A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, July 30, 1963 at 9:30 a.m.

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

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

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

Mr. Young, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Baughman, Brill, Eastburn, Garvy, Green, Holland, 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. Hersey, Adviser, Division of International Finance, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Quick, Secretary, Office of the Secretary, Board of Governors

Messrs. Patterson and Hemmings, First Vice Presidents of the Federal Reserve Banks of Atlanta and San Francisco, respectively
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. Eisenmenger, Director of Research, Federal Reserve Bank of Boston
Messrs. Cooper and Meek, Managers of the Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on June 18 and July 9, 1963, were approved.

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 July 9 through July 24, 1963, together with a supplementary report covering the period July 25 through July 29, 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 with respect to the U. S. gold stock and summarized developments in the London gold market. He went on to say that judgment abroad as to the proposed "interest equalization" tax on U. S. purchases of long-term foreign securities was still hanging in the balance. On the one hand there was some feeling that the tax, by imposing a freeze on American purchases of foreign securities--new issues as well as outstanding--should have a strengthening effect on U. S. dollar rates. On the other hand there was a rather widespread feeling that the tax could be circumvented through bank term lending and that a system of direct controls might eventuate.

Mr. Coombs noted that in connection with the President's balance of payments message on July 18, efforts had been made by foreign central banks, in conjunction with the efforts of the Federal Reserve and the Treasury, to keep up dollar rates, and if possible to show some improvement. These efforts had contrived to keep dollar rates fairly steady except in the case of the Swiss franc. If the dollar went to the floor against the Swiss franc, that might have been regarded as a sign of no confidence. Therefore, as spelled out in the written reports a variety of measures were taken to try to hold up the dollar against the Swiss franc, but market pressures were strong enough to force a gradual decline in the dollar rate. In addition, a $25 million drawing under the System's swap facility with the Swiss National Bank was proposed yesterday. However, the National Bank had suggested holding off for a day or two, with the thought that the demand for Swiss francs might ease after the end of the month.. There were indications of some speculative content in the buying of francs, but continued tight money market conditions in Zurich might offer a more important explanation. The situation was similar in most of the other major financial centers on the Continent. There had been no further deliberate tightening of these markets, except in Belgium following the discount rate increase in that country, but for several months there had been a gradual tightening up in these markets and the effects were now beginning to be seen. It probably would not be possible to get the maximum benefits from short-term rate increases in this country unless the Continental central banks found it possible to inject additional liquidity into their money markets.

Last week, Mr. Coombs pointed out, the Swiss took a step in that direction by releasing 150 million Swiss francs from blocked commercial bank balances, and there was hope that the Swiss authorities might release more. In Amsterdam there had been some recent easing of the money market, possibly assisted by central bank action, with improvement in the dollar rate. In Germany, France, and Italy there were no signs of any important easing. The German authorities, however, were cognizant of the problem faced by this country in trying to improve its position in terms of interest rate differentials, and the German Federal Bank might make some concessions in the way of easing. If it were possible to obtain some easing in the Continental money centers, this should have the effect of relieving some of the upward pressure on Euro-dollar rates and narrowing the spread between short-term rates in New York and Euro-dollar quotations. However, if the interest equalization tax should curtail the flow of money to Europe and Japan, there might be a shifting of the demand for medium and long-term money into the short-term market.

Mr. Coombs noted a slight increase in the British bill rate and a narrowing of the discount on forward sterling. As to Canada, the major gyrations occasioned by announcement of the proposed interest equalization tax had changed into a situation where latest reports suggested that the Canadian bill rate might be settling at a level around the U. S. bill rate.

In reply to a question with regard to the rationale of System and Treasury operations related to the Swiss franc, Mr. Coombs commented that the hope was to see some easing of the Swiss money market. This could be brought about if the Swiss commercial banks repatriated funds, but this would result in dollar accumulations by the Swiss National Bank. If the Swiss National Bank should add further to the liquidity of the market, that would be the preferable solution. The officials of the National Bank realized this problem and wanted to be helpful, but they were concerned, of course, about the risk of easing too much and inciting inflationary pressures.

