.

These substantial operations have eased the market's adjustment process to a modified policy posture, although they have not completely thwarted that process, for prices of intermediate and long-term issues have declined roughly 1/4 to 1/2 point and yields have risen by roughly 1 to 10 basis points in the interim since the last meeting. The changed market outlook is revealed more strikingly by the shift in dealer inventories in intermediate and longer issues during this period of large-scale Treasury buying. Thus, at the end of April, dealers had a net long position about $120 million in over-5-year maturities while on May 24 there was a net short position of about $40 million.

Given this heavy volume of buying for the Treasury--and it is not yet over, for we have somewhat over $100 million yet to do by Friday--we have sought to meet most of this week's reserve needs by running down the Treasury balance at the Reserve Banks from its recent level of $900 million. And we anticipate meeting a part of the even larger reserve needs of the next two weeks in the same way. Otherwise, we would be heavy buyers in a market that had been largely stripped of securities by Treasury buying, and the rate impact of the policy shift would be largely undone.

Other segments of the capital market also seem to be still in the process of adjustment. In the corporate market, sizable unsold balances remain of the $250 million American Telephone issue offered at 4.33 per cent just three weeks ago, and of a few other high-grade issues that had been aggressively bid for and too fully priced to whet investors' appetites. Some lesser rated issues have moved out well, however, and with the immediate calendar rather light it may be that the large issues still in syndicate won't fare too badly. In contrast, some congestion has again developed in the tax-exempt bond area, and dealers' advertised inventories have been worked down only with the help of price concessions. The concessions generally have not had to be very large, however, and there is a background feeling in this market, too, that underlying savings flows remain substantial and will tend to cushion price and rate adjustments.

The immediate prospect for debt limit legislation is still uncertain, but if the limit is lifted in time we understand that the Treasury may offer for cash an issue of intermediate-term bonds in the amount of about $1 billion or a little more--with announcement to occur next week and payment about the middle of June. If the Treasury should attempt such an offering, it may be confronted with a particularly difficult job of pricing the issue--both because the market would not have had sufficient time to appraise the extent of the System's policy shift, and because the reaction on intermediate and long-term prices and rates to that shift has thus far been offset in good part by the Treasury's recent purchases on behalf of the Government investment accounts. I might add, too, that our estimates at the New York Bank do not indicate any real cash need for the Treasury before late June. Debt limit permitting, the Treasury may be back again to borrow more near the end of June, in order to get a further start on its large financing needs in the second half of the year.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period May 7 through May 27, 1963, were approved, ratified, and confirmed.

The staff economic and financial review at this meeting was in the form of a visual-auditory presentation, for which Messrs.

Garfield, Hersey, Altmann, and Axilrod of the Board's staff joined the meeting. Other participants included Messrs. Noyes and Koch. Copies of the text of the presentation, and of the accompanying charts, have been placed in the files of the Open Market Committee.

The introductory portion of the review, presented by Mr. Noyes, was as follows:

> The record of the past year shows wide swings in expectations but only moderate changes in activity. Last summer, after the sharp drop in common stock prices, forecasts of recession--beginning in early 1963 or before--were common enough to gain a hearing for an immediate general tax cut. Even in the fall the so-called standard forecast called for a mild recession that would be at its low point right about now.
>
> In the actual event, industrial production and prices were substantially unchanged during the second half of 1962, while gross national product rose moderately. Outlays for plant and equipment stopped increasing, and with stocks of steel and some consumer goods being liquidated, over-all inventory accumulation was reduced to a low rate.
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> In the final quarter of 1962, however, sales of autos and other goods to consumers increased substantially, and this year retail trade has been maintained at the higher level. Surveys of plans for plant and equipment outlays taken early in 1963 indicated a renewed advance, and new orders for durable goods have shown considerable strength. Common stock prices have risen sharply since October, almost regaining the record highs of December 1961. Industrial production finally turned up, rising 3 per cent from January to April.
>
> As of April, the current period of recovery and expansion was 26 months old. At the comparable point in time after the 1958 recession low, the expansion was over and production was on the verge of decline. In the 1954-57 expansion, there was an extended period of stability not unlike the one we have recently experienced, and it was followed, after the 1956 steel strike, by a small further rise to a new high. Whatever the apparent similarities so far between that period and the current one, however, the differences seem at least as significant.

> The stability in production after October 1955 was at a level associated with an employment rate of 96 per cent, or an unemployment rate of 4 per cent. Throughout the current period, labor force use has been appreciably lower, with unemployment between 5-1/2 and 6 per cent. Utilization of manufacturing capacity also has been lower--for major materials about 80 per cent in the first quarter, compared with over 90 per cent in late 1955 and early 1956. Business capital outlays, in contrast to the easing last winter, continued to increase rapidly through 1956 while residential building declined.
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> But perhaps the most striking difference between the two periods is in the behavior of prices. Industrial prices are no higher now than at the bottom of the recession in February 1961. By the autumn of 1956 industrial prices were up substantially. With resource use relatively high in that period and business investment demands booming, rising prices probably contributed to a shift in resources away from consumer goods industries to capital goods industries.
>
> Significant differences appear also in interest rate developments. Yields on long-term Governments, for example, have risen little so far in this expansion, whereas at this stage in the two preceding expansion periods they were up substantially. The level of yields this time has been higher than during 1955 and 1956 but lower than in 1959. Evidently, considering developments in prices, capital outlays, and interest rates, no close parallel can be drawn with earlier postwar periods of expansion.

There followed sections dealing with production and investment in productive facilities, prices, resource utilization, the balance of payments, and financial developments. The concluding portion of the review, presented by Mr. Koch, was as follows:

> Our review of economic developments this morning indicates a marked pickup in activity in recent months. But, as at other times during the last year or so, expectations and psychology again appear to be outrunning the facts.
>
> The unemployment rate continues disturbingly high, over 5-1/2 per cent. Machinery and plant facilities are still ample, providing the basis for considerable further expansion of business sales. While consumer prices have shown some further rise,

wholesale commodity prices as a group have remained at the level prevailing for the past five years.

In the months immediately ahead, a slackened pace of steel buying will no doubt tend to slow down the over-all rate of economic expansion. A reduction in Federal taxes would tend to stimulate buying and activity, but the amount and timing of any reduction are still uncertain.

Financial developments have exhibited rather moderate movements in recent months. Total commercial bank credit has increased at a seasonally adjusted annual rate of about 6 per cent thus far this year, as compared with 9 per cent last year. The narrowly--defined money supply has risen at a 2 per cent rate since January, as compared with over 7 per cent late last year. New corporate and municipal security financing has been running almost 10 per cent below last year's pace.

Moreover, the private market appears to be taking some steps, tentative as they may be, to correct some of the financial excesses that have developed over recent years. It is difficult, at best, to measure credit deterioration. One very rough indication for commercial banks is the ratio of substandard loans, as classified by examiners, to total loans. Such a ratio--at a small sample of banks in three Reserve districts--has tended to rise since 1959, but it is still at a very low level. Banks are also in a more exposed position now because of their more aggressive investment policies, but some institutions are apparently becoming more cautious in the face of the cost of attracting interest-bearing deposits, potentially of considerable volatility.

Concern over excesses has been greatest in mortgage markets in recent years. Delinquencies and foreclosures are on the rise, but both still appear low. Investor interest in real estate investment trusts and syndicates has greatly diminished, apparently before a substantial amount of small savings was drawn to them. Also, a number of savings and loan associations in various sections of the country have recently announced reductions in rates paid on shareholdings.

Turning to the role of monetary policy in recent developments, the volume of required reserves behind total private deposits is probably as good as any other single indicator of the effects of policy on money and banking developments. As we all know, monetary policy, expressed in a given degree of money market ease or tightness, does not necessarily bring with it the same required reserve expansion at all times. During the second half of last year, when money market ease was slightly less than in the first half, reserve expansion was considerably larger. Thus far this year, in contrast, with ease reduced a little more, the rate of reserve expansion has also decreased, especially after the early weeks of the year.

A cautious note is suggested for any short-run interpretation of the total required reserves guideline. For the past year and a half, although required reserves behind total private deposits have increased at a seasonally adjusted annual rate of about 3-1/3 per cent, almost all of this expansion has gone to support the sharp growth in time and savings deposits. Since the end of 1961, required reserves behind demand deposits have increased at a seasonally adjusted annual rate of less than 1 per cent. Of course, some of the recent growth of time deposits has reflected the transfer of idle accounts out of the demand category. To the extent that this has been so, money supply growth has understated the rise in transactions balances.

In the case of recent modest shifts in policy, the change in the money supply apparently has depended mainly on the strength of the demand for bank loans. As you recall, money supply actually declined through August last year and then expanded rapidly in the final months when the demand for business loans was particularly strong. As banks seek to satisfy their customers, the System--following a given free reserve or tone of the money market guide to day-to-day open market operations--tends to supply the reserves demanded by banks at the prevailing interest rate structure. Thus, 1962 developments suggest that--assuming continuance of the moderate lessening of monetary ease adopted at the May 7 meeting and a continuation of the strong public preference for interest-bearing liquid assets--the money supply may not show any significant growth until the demand for loans quickens in the fall.

Of course, one's over-all assessment of the effects of monetary policy on the economy in the weeks and months ahead must look beyond the impact on bank reserves and money. In particular, it must take into account effects of policy on interest rates, and the likely effects, in turn, of changes in interest rates on the cost and availability of domestic borrowing on the one hand and of international investing on the other.

In the area of interest rates, short-term expectational effects resulting from gradual market recognition of the recent policy shift may lead to some further firming of rates, as has

> been occurring in recent days in the Treasury bill market. But any marked advance in rates, particularly in the longer term area, would seem to depend on a fall-off in the flow of savings or a substantial pickup in the demand for capital financing, since present demand and supply relationships in credit markets are not based on a high rate of monetary expansion.
>
> Unless the Committee is prepared to take much more drastic action than it has thus far contemplated, it seems likely that monetary policy will play an essentially neutral role in the period immediately ahead. On the one hand, any really significant lessening of credit availability, in the face of the large flow of savings, might well require monetary contraction. On the other hand, a move toward significantly more ease would mean sacrificing the constraints of higher short-term rates in tending to discourage capital flows abroad.

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

> Most of the current statistics point to continuing improvement in the general business situation. Production and orders have risen not only in steel but in a number of other industries. Housing figures look better than they did, and automobile sales are remarkably strong. The dip in retail sales in April may reflect inadequate adjustment for the date of Easter this year; and consumer spending plans continue to look encouraging. There is still no firm evidence of the expected pick-up in plant and equipment spending. Despite sizable advances in employment, the unemployment rate remains about unchanged because of a very sharp rise in the labor force.
>
> Although there have been a fair number of price increases scattered through various industries in recent weeks, it is not certain that all of them will "stick," and so far they have not been reflected in any significant changes in the general price indices. There is some uneasiness as to inflationary threats in other areas, especially real estate and securities prices. Stock prices are of course close to their all-time high, and the volume of stock market credit has reached a new peak.
>
> On the basis of reporting bank data for the first three weeks of May, bank credit rose more than seasonally. Much of this was due to an unusual bulge in security loans connected particularly with increased dealer inventories of slow-moving

securities and certificates of deposit. There are at least a few tentative suggestions in the statistics as well as in reports from loan officers at the larger New York banks that business loan demand has gained some momentum in the last month or two. High corporate liquidity has been a dampening influence on such loan demand. While this situation could change rapidly as economic activity rises further, bank liquidity still seems fairly ample to cope with such demands. Even though the growth of time deposits picked up in May after the noticeably slower growth rate in April, it seems quite possible that a renewed slowdown may be ahead as rising market interest rates tend to increase the attractiveness of bills vis-a-vis rates that banks are willing to offer on time certificates of deposit. In general, nonbank liquidity continues plentiful.

I have been much interested in the comments at recent meetings of the Committee as to deterioration of lending and investing standards in some areas of the financial structure. There seems to be little doubt that some degree of deterioration is occurring, principally because of pressure on institutional lenders to find outlets for a large and perhaps growing volume of savings funds. The real estate area seems to be the principal one in which a lowering of standards facilitates speculative activities. There is little evidence of any general lowering of standards in banking.

Our balance of payments position remains grave, with our deficit running at an annual rate of more than $3 billion. In April the deficit was about $270 million, and during the first half of May it may have been close to $200 million. It is still unusually hard to analyze the trade figures because of the uncertain impact of the longshoremen's strike; but it is clear that foreign short-term and long-term borrowing in our financial markets continues on a large scale. Because of our relatively cheap rates, there has been a remarkable expansion in the volume of dollar acceptance financing of merchandise shipments between foreign countries, which now amounts to $1.1 billion, or more than two-fifths of all dollar acceptances outstanding.