There followed comments by Mr. Coombs in response to questions with regard to the prospective effect of the interest equalization tax on Japan. Mr. Coombs also commented on the prospective effects of the proposed tax generally and summarized by expressing the view that it might add up to a virtual freeze on American investments in foreign securities for some time to come. The impact had already been severe in certain instances.

Mr. Hayes said the New York Reserve Bank had been told by a number of New York bankers that applications for foreign term loans were tending to burgeon. The bankers appeared somewhat puzzled as to what their approach should be. If official pronouncements were taken at face value, bank loans were specifically exempted; Administration spokesmen had indicated that bank loans should be covered by general monetary policy. Mr. Hayes said he had been referring such inquiries to the Treasury.

Mr. Coombs added that for the past couple of years persons had been coming into the New York Reserve Bank and inquiring, apparently out of a sense of real concern, whether they should hold back on foreign lending. Until the announcement of the present balance of payments measures, the standard line of the Government had been that there was no policy of restraint. However, now that the Government had taken a stand, a backing away might be seen in view of the clear-cut Government attitude.

After further discussion, Chairman Martin expressed the view that inquiries of the kind mentioned by Messrs. Hayes and Coombs should be referred to the Treasury. System spokesmen should not take it upon themselves to define Government policy in this area.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period July 9-29, 1963, were approved, ratified, and confirmed.

Mr. Coombs noted that a $25 million drawing under the swap arrangement with the German Federal Bank would mature August 20, 1963, and that another $25 million drawing would mature August 26. He recommended renewal in each case.

The proposed renewals, as recommended by Mr. Coombs, were noted without objection.

Mr. Coombs added, in this connection, that before the second maturity dates were reached consideration should be given to how the drawings might be unwound. It was possible that the German Federal Bank would accept an issue of medium-term Treasury bonds denominated in German marks. Unless in the meantime there was some shift in favor of the dollar against the mark, it might be worthwhile to consider such a procedure.

This concluded the discussion of System foreign currency operations and related matters.

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 July 9 through July 24, 1963, and a supplementary report covering the period July 25 through July 29, 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:

In the ten days or so preceding the last meeting of the Committee we had a classic case of the powerful role played by short-term expectations in shaping day-to-day market behavior. Largely in anticipation of a discount rate rise, which had been widely discussed in the financial press and broadly hinted at in official statements, Treasury bill rates had risen by close to 1/4 percentage point and bond yields had also moved higher. In the past three weeks, on the other hand, during which the widely expected discount rate rise actually occurred, the market has been subjected to a combination of influences that tended to restrain any further rise in yields and in some sectors has pulled yields lower than they were before the discount rate increase took effect.

In the case of Treasury bills, rates are only slightly above where they were three weeks ago, and are somewhat below the level touched the day after the discount rate increase was announced. There seem to have been two major, and related reasons for the recent performance of the bill market. First, dealers had undertaken to reduce their positions to a very low level during the period that a discount rate increase was widely expected. On July 15, for example (just a day before the rate increase was announced), 7 out of the 20 dealers showed, in their trading accounts, short positions ranging up to $50 million in bills up to three months; three other dealers showed a net position of zero; and six others showed long positions of less than $20 million. At the same time that dealers were trimming their holdings to these low levels, investors were withholding commitments waiting for the air to clear. The air cleared with the announcement of the discount rate change on July 16, effective July 17, and the accumulated funds that had been held off the market came rushing in to capture the bill rates that emerged immediately following the discount rate change. That demand encountered the kind of dealer positions I have just outlined--and of course the rate went down.