On the exchanges, the dollar has been under increased strain recently, in part because of some tightening of money market conditions in several European countries. With inflationary tendencies rampant in several of these countries, we can hardly count on declining interest rates abroad to help in restraining or reversing capital outflows from the United States.

For the time being the Treasury is out of the market, insofar as new issues and refundings are concerned, so that monetary policy need not be inhibited by "even keel" considerations. Just how long this will last is problematical, as the Treasury may wish to anticipate some of its July needs during June. According to our calculations, they will not actually need to obtain additional cash until toward the end of June.

In view of the lack of progress in improving our balance of payments situation and the evidence of renewed questioning abroad of our policies and intentions, and against the background of better domestic business prospects, I feel that the Committee clearly made the right decision at the last meeting. With respect to specific goals, it would be prudent to seek a 90-day Treasury bill rate of about 3 per cent, perhaps occasionally above and occasionally below, and a Federal funds rate consistently, as it has been, at 3 per cent. The problem of maintaining a firm bill rate may be rendered more difficult by the current need to add reserves up to the time of the mid-June float bulge, by the continuing demand for bills from nonbank sources, and by the complex maneuvers to which the Treasury has had to resort to cope with the debt ceiling problem. Under these conditions, achievement of our goal with respect to the bill rate may at times require lower free reserves, perhaps around the $100 million level, with correspondingly increased borrowings. On the other hand, a fuller realization in the market of a shift of monetary policy may make for higher short-term rates without requiring much change in recent levels of free reserves. Free reserve levels may therefore be an especially poor indicator of policy at the present time.

It seems to me that the time is fast approaching when a clear signal will be appropriate in the form of an increase in the discount rate, probably by 1/2 per cent. Our directors have felt for some time that the System should be doing more to defend the dollar's international position. I believe that some further period of "paving the way" through open market operations seems desirable; but it is perhaps not too soon to be thinking of the best timing for this more definite step, with due consideration of the timing of Treasury financing plans--and always provided, of course, that underlying conditions remain substantially as they are.

As for the directive, I would like to see wording that would accommodate the specific objectives I have already outlined. This would probably call for only a minor change in the present wording.

Mr. Shuford reported that economic activity in the major cities of the Eighth District had regained the ground lost in the latter part of 1962. Employment had recovered from the decline of last fall and now stood about one per cent above a year ago; the industrial use of electric power had moved up after showing some weakness in the last half of 1962; and department store sales moved up in March and April to levels substantially above a year earlier. Economic gains had been particularly marked in the St. Louis area, probably attributable largely to the increase in defense and space undertakings by one large firm in the area.

Turning to the national scene, Mr. Shuford commented that apparently the quickening of business activity this year had been quite similar to the quickening that occurred in the early part of last year. In both instances activity probably had been stimulated in considerable measure by the steel situation. In both instances the quickening was preceded by a marked expansion of the money supply. This year the industrial production index rose 3 points from January to April, about the same as last year. Employment and durable goods orders had risen more rapidly this year than in the like period of 1962. On the other hand, personal income and retail sales suggested less strength now than last year. Price indices had been relatively stable for quite a long period of time.

With regard to monetary policy considerations, Mr. Shuford said he was impressed by the continued worsening of the balance of payments situation and of dollar relationships on an international basis. Consequently, he was inclined to feel that perhaps it was time to begin thinking of some discount rate move. He also was inclined to feel that when the System made a policy move, perhaps it should be somewhat more significant than the policy moves in the recent past. In his opinion the policy decision made at the May 7 Committee meeting to achieve a slightly greater degree of firmness in the money market was a salutary one to the extent that short-term rates had moved up moderately. It might still be too early, he noted, to appraise the full effect of that policy change. For the present, therefore, he would favor no change in existing policy. If this should be the decision of the Committee, certain technical changes in the policy directive would seem necessary.

Mr. Bryan said that Sixth District statistics did not appear to require detailed comment. In brief, nonfarm employment was up, manufacturing employment was up, unemployment was down, and most other District statistics looked quite good. For the longer run, the most significant events now occurring in the District seemed to be those in the sociological field. Undoubtedly these events would have substantial economic repercussions at some point.

Turning to policy considerations, Mr. Bryan recalled that he had felt at the May 7 meeting that the Committee should adopt a moderately less easy policy. That having been decided upon, he would advocate no change in policy at the present. He would not provide for much more than seasonal adjustment in supplying reserves, certainly not more than a 2 per cent annual growth rate in terms of required reserves against private deposits.

Mr. Bopp reported that economic activity continued to be fairly strong in the Third District. Measurements of unemployment were showing consistent improvement, above seasonal expectations. Unemployment claims had reached low levels. Continued claims in Pennsylvania had dropped more than seasonally since mid-January, and new claims had decreased more than seasonally since mid-April. The rise in seasonally adjusted unemployment rates that began late in 1962 had aborted, and declines had ensued. The Philadelphia help-wanted index, which dropped steeply in 1962, had increased irregularly all through the winter and early spring. Output was holding up, though there was as yet no evidence of strong gains except in steel. Department store sales, however, were below year-ago levels.

There had been few significant developments in District banking in recent weeks. Bank credit at reporting banks declined in the first half of May by the same amount as in the comparable period last year. Time deposits continued to increase, while demand deposits fell. There seemed to be little, if any, pressure on the reserve positions of District banks.

The improved business climate, both nationally and in the Third District, was encouraging, Mr. Bopp observed. However, one should not lose sight of the fact that the rate of unemployment was likely to remain unsatisfactorily high in coming months even though the economy moved ahead. It was largely for this reason that he would have preferred to see money and credit somewhat easier than it had been very recently. While he would not now advocate a return to the Committee's earlier position, he did feel strongly that there should not be a further move toward less ease. It would be well at this point, he believed, to pause and observe the effects of somewhat higher rates and less ample reserves. In the meantime, he would like to see the flow of funds through the capital markets proceed as smoothly as possible. If necessary to avoid further congestion, he would advocate substantial purchases of longer-term issues. No change in the discount rate seemed to him to be called for at this time. The policy directive should call for operations with a view to maintaining, but not increasing, the slightly greater degree of money market firmness that had been sought pursuant to the decision reached by the Committee at the May 7 meeting.