The second major factor in the bill market, and one that reinforced the influence of the first, was the very easy condition of the central money market, which became particularly conspicuous toward the close of the country bank settlement period ended July 24. In turn, that easy money market was a product of the heavy borrowings in the early part of the week, and particularly the sharp reduction in the basic reserve deficiency of the major New York City banks. Indeed, their basic deficiency declined from an average of $862 million two weeks ago to only $81 million last week--and their demand for Federal funds declined accordingly.

These factors that have tended to pull bill rates lower would seem to be largely temporary, but it is not possible to say how long it will take to overcome their influence. It might take only a few days--with yesterday's moderate rise in bill rates perhaps the first step in a move to a somewhat higher range of variation. On the other hand, it might take considerably longer, perhaps as long as a month, for the recent influences to be worked out.

Apart from whatever decision on policy the Committee may make today, it seems to me that there are three factors likely to be of major importance in determining whether bill rates carry through yesterday's rise and move into somewhat higher ground:

1. A further firming of the money market--which will depend largely on whether the New York banks return to their usual sizable basic deficit position, and thus once again be major bidders for Federal funds. As a firming of the money market occurs, it should increase dealers' financing costs and perhaps induce some commercial bank selling of bills.

2. The second factor is the course of nonbank demand for bills. Some abatement of this demand might come about either because more attractive investment alternatives are available (for example, in certificates of deposit at the new rate levels) or because of some working down of corporate liquidity, particularly in the automobile industry in the next month or so. However, it is very hard to estimate how nonbank demand for bills will develop.

3. The third factor is a Treasury offering of a strip of bills. We understand that the Treasury is prepared to offer a strip of about $800 million of Treasury bills at any time with a view to bolstering the short rate structure. This is a useful backstop to current efforts to stiffen short rates, but if possible it might be preferable to wait until dealer positions have been restored somewhat, in order to achieve maximum rate impact from the strip offering. Indeed, there is no assurance that a bill strip offering will succeed in raising rates more than very temporarily if the money market does not firm or if nonbank demand for bills should be strong.

If the recent period has taught us nothing else, it has demonstrated beyond question that the inter-relationships among bill rates, Federal funds rates, dealer positions and attitudes, and reserve management of various groups of banks are highly complex. The money market has been feeling its way along in a somewhat changed environment, and in conducting open market operations we too have had to feel our own way along through the same set of changing relationships. It appears that in the current statement week some measure of firmness in the money market has been regained. In meeting this week's reserve needs we have sought to stay a step or two behind the reflection of those needs in the market in order to avoid pushing the market off the delicate balance in which it is poised and sending it back toward the excessively easy conditions that prevailed recently. But the basic reserve position of the New York banks has remained unusually comfortable, and dealer positions have remained unusually light--and until these parts of the picture are back in their normal places it is rather difficult to have much confidence in the maintenance of a firm money market.

The performance of the Treasury note and bond market since the discount rate increase has also been somewhat out of the ordinary--in that prices of notes and bonds have tended to move higher. In this case, the market has given a good deal of attention to the various statements by Administration officials to the general effect that vigorous efforts would be made by the nation's financial authorities to avoid higher domestic long-term interest rates. While there has apparently been only moderate investor buying of intermediate and longer issues, dealers have made considerable efforts to cover short positions and have put prices up in the process. Another upward price influence during the recent period emerged from the fact that the Treasury confined its August refunding maturity to a single short-term issue--offering a new 3-3/4 per cent note to mature in November 1964. The subscription books are still open on this exchange offering today and tomorrow, and all reports indicate a smooth and successful operation. Indeed, with public holdings of rights amounting to only $2.5 billion, the operation appears to be generating only a moderate volume of market activity.

Still another strengthening influence on the bond market has been the prospective reinvestment demand from a $197 million advance refunding planned for today by the Grant County Public Utility District of Washington. The District, which has built the Wanapum Dam, plans to offer these tax-exempt bonds today in order to refund an issue that is callable in 1970. In the meantime, they propose to invest the proceeds of the current offering in Treasury bonds, mainly the 4's of August 1970--which will more than cover the prospective interest cost of their new issue--and this has already been placing some upward pressure on that and surrounding issues.

Given these various upward price influences in the market for notes and bonds, the System's job of providing reserves for next week is further complicated, for recent offerings of coupon issues to the Desk generally have been few in number, small in size, and typically priced to the full offered side of the market--providing little opportunity to inject reserves through purchases in this maturity area without pushing prices to unsustainable levels.

I would like to add, with respect to the current Treasury offering, that the System holds $4,075 million of maturing rights and we plan to exchange this entire holding for the new 3-3/4 per cent notes.

Finally, it seems to me that the temporary reasons for which the Committee enlarged the System Account's leeway for net purchases and sales between meetings to $1.5 billion have now passed. Accordingly, the Committee may wish to return the leeway to the old figure of $1 billion.

In discussion, Mr. Mills noted that the Manager had indicated some lack of confidence in the maintenance of a strong rate structure in the short-term Government securities market. However, with Federal funds trading at 3-1/2 per cent and the rate to Government securities dealers by New York City banks running as high as 3-3/4 per cent, presumably the dealers had an unfavorable carry on their inventories. Presumably, also, banks that adjusted their positions through the Federal funds market would find the cost excessive to attempt to continue their positions in lower-yielding Government securities. Granted the need for bringing market rates into alignment with the discount rate, he asked the Manager how much offsetting influence the latter estimated from the dealers' unsatisfactory carrying position and the Federal funds rate.

Mr. Stone replied that if the Federal funds rate could be maintained rather consistently at 3-1/2 per cent, that would exert an upward pull on all short-term rates. The question was whether a 3-1/2 per cent Federal funds rate could be maintained at a time when the basic reserve positions of the New York City banks were as comfortable as they were, and dealer positions as low as they were. If dealer positions should rise, a significant part of the increase in such positions would be financed at the New York City banks, which would increase the demand for Federal funds. In effect, New York City banks would be drawing funds from around the country at 3-1/2 per cent and lending to dealers at 3-3/4 or 3-7/8 per cent. Before this process could take place, however, the New York City banks must have a strong incentive to obtain funds. Until that occurred, he found it difficult to have confidence in the maintenance of the Federal funds rate at the discount rate.

Mr. Hickman observed that this reasoning did not take account of the possibility of the Committee allowing net free reserves to fall to zero or lower, which would cause the banks at some point to divest bills.

Mr. Stone replied that he had not wanted to anticipate what action the Committee might take today. Instead, he had attempted to spell out some of the factors for the Committee's evaluation.

Mr. Deming asked whether, if the Treasury decided to undertake a monthly auction of one-year bills, the Manager would foresee any serious problem from the standpoint of freedom of System policy.

Mr. Stone replied that after the first three or four monthly auctions, such auctions probably would become about as routine as the current weekly auctions of shorter bills. He anticipated that the market would acquire the one-year bills in the auctions and distribute them quite promptly--within three or four days--and that the monthly auctions would impose little or no restraint on System policy.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period July 9 through July 29, 1963, were approved, ratified, and confirmed.

The Chairman then called for the usual staff economic and financial reports beginning with Mr. Noyes, who presented the following statement on economic developments:

> As was reported during the period, the economy advanced considerably in the second quarter--and, as was also repeatedly pointed out, some of the gain was at the expense of subsequent activity.

The most spectacular increase was in industrial production, which spurted from 121 in March to 125 in June. Total GNP was up an estimated $7.2 billion annual rate, with inventory accumulation contributing less than it had in the preceding quarter. Thus, final purchases increased more--about $9 billion. But less than $1 billion of this gain was in consumer purchases of goods, and the relatively weak performance of retail sales, which again was noted as the quarter progressed, muted the optimism that the overall performance might have seemed to justify.