Mr. Hickman noted that national business developments had continued favorable in recent weeks, with both performance and outlook sentiment strengthening further. Recent gains in production had been at a rate from one-half to two-thirds as large as those registered in the spring of 1961, a time of particularly vigorous upward thrust. Most measures of manufacturing activity confirmed this recent briskness, including new orders, order backlogs, payrolls, and employment; even such a limping indicator as freight carloadings had recently shown some signs of life.

Developments in the Fourth District confirmed the favorable tone of business generally, Mr. Hickman said. Since the preceding Committee meeting, the insured unemployment rate had declined further in all major labor market areas in the District, with the most pronounced improvement in Toledo and in the steel-producing centers. At mid-May, insured unemployment in the District, after seasonal adjustment, reached its lowest point in more than three years, and for the first time in three years stood below the national average.

New car sales continued at a strong pace in May, both in the nation and the District, although down slightly from the contest-supported levels of April. New car inventories declined in the first 20 days of May, partly because of the high sales rate and partly because of work stoppages. Auto production was now expected to exceed 2 million in the second quarter, bringing total output for the first half of the year to a near record of 4 million cars. Estimates of production of domestic cars for the year were running at a rate of 7.1 to 7.3 million.

Steel production in May, after seasonal adjustment, was estimated at an annual rate of 135 million tons, which could not be maintained. Analysts in the Fourth District currently were estimating 1963 steel production between 105 and 108 million ingot tons. The timing of the decline in output, after due allowance for seasonal adjustments, would hinge upon the timing of the labor settlement, which at the moment was still highly uncertain.

Raising of sights by forecasters was illustrated by recent projections of a group of business economists representing 25 large manufacturing and utility concerns mainly headquartered in the Fourth District. At a meeting at the Cleveland Reserve Bank on May 24, this group's median forecast of the industrial production index showed a maintenance of the present level expected for the third quarter of this year, followed by rises in the final quarter and in the first two quarters of next year. The change in attitudes was indicated by the fact that only 5 of the 25 participants foresaw any decline in general business within the next six months, whereas at the previous meeting last November as many as 17 expected a decline within the ensuing six months.

In evaluating the financial scene, Mr. Hickman expressed concern over the fact that risk assets held by commercial banks continued to edge upward steadily. At the end of April, the risk-asset ratio for all commercial banks stood 3 percentage points higher than a year earlier, and 4 percentage points higher than two years earlier, thus providing further evidence of the vigorous competition for less liquid types of assets and the steady surrender of liquidity by banks to maintain earnings. Moreover, within the "non-risk" category, the liquidity of U. S. Government securities portfolios of weekly reporting member banks continued to decline, with the proportion of Governments due to mature in less than one year down appreciably from a year ago.

The balance of payments statistics showed no evidence of improvement, Mr. Hickman noted. The weakness of the dollar against most major foreign currencies was too widespread to be explained by purely technical factors. It thus seemed to him that the Committee should continue to press towards still greater firmness in money and capital markets than had prevailed in recent weeks. The System should help to resolve market indecision, and its actions should confirm a definite change in official policy toward less ease.

The portion of the current policy directive that referred to Treasury financing should be deleted, and the directive--as amended--should be interpreted, in Mr. Hickman's opinion, to mean that less ease would be permitted in the next three weeks than during the past three weeks. If sufficient upward pressure were applied to the term structure of interest rates, he felt that an increase in the discount rate might appropriately be considered at the Committee's next meeting.

Mr. Mitchell presented the following statement:

Last week's probe, not too adroitly executed because of the nature of things, was in my judgment a more serious gamble with expectations and underlying trends in the economy than appears on the surface.

It was intended as a move toward less ease accompanied by a discernible upward movement in short rates. In my judgment, neither the domestic situation nor the balance of payments justified it.

We have been asserting that our posture is aimed at keeping U. S. short-term rates competitive; apart from temporary vagaries, they have not been less competitive in recent weeks. And we have very little, if any, evidence that a few basis points one way or the other can induce international flows.

I could only rationalize this move by interpreting it as being aimed at some other objective. One posture that has been urged on the Committee is to make some overt sign that it is willing to yield to "international monetary discipline." If this was the purpose of the recent action, it seems to me to have been a serious mistake. We have evidence from reports of discussions in OECD that our domestic monetary situation is not well understood by those who are pushing hardest for a firming of interest rates here. In particular, what is not understood is the effect on domestic expenditures of a move to tighten monetary policy.

Another purpose of the recent shift in policy might be to restrict the supply of long-term funds in order to make long-term interest rates more competitive with rates abroad. Here, it seems to me, the argument is on very weak grounds. Long-term rates are now high by historical or analytical standards. Despite the claim that the economy is overly liquid, long-term yields are high by comparison with any period in this century except for a few unusual episodes such as 1920 and late 1959-early 1960. Long-term rates are far above levels historically associated with even moderately easy money. Furthermore, existing and prospective flows--on both the demand and supply sides--are likely to be exerting downward pressures on long-term rates, or at most to balance out at a steady yield level. And market expectations are attuned to such stability. In these conditions, an effort by the System to boost long-term interest rates against the market can be successful only at the risk of slowing the expansion in domestic economic activity.

In this connection, I want to stress again that money creation has been making only a small contribution to the financing of expenditures. For the most part, voluntary saving has been flowing through financial institutions, including commercial banks, and into credit markets. In order to reduce this supply of funds significantly, we would have to halt monetary expansion completely at a time when it has already been much slower than the growth of incomes and output. Thus, if an increase in long rates was the objective of the shift in policy, it involves a serious gamble.

The only remaining possible justification for a move toward less ease concerns the quality of credit. Is it appropriate to deal with the credit quality problem, to the extent that it exists today, by restricting the supply of credit through tighter monetary policy?

In seeking an answer to this question, we must recognize that lenders have choices regarding the manner in which they respond when the flow of funds at their command increases faster than the investment outlets visible to them. Lenders may reduce the interest rates they pay; they may lower the interest rates they charge to borrowers; they may liberalize credit standards and terms other than interest rates; or they may offer a combination of these responses. The point to be emphasized is that the choices that lenders adopt among these techniques of making their product more attractive to borrowers ought not to be a major determinant of monetary policy.