We are now just in the middle of the so-called summer doldrums, and current indications are for considerably less expansion in the production index and GNP in the current quarter than in the one just past. The rate of unemployment, to be released later this week, will probably be unchanged from June to July. The greatest likelihood is that the July production index will hold at 125 rather than rise or fall. As was widely noted, new orders dropped in June, not only for steel, where a sharp drop was anticipated, but for a wide range of durable goods. Housing starts in June were also off from the unexpectedly high levels of the late spring, suggesting that we may see some leveling out in the spurt in construction activity that has been going on in recent months.

On the other hand, retail sales, especially at department stores, have shown signs of picking up. In fact, even the auto market seems to have regained momentum in the first 20 days of July. Characterizing the situation, as one Washington letter did, as a "near buying spree" is too strong, but there is some very welcome improvement.

The 4/10 of 1 per cent increase in consumer prices in June was rather sharp for that sluggish index, but the increase was selective and not of a sort that appears to be contagious. Wholesale commodity prices remained little changed.

By and large, developments in the domestic economy have not varied much from the anticipated pattern. Some weakening, at least in the pace of advance, was almost inevitable after mid-year, and what we have seen thus far is well within the range that should have been expected.

The current attitudes and expectations of the business community appear to be mixed. Certainly, the President's balance of payments message did not bolster confidence in the dollar as much as one might have hoped. Second quarter profits ranged from good to terrific--but they have not excited buying interest in the stock market. Demonstrations for civil rights have unquestionably added to business uncertainty in some areas, as has the situation in the railroad industry.

It is very doubtful that sentiment as to the future will crystallize in the weeks immediately ahead. Some further sideways movement, with mixed components, is generally expected and very likely to be realized. Beyond that, as we move through September, observers differ as to what is most likely, but they would all agree that some further strength in consumer buying is essential if we are to avoid serious doubts as to the sustainability of recent rates of expansion, much less the possibility of further increases.

As I suggested six weeks ago, from a purely domestic point of view, this summer would be a good time--quite apart from any significant change in policy--to let some of the ease stemming from moderation of expansionary forces and less optimistic appraisals of the outlook reflect itself in credit markets. Whether this is possible, in the light of our balance of payments problem, is another question.

Mr. Holland presented the following statement on financial developments:

The financial system is undergoing a progressive adjustment to the variety of official actions and statements that have been packed into the past two weeks. Here in the United States, the adjustments in most cases appear mild to date--partly because of anticipatory market movements earlier. In the shortest and longest term markets for funds, adjustments have carried far enough to provide a reasonable outline of their portents for the near future. In the bill market and the banking system, however--both key sectors for policy-making purposes--developments of recent weeks have been enigmatic. In these areas, a proper appraisal of the likely trend of events under the current policy environment probably has to await further clarifying developments.

Mr. Stone has outlined the whipsawing in bank reserve positions and the Federal funds market during the weeks surrounding the discount rate change. But with all Reserve Bank discount rates at 3-1/2 per cent in the current statement week, these distortions seem to be working out, and the Federal funds rate has moved into a more logical relationship to the new discount rate. So long as the free reserve target is low enough to involve a significant volume of large bank borrowing, the Federal funds rate ought to be expected to range most of the time in close proximity to the discount rate. From my own observations, I would guess that free reserves in the range of $100-$200 million and a Federal funds rate ranging from 3-1/4 to 3-1/2 per cent would be broadly consistent at this juncture.

The bill market is a different matter. Investor demand has been strong this past month, blotting up more than a billion dollars of net sales of bills by dealers and New York City banks. Bill rates, meanwhile, have oscillated in a 3.18-3.27 per cent range following their upward adjustment to Secretary Dillon's testimony on July 8. But I doubt they world have held this high in the absence of market anticipation of higher rates to come, for the rate advances have centered around official statements or actions with rate implication, with intervening downward drifts of quotations as investor buying reduced available supplies. Indeed, the willingness of dealers and leading banks to sell off their own bill holdings in these circumstances was partly related to expectations of higher rates later.