If lenders ease credit standards as an alternative to lowering interest charges, they choose in effect to increase their risk exposure. Perhaps this is what has been happening in mortgage markets. Despite the reported plethora of mortgage funds, mortgage yields in the past year have declined only 20 basis points for FHA's and perhaps 15 basis points for conventionals.

This distinction between relaxing credit standards on the one hand and interest costs on the other should be familiar to all in the Federal Reserve. We frequently distinguish between cost and availability of credit, recognizing that in some credit markets availability may increase substantially with little downward movement in interest rates. As this happens, some terms of the credit contract are inevitably eased, for lenders are pushing on the flexible margin between eligible and ineligible borrowers.

When lenders push on this margin, they are narrowing the spread between their interest earnings and the cost of lending (unless the price paid for their funds also declines). This narrowing in spread occurs whether lenders lower the interest rates they charge or relax other credit terms, thereby

> increasing risk exposure. An increase in risk exposure constitutes a potential increase in cost, and lenders may need to be reminded of this fact.
>
> Lenders may choose either to reduce rates or to liberalize credit standards in seeking marginal borrowers for the additional credit that is being made available to the economy. The main question for this Committee is whether that volume of credit is appropriate. A decision to restrict the supply of credit in order to eliminate flows of funds into outlets that are enjoying easier credit standards would undoubtedly affect expenditures and discourage economic expansion.
>
> As long as output and employment remain well below full utilization, as at present, there are no economic grounds domestically for restricting the supply of funds. When and if total demands need to be restrained, it will be appropriate to restrict the supply of credit, regardless of the choice lenders have been making between adjusting interest rates and adjusting other terms of the credit bargain.

In further comments, Mr. Mitchell said there were certain questions about current economic developments that he felt ought to be resolved before the Committee made any overt move in the direction of tightening monetary policy. One of them related to the steel situation. Looking behind the figures, it was obvious that a factor underlying the recent strength was the attempt to hoard inventories. Certainly there was going to be a contraction of steel output in the next three or four months, depending somewhat on how the question of a strike was resolved. In a delicately balanced economy, developments in this connection might have an important impact, and he believed that more information should be available before any decision was made to move in the direction of more monetary restraint. Also, he believed that the automobile industry might be in a somewhat exposed position after two years of output at quite a high level. Further, there was a lack of sufficient assurance of expansion of business plant and equipment to feel that this was going to provide a boost to the economy. For these reasons, he would favor trying to get back to the policy posture that had prevailed prior to the May 7 meeting and staying in such a posture until the domestic economic situation showed more signs of continuing life.

Mr. King expressed the view that it was too early to make any further move toward a tightening of monetary policy. It would take a little time to observe the effects of the slight policy move made three weeks ago. Accordingly, he would recommend that System policy remain approximately the same as during the past three weeks, and he would restrict changes in the policy directive to technical corrections. He would not favor a change in the discount rate at this time.

Mr. Shepardson mentioned that he had attended yesterday a meeting of institutional lenders to agriculture during which a substantial period of time was devoted to the question of the quality of credit. There were numerous comments by lenders in various categories about a deterioration that they believed they observed in the quality of credit being extended by other types of lenders. This deterioration was said to take the form of higher loans on higher appraisals and easier credit terms without too much appraisal of the borrowers. In short, there was reported to be evidence of widespread deterioration in the quality of agricultural lending.

As to monetary policy, Mr. Shepardson expressed the view that the shift in policy made at the May 7 meeting was appropriate. He would favor a continuation of the slightly greater degree of money market firmness called for by that policy decision. It would seem appropriate to make certain technical changes in the policy directive.

Mr. Mills commented that as he interpreted the information presented in today's chart show, the gist of it was that the national economy had improved but had not moved either upward or outward impressively. This raised a question as to the posture monetary and credit policy ought to assume within the context of that kind of situation. The concluding statement in the staff discussion, as he recalled it, was to the effect that possibly the Open Market Committee should consider following a neutral policy, one that might give sufficient stimulus to the economy to encourage economic growth and at the same time serve as a buffer against the balance of payments deficit. A neutral policy, Mr. Mills observed, is essentially a passive policy, and it did not seem to him prudent for the System--and the Committee--to take a passive attitude against the background of the present economic situation, as compared with an active posture that would serve to encourage a reasonable degree of credit expansion.

In Mr. Mills' opinion, the Committee had allowed its thinking to be progressively overshadowed by the balance of payments problem, which in a sense was intractable of treatment by monetary policy.

Illustrative of the folly of attempting to use monetary policy as the sole weapon to attack the balance of payments problem were the memoranda supplied to the Committee regarding the situation in the United Kingdom. As he recalled, it was indicated that if the balance of payments situation became difficult, the United Kingdom would be likely to move to bring up short- and long-term interest rates as a defensive measure. This suggested that not only the United Kingdom but other Western European countries could be expected to look to their own interests first; and if dangerous situations required, to meet the problem through the interest rate approach. The only recourse left to the United States would be to bring up its own interest rates, with the foreknowledge that they would never be allowed to be raised to levels that foreign countries felt it was necessary for them to adopt defensively.

But to him the worst difficulty stemming out of the policy decided upon at the May 7 meeting, Mr. Mills said, was that cumulatively and through lagged effects such a policy was going to involve a reduction of credit availability at a time when reasonable credit availability was needed to foster the economic growth and liveliness that the System should have as a policy objective. If this policy was continued and strengthened, and resulted in a contraction of credit availability, that would not exert a corrective influence on the trend among commercial banks to be less careful in their extensions of credit. Instead, as credit became cumulatively tighter the banks would find loans becoming substandard, for the reason that the businessman depends on the support of credit not only for his own operations but through the general economic and financial scheme of things. If credit were less available, that would exert an adverse influence on his position, and consequently on the general structure of credit. Pursuing that line of reasoning, the Committee would do well to think seriously as to whether a general tightening of credit was the most appropriate policy. The Committee should consider whether that was the kind of policy most conducive to maintaining a thriving U. S. economy, one that would provide a general protection to the standards of world economic activity. He continued to believe that the economy of the United States was the anchor to which all other economies were tied. The System's first and last effort should be to use monetary policy to encourage strength and activity at home.