Nonbank demand for bills may continue strong over the next few weeks, and there is a possibility it could override the expectational forces now in the market, unless they are reinforced by policy action. Such reinforcement could come by issuance of a bill strip; as has been noted, the Treasury is ready to do this on short notice within the next two weeks even though it does not need the cash. The reinforcement could also come from greater System efforts to supply reserves by purchases of coupon issues, with or without offsetting sales of bills. Each of these measures has its disadvantages, but the current public policy dialogue would seem to call for some consideration of both before resort is had to the third alternative for resisting any undesired rate declines, namely, a further general reduction in the level of reserve availability.

There is a potential market development that could spare the Federal Reserve this need to chose among objectives. That is a substantial expansion of sales of time certificates of deposit by banks and dealers to customers as an alternative to investment in Treasury bills. If banks take full advantage of the liberalization of Regulation Q in the issuance of certificates of deposit, they may divert a significant amount of money that would otherwise push into the bill market directly. In fact, there was an increase in other time deposits of city banks in early July, and there was a sharply concentrated $145 million run-up at New York City banks in late July. But this latter pace almost certainly cannot be continued; in particular, New York City banks are posting negotiable certificates of deposit rates that are at the lower end of the effective scale of competition for short-term funds.

Despite their success in attracting more certificates of deposit money, city banks reported a substantial net shrinkage in credit and deposits during the first three weeks of July. For the most part, this stemmed from a larger than seasonal drop in U.S. Government securities holdings on the asset side and in Government deposits on the liability side. This followed on the heels of a large June increase in both items; it reflected largely the timing of Treasury financing, although perhaps also some response to the less easy prevailing reserve positions during the month. Securities loans and loans to financial institutions at leading banks also were lower. But commercial loans tended to show no more than the usual July downdrift; and real estate and consumer loans continued to mount, with only a slightly abated pace. Meanwhile, banks outside the leading cities were continuing to demonstrate about the same seasonally adjusted credit rise as earlier this year. One consequence of all these banking changes was to confine the net deposit shrinkage of the banking system primarily to the Government area. Reserves against private deposits have averaged about $80-$100 million above the Board guideline during July. Thus far in July, money supply has been running about $900 million higher than the last half of June, with time deposits also continuing to climb briskly. Additional net Government deposit pay-outs scheduled during the first half of August should bolster the money supply even further in the weeks ahead. Thus the private liquidity in the economy has built in a certain degree of cushioning against bank credit contraction in the current monetary climate.

Long-term credit markets have been behaving as if they expected to suffer no adverse consequences from the combination of recent and prospective official actions on the balance of payments front. Yields on domestic issues have been stable to buoyant, and the flow of investible funds is unabated. This may reflect partly solid confidence in repeated official statements that no upward pressure on long rates is desired, and partly a market consensus that the higher discount rate will not trigger any important net reduction in bank lending to long-term borrowers. Were banks to reduce in any important degree their more than one-billion dollars-a-month of net acquisitions of real estate, municipal, and agency obligations, the capital markets would certainly be affected adversely. But the current rate stability in these markets suggests that no such prospect is foreseen. For the time being at least, higher rates in some short-term areas without higher long-term rates are an accomplished fact.

What remains to be seen more clearly is whether bill rates can hold at something like their present level from now until the onset of seasonally firming pressures in the fall, and whether the banking system can maintain an appropriate rate of expansion without being hampered by the one-half per cent higher cost of the marginal borrowings made necessary by the prevailing level of free reserves. On these points, I judge the developments to date to be inconclusive. We can be reasonably sure, I think, that the new combination of a discount rate of 3-1/2 per cent, free reserves in the range of $100-$200 million, and a Federal funds rate around 3-1/4 to 3-1/2 per cent can be fairly consistently maintained. But to be clear as to the further consequences of such a combination, we need to maintain it a little longer. This also, I think, fills the prescription for an "even keel" policy, which would seem to be in order in any event through the first part of the next three weeks in view of the Treasury refunding now under way.