Mr. Wayne reported that Fifth District business was apparently still expanding, on balance, although the statistical evidence was somewhat more mixed than three weeks ago. Seasonally adjusted bank debits hit a new high in April, and nonfarm employment also rose to a record level, due largely to strong gains in trade and contract construction. Insured unemployment had continued to decline more than seasonally. The April increase in nonagricultural employment was actually quite modest because the small net gain achieved by nonmanufacturing enterprises was partially offset by declines in factory jobs. Reductions in factory man-hours were, in fact, rather widespread in April and were particularly sharp in textiles, but in most other cases the strong March gains were only partly offset. In the Reserve Bank's latest survey, manufacturers--including textile producers--reported a distinct upward trend in new and unfilled orders and shipments, but virtually no change in employment or hours. Survey respondents also indicated that retail sales were still improving slightly, and that construction activity remained strong.

In the country as a whole, Mr. Wayne continued, the improvement in economic activity had continued long enough to indicate that it was not an erratic short-term fluctuation. Two other characteristics of the expansion were equally apparent; it was of moderate proportions, and it had resulted to a significant extent from the build-up of steel inventories. In addition, inventory figures for the first quarter showed a general and significant accumulation of inventories of non-durable goods. Current statistics on the production and use of steel suggested that the economy probably had already felt substantially all of the upward impetus to be derived from the steel build-up, and that at some point not far in the future the inevitable reversal in this relationship would exert a downward pull. Currently, the failure of retail sales to maintain the encouraging gains of the first quarter and the sluggishness of outlays for construction and producers' durable equipment did not inspire confidence that these areas would provide the spark to keep the economy rising. Mr. Wayne's conclusion was that after three months of significant gains the economy faced uncertainties in continuing the present rate of improvement.

In the policy area, Mr. Wayne pointed out that for nearly three years the System had been moving by very small steps, such as the one taken at the May 7 Committee meeting. Except for such psychological effect as they might have on attitudes abroad, he was skeptical of the effects of such moves on this country's international position. In any event, it seemed to him that a position had been reached in which any substantial further tightening would have to be accomplished by a larger and more dramatic move; that is, an increase in the discount rate. The bill rate was now approaching the discount rate, and any further substantial reduction of reserves through open market operations could put the bill rate on top. If the differential should be significant and continue for more than a few days, it would almost certainly be interpreted by the market as a forerunner of an increase in the discount rate and would also cause unpredictable and probably very disturbing effects on the market for Federal funds, which now played an important role in the money market. He believed the System should not assume the risks that would be involved in such a situation. In the same way, an increase in the discount rate, by its very nature, would be interpreted as a major change of policy toward tight money.

He did not believe that the condition of the domestic economy either required or could stand such a move at this time.

Mr. Wayne assumed that the degree of firmness in the market at the end of last week was reached inadvertently; it seemed to him that it was a little more tightness than the Committee desired in framing the directive. For the next three weeks, he would favor a continuation of present policy, which he would interpret to mean about the degree of firmness which prevailed on the average over the past three weeks--which would be a little less than had prevailed in the past few days. He would suggest amending the directive to specify that degree of firmness. He would strongly oppose raising the discount rate at this time.

Mr. Clay advised that farm production prospects in the Tenth District had deteriorated substantially in recent weeks. Weather conditions had been extremely unfavorable for both crop and pasture production. Precipitation throughout most of the winter wheat area of the District was less than 25 per cent of normal in April, with much of the area receiving no measurable precipitation during this crucial month for the wheat crop, and conditions during the first half of May showed little improvement in the worst drought areas. Variable showers last week provided the most beneficial precipitation received in the southern High Plains area since last September. This moisture came too late to save much of the winter wheat crop, and more than half of the seeded acreage of wheat had been abandoned in southwestern Kansas, southeastern and east-central Colorado, and the Oklahoma Panhandle. Supplies of irrigation water also were inadequate throughout most of Colorado and New Mexico. While last week's moisture would be most beneficial in helping pastures start growing, pasture conditions were extremely poor in Colorado, western Kansas, the Oklahoma Panhandle, and New Mexico. Considerably more moisture would be needed soon if pastures were to develop normally in this area. In Nebraska and Wyoming, pasture conditions were somewhat better than normal.

Meat animal prices continued to remain under pressure, with both cattle and hog prices below year-earlier levels. Unless weather conditions improved substantially, a reduced volume of crop production, combined with a lower level of meat animal prices, was likely to cause a significant reduction in farm income in the region.

Tenth District nonfarm economic developments, as suggested by employment trends, had differed from the national pattern. The District appeared somewhat stronger than the nation during the last half of 1962, but it had shown little gain thus far in 1963. The national sequence was just the reverse of this pattern, with the early months of 1963 showing new evidence of expansion. In the District, manufacturing employment declined somewhat less than nationally during the last half of 1962, but it had continued soft in early 1963. As a consequence, District manufacturing employment, seasonally adjusted, was down about

2 per cent from last summer, while U. S. manufacturing employment regained last summer's level in April.

At the meeting of the Kansas City Bank's Board of Directors two weeks ago, Mr. Clay continued, the directors engaged in an extended discussion of domestic business conditions and prospects, with particular reference to price developments. The discussion was initiated by the position taken by one director at the executive committee meeting a week earlier, arguing for the need for prompt credit restraint and citing the rapid expansion of the economy and the developing threat of price inflation as the basis for such action. The most active participants in the discussion were six businessmen, including one visiting branch director who was asked by the chairman for his views. While most of these men were involved in several business undertakings, their principal businesses included electric power, petroleum, chemicals, nonferous metals, natural gas, foods, and construction. Most of the businesses were large regional or national firms, and three were international in scope. The general view expressed was that most business firms were unable to find enough customers at current prices and that they were not in a position to make significant advances in prices. Speaking both for their own firms and others with which they were familiar, they contended that competition and below-capacity operations simply would not permit much upward movement in prices. It was the consensus of the group that, so far as domestic business activity was concerned, there was no need to place restraint on the national economy but that restraint rather ought to be avoided. Concern was expressed over the upward push on costs from wage rate increases. It was indicated that these wage rate developments would put a squeeze on business profits in the form of costs that could not be passed on under present market conditions. In the long run, however, it was thought these cost increases would lead to higher prices.

Turning to monetary policy, Mr. Clay noted that the Committee had decided upon a slight shift in policy at its last meeting. While all of the secondary effects of that policy change had not permeated the financial structure, the basic action already had been largely implemented by the Account Manager during the past two weeks. The importance of this shift in policy depended upon whether it was the forerunner to further action now or shortly hereafter. It was hard to argue that this change by itself would prove a perceptible deterrent to the national economy. There also might be some question as to how much effect it would have on the international flow of funds.