In reply to a question, Mr. Holland noted that the larger banks had divested a substantial amount of U. S. Government securities during the month of July, whereas there had been a large increase in holdings of such securities in the month of June. At country banks there may have been some divestment of Government securities in July, but apparently to no substantial extent.

Mr. Hersey presented the following statement with respect to the U. S. balance of payments:

The initial effects of the System's raising of discount rates and Regulation Q ceilings on July 17 and of the announcement on July 18 of the proposed interest equalization tax have not been clearly favorable for the U. S. balance of payments outlook. The evidence is of course very scanty, and it is much too early to draw conclusions yet.

The tax proposal and the subsequent exemption for Canada did have a net effect in the exchange markets of strengthening the U. S. dollar somewhat against the Canadian dollar, after a rather sharp impact at the first announcement. Also, as a result of the discussions with Canadian officials, and assuming that the Canadian current account balance of payments does not deteriorate so as to justify additional borrowings, we can now be reasonably confident that the bulge in the U. S. outflow for new Canadian security issues will in fact taper off in coming months, as we had previously hoped it would. In the first half of this year this outflow exceeded $600 million. In the years 1956 to 1959, the average flow to Canada had been less than $200 million per half-year, before it declined to a still lower rate in 1960, 1961, and the first three quearters of 1962. Thus, in annual rate terms, the outflow on new Canadian issues in the first half of this year was worsening our balance of payments, as compared with the 1956-to-1959 period, by twice the difference of these two figures, i.e., by nearly $0,9 billion annual rate. We can now look forward to some diminution of this flow. What actions the Canadian authorities may take to enforce a reduction in borrowings from the United States, or how quickly any such actions may have their effect, are not at all clear.

The tax proposal, if enacted, will cut off and reduce to zero any growth that might have developed in European issues in our capital market. It should help to demonstrate to the Europeans the importance we attach, in the long run, to a satisfactory development of their own capital markets. In the first half of 1963, the outflow to Europe on new issues, net of foreign participation, was about $100 million, not quite as large as it had been in the corresponding period a year earlier. Also, new issues by Japanese borrowers (which were over $100 million in the first six months of this year), and by governments and companies in other industrially developed countries, will be curtailed. But we may find that reductions of outflow to some of these countries through this channel will be offset by increased bank lending, or by growth of the outflow on new issues to exempted countries, such as Mexico.

The discount rate and time deposit ceiling increases, or rather the advances that developed in the first half of July in market rates on U. S. Treasury bills and on negotiable time certificates of deposit, which have been, so to speak, ratified by the Federal Reserve actions, have had little or no effect on covered interest differentials vis-a-vis the Euro-dollar market. Willingness of the Japanese authorities to allow higher rates to be paid if necessary for Euro-dollar funds was one of the factors in the rise of Euro-dollar rates.

Other effects that might have been hoped for from the Federal Reserve and Administration actions, in terms of strengthening confidence in the dollar and diminishing outflows of funds motivated by the psychological climate, are not evident as of now. Critical reactions to the tax proposal are appearing in the European press. There has been little or no general improvement for the dollar in exchange markets, apart from the Canadian. And the first tentative indications of the over-all balance of payments in the week ending last Wednesday suggested that the deficit was running at a very high rate.

Before trying to evaluate this last piece of evidence, it may be useful to look briefly at the balance of payments in the second quarter of this year. The initial estimate given to the Committee three weeks ago has had to be revised sharply in the light of more or less final figures of reserves and related liabilities for June. The second-quarter deficit, seasonally adjusted, and before counting receipts from special government transactions, is now estimated at about $1-1/4 billion, almost as large as in the fourth quarter of last year, and considerably larger than the gross deficit in the first quarter of this year. It is now quite clear that the worsening by $300 or $400 million between the first and second quarters can be fully explained, and more, by a rise in bank lending to foreigners, even without taking account of other outflows of short-term capital recorded or unrecorded.