Recent domestic economic developments had been encouraging, Mr. Clay added, but they were not such as to call for restraint. Credit tightening sufficient to affect international capital flows substantially would seem to be of that order. Without passing judgment as to appropriate credit action at some later date, it appeared to him that no further credit tightening should be undertaken at this time. Accordingly, the discount rate should be left unchanged. The wording of the directive should be changed so as to remove the reference to Treasury financing and also so as to prevent cumulative credit tightening as a result of the language adopted at the last meeting. Operations in longer maturities should be undertaken by the Manager as necessary to facilitate attainment of the Committee's goal with respect to the short-term rate.

Mr. Scanlon reported that business and banking sentiment in the Seventh District remained optimistic, although he heard of elements in the picture that suggested caution.

As others had noted previously, steel output was likely to decline fairly soon. In the past few weeks the rate of new orders for one local producer had been only half as great as in the previous two or three months, when orders were "well in excess of capacity." Retail trade in April and May, in the District, had been somewhat below the rate of the two previous months. According to merchants, cold weather had had an adverse effect on the sale of soft goods in recent weeks.

The rate of growth of time deposits at member banks in the District appeared to have declined further in the first half of May but was still at a high level. The seasonally adjusted inflow rate declined in April both for regular savings and individuals' holdings of time certificates, while the withdrawal rate for regular savings deposits continued near the high March rate. At savings and loan associations there was a rise in withdrawals in March similar to that noted for bank savings deposits and probably attributable to the same causes, i.e., increased spending for durables and greater use of past savings for payment of income and real estate taxes. There had been a renewed rise in time certificates of deposit issued to corporations in recent weeks.

Deliveries of domestically-produced cars to U. S. customers continued high. Output of 1963 models was now about set at 7,250,000--a new record exceeding the previous high of 7,130,000 in the 1955 model year. Reportedly, there would be about 90,000 1963 models produced in August. Then, following the changeover shut down, it was expected that about 100,000 1964 models will be produced during the remainder of the month.

Total bank credit declined relatively more in the first two weeks of May in the District than in the nation. Both loans and investments were reduced. The loan decline was traceable largely to repayments by finance companies and security dealers. However, business loans did not rise in this period as in most other recent years, notwithstanding the rise of steel inventories.

As to policy, Mr. Scanlon recalled having felt three weeks ago that if the Committee were to change policy, as the directive indicated, to "putting increased emphasis on money market conditions that would contribute to an improvement in the capital account of the U. S. balance of payments," the change should be more than a "probing" action. It should be a clear signal, obvious to everybody. For this and other reasons, he would have preferred to wait for somewhat clearer evidence of the strength of current expansionary forces. However, inasmuch as a slight shift in policy had been made, he would favor maintaining the current posture for the present and observing its effects during the next three-week period. He would not change the discount rate just yet. He would change the directive to the extent of making technical corrections and providing against a cumulatively greater money market firmness.

Mr. Swan, in summarizing developments in the Twelfth District, noted that the primary metal industries were doing quite well and that even in the lumber industry there had been a slightly improved relationship between orders, production, and inventories in early May. However, the unemployment rate in the Pacific Coast States increased sharply in April to a 15-month high on a seasonally adjusted basis, apparently largely because of adverse weather, which affected employment in agriculture, construction, and lumber, and because of some further reduction of employment in defense industries. One major labor market area (San Jose) had been reclassified from the category of moderate to substantial unemployment, making a total of five major areas in the District so classified. Department store sales in the District declined in April but improved somewhat in the first half of May. In late April and early May, the possibility of a strike at a major aircraft firm in the Seattle area was reflected in a substantial cut-back in consumer spending until the strike threat disappeared. Weather in the District in April and early May was marked by excessive rainfall, which had affected fruit crop prospects adversely.

As to District banking developments, Mr. Swan noted that while the large banks continued to be net sellers of Federal funds, borrowing from the Federal Reserve Bank had increased, especially in the weeks ended May 15 and May 22. There had been considerable discussion recently of the possibility of a reduction in rates paid by savings and loan associations for savings funds. The largest savings and loan institution in Arizona had announced a reduced dividend rate on share accounts effective the middle of this year.

Mr. Swan expressed the view that the business situation did not justify any further tightening of monetary policy at this point and that System policy should continue in its present posture. Since policy shift had been decided upon at the May 7 meeting, he would not advocate going back to greater ease at this time. However, he questioned whether the degree of firmness achieved in the past two weeks was fully intended within the scope of the policy decision three weeks ago. He had understood the emphasis at that time to be on "slightly" less ease. The situation since May 15 left the impression that the word "slightly" had been stretched quite far, although he gathered this was partly inadvertent. In summary, it would be his feeling that the Committee should continue the policy it had instituted at the May 7 meeting, which in his view would call for slightly more ease than had obtained in the past ten days. He would not favor changing the discount rate at this time, and he felt the directive should be so worded as to avoid the possibility of cumulative tightening.

Mr. Irons noted a gradual strengthening in most of the areas of business activity in the Eleventh District. The industrial production index was up a couple of points in April and probably another point in May, with fairly broad participation in the increase. The petroleum situation had been a little stronger in May, and construction activity continued strong. Employment continued to rise, and unemployment stood at about 4.5 per cent of the labor force. Retail trade figures were well above year-ago levels.

The over-all position of District banks was not tight; in general, the banks apparently were able to meet any foreseeable loan requirements. Both demand and time deposits had risen during the past three weeks.

Mr. Irons expressed satisfaction with the operations of the Desk during the past three weeks, stating that he thought the Desk had done what was called for by the Committee's May 7 action, namely, to achieve a slightly greater degree of firmness in the money market.

There seemed to have been no lack of availability of reserves, although member bank borrowings had increased somewhat. At the same time, he felt that the movements of the past three weeks were bringing the Committee quite close to the point of major decision, and he was not sure that he was ready for such a decision at this time. In other words, there had been a slightly greater degree of firmness, of which he approved, but if this were made cumulative the Committee soon would be at a point where it would almost have to make a decision to move on the discount rate and shift to a policy of real firmness, in contrast to a moderate degree of firmness. He would not be prepared to raise the discount rate today, and therefore would favor continuing the level of firmness reached during the past two weeks rather than to proceed in a cumulative manner.

As a target, Mr. Irons suggested that the short-term rate be at about 3 per cent. Free reserves, though not a reliable measure under present conditions, might be somewhere in the area of $150-$200 million. Federal funds should be at 3 per cent and at times not adequately available, thus giving rise to some member bank borrowing. On that basis, he would want to observe developments for at least a further three-week period.

Mr. Ellis noted that the New England economy was falling short of the pickup of business activity evident in the national figures. While consumer spending was higher than a year ago--as evidenced by activity in auto show rooms, department stores, and resort areas--and business investment was increasing, the increases were not occurring at the national rate. The level of residential construction was above a year ago, but again the increase had not been as significant as the improvement nationally. Manufacturing output was just about on a par with a year earlier. Initial claims for unemployment compensation were about equal to those of a year ago, while the unemployment rate stood at approximately year-ago levels. There had been an increase in loan demand at District banks since the March tax date and business loans had risen better than seasonally, especially since the past few weeks. Savings growth slowed down in April, but seemed to have quickened since that time.

Mr. Ellis indicated that he would continue to regard the present posture of System policy as one of ease. As he understood the decision at the May 7 meeting, the Committee was experimenting with a slightly lesser degree of ease. He had not viewed the shift of policy as a decision to undertake an uninterrupted and progressive tightening, and he would not expect another 7 basis-point rise in the bill rate during the forthcoming two weeks or on a cumulative basis thereafter. Instead, he saw this as a time for the Committee to be consolidating its position, allowing the market to obtain an understanding that the System was not engaged in a full-fledged continuing move toward a restrictive monetary policy. It was too early, in his opinion, to start considering discount rate action. For the forthcoming three weeks, he agreed with the targets expressed by Mr. Irons. As to the directive, he would suggest language indicative of no further shift of policy at present.

Mr. Balderston said that the comments of Messrs. Irons and Ellis as to monetary policy reflected his own point of view. He would favor continuing open market operations along the same lines as conducted by the Desk during the past three weeks. In composing the policy directive, he hoped that the Committee could avoid expressions signifying a tightening of monetary policy at this time. As he looked at the increase in the money supply during the past year and the way in which reserves had mounted, it seemed to him that System policy continued to be one of ease, although somewhat less ease.

Mr. Balderston then referred to the series of observations at the May 7 meeting concerning the quality of lending and said he hoped the Reserve Bank Presidents would explore this question more fully. While he was not sure that a great deal of help could come from reviewing reports of examination of member banks, this was one source that could be used. In addition, he hoped the Presidents would ask the Reserve Bank directors what evidences they found in their business activities of deterioration in lending standards. Real estate lending probably was one area to examine closely. He suspected that lending standards were being reduced more by savings and loan associations and others than by commercial banks. In any case, however, it was important for the Committee and the System as a whole to know what was going on rather than to be surprised at a later date.

Chairman Martin noted that sometimes there tended to be comments at Committee meetings that sounded as though the economy was going to be made or broken by shifts of, say, $50 or $100 million in free reserves. This, of course, was not the case. At the same time, as he had stressed at the May 7 meeting, he felt that the posture of the Federal Reserve System was very important at this juncture. On the whole, and through the years, he believed that the posture of the System had been quite sound. He believed, also, that the policy developed recently was good, provided it did not get ahead of itself. The Committee was dealing with short periods of time in its policy discussions, he pointed out, since it met every three weeks.

The Chairman went on to say that two matters seemed to him of paramount importance at the moment. First, there was the problem of the Treasury in relation to the debt ceiling. The impact of this situation on the money market should not be overlooked. The problem was important from the standpoint of monetary policy as well as debt management. Second, Chairman Martin referred to developments in the foreign exchange market as critical. It might be months or years before the situation reached the point of serious trouble but developments seemed to him to be moving in that direction.

In view of the problems to which he had referred, the Chairman expressed the view that this would be an unfortunate time for the Federal Reserve System to be making relatively unimportant moves in the money market. At the same time, the posture developed by the Federal Reserve was highly important.

Continuing, the Chairman noted that at last week's meeting of the Federal Advisory Council with the Board of Governors the President of the Council had pointed out that in a situation of slightly less easy credit some forms of credit, such as for hotel speculation, might be deferred in favor of more sound loans. Shortly after that meeting, he (Chairman Martin) had heard of a specific instance where a large real estate transaction was deferred because the bank concerned had found a more constructive outlet for its funds. While this coincidental occurrence should not be overemphasized, he thought it was interesting. The availability of credit, the Chairman added, inevitably has some bearing on the quality of credit. It is virtually impossible, likewise, to separate completely the cost of credit and its availability. Similarly, despite Federal Reserve actions, interest rates must be viewed against the shifting background of the economy as a whole. Generally speaking, when the economy moves downward, rates move down and vice versa. When the economy is on a plateau, rates tend to be stationary.

Chairman Martin expressed the view that current Federal Reserve policy was appropriate and said he would favor a continuation of the status quo. He hoped that was the posture the System would assume at this time.

It was then suggested that a vote be taken on no change of policy during the forthcoming three weeks to determine whether that was the consensus of the Committee, and language for a revised second paragraph of the current economic policy directive that would reflect such a decision by the Committee was suggested.

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

It is the Committee's current policy to accommodate moderate growth in bank credit, while putting increased emphasis on money market conditions that would contribute to an improvement in the capital account of the U. S. balance of payments. This policy takes into consideration the continuing adverse balance of payments position and its cumulative effects and the improved domestic business outlook, as well as the increases in bank credit, money supply, and the reserve base in recent months. At the same time, however, it recognizes the continuing underutilization of resources.

To implement this policy, System open market operations shall be conducted with a view to continuing the degree of firmness in the money market that has prevailed recently, while accommodating moderate reserve expansion.

> Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Clay, Irons, King, Mills, Scanlon, and Shepardson. Vote against this action: Mr. Mitchell.

In a comment made with respect to his vote, Mr. Mills brought out that his views were not in agreement with the shift in policy that had been decided upon at the May 7 Committee meeting. However, he voted in favor of the policy directive approved at this meeting because he felt that a shifting of policy back and forth at this time would be more harmful than helpful.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, June 18, 1963.

The meeting then adjourned.

Ralph A. Young

Secretary