Bank-reported claims on foreigners, short-term and medium-term, rose in April, May, and June by $650 million, in contrast to a reduction of somewhat under $100 million in the first quarter. Bank-reported claims do include some foreign currency deposits and some investments in foreign money market assets for account of U. S. customers. But changes reported for April and May in these elements were small, and it appears that the bulk of the outflow in those months was in acceptance credits, collections outstanding, and bank loans. Flows of these kinds are responsive to trade developments and to borrowers' needs or desires, and they are not easily influenced by small changes in U. S. money market rates. The drop in outflows of bank-reported claims denominated in dollars from about $1.3 billion in 1961 to about $450 million in 1962 can not be ascribed in any significant part to interest rate changes. Nor can this latest rise in outflows--which makes the rate for the first half year almost as high as the 1961 outflow, and the rate for the second quarter by itself much higher. The only moral to be drawn from this is that we need a much stronger balance on trade and other accounts, to allow us to take this sort of variation in the flow of bank lending in our stride.

In conclusion, I would like to go back to the tentative weekly indications of the gross deficit in recent weeks, and sound an agnostic note. These indicators show, for the three weeks ending last Wednesday, an average weekly gross deficit of over $150 million, with increases in the amount from week to week. These are very large figures, implying a monthly rate of deficit of over $600 million. However, it would be wrong to jump to a conclusion that these latest figures necessarily indicate any real worsening in any part of the balance of payments--trade, aid, or capital--as compared with the second quarter. This is because we are now in the season of heavy tourist expenditures abroad, and at a time of year when exports drop off seasonally more than imports do, and more than Government aid and imports combined. These factors, offset to a small extent by other seasonal factors that work the other way, tend to increase the average monthly deficit in the third quarter, as compared with the second quarter, by about $150 million. July is particularly strongly affected. Thus even a deficit of $600 million in July, unadjusted, might represent little or no further net worsening from the second-quarter average unadjusted gross deficit of a little under $400 million. It is not yet demonstrated that the very bad figures of May and June have grown even worse in July.

The Chairman then called for the go-around of comments and views on economic conditions and monetary policy. He turned first to Mr. Hayes, who presented the following statement:

While the business picture has shown no significant change since the last meeting, with a continued slow advance to be expected, there are perhaps more uncertainties in the near-term outlook than there have been in the past couple of months. There are some slight doubts about the strength of the prospects for capital spending and housing, which have been counted on to provide an offset to steel inventory liquidation; and Government outlays seem to be leveling off. The general outlook has been clouded by several uncertainties that have come to the fore recently and that have undoubtedly contributed to the downward trend of the stock market. The apparent inability of the Congress to cope effectively with the growing mass of legislative proposals before it, including income tax legislation, is itself a major impediment to a vigorous business advance. The stock market may be said to have behaved reasonably well in the face of such events as the SEC report, the rise in discount rates, the President's interest equalization tax proposal, and the threatened rail strike.

Bank credit declined in the first three weeks of July primarily as a reflection of the June Treasury financing; but the somewhat slower growth of credit in recent months was of course quite consistent with the Committee's policy actions. There is a continuing absence of strength in business loan demand. Nonbank liquidity in general remains ample, and the banks' position is still comfortable. The timely raising of the interest rate ceilings under Regulation Q has already given a new lease of life to the volume of certificates of deposit outstanding.

I might note in passing that the Treasury's financing problems now look much less burdensome than seemed likely six months ago. The cash deficit was only about $4 billion in fiscal 1963 and is now projected at only about $7 billion for fiscal 1964 after allowing for the effects of the proposed tax reduction bill. There is much less ground than there might have been earlier for opposition to the tax bill because of doubts as to the possibility of the resulting deficit being soundly financed; and certainly the tax cut is needed more than ever as a means of relieving monetary policy of some of its burden of encouraging domestic expansion.

As for the balance of payments, the latest indicators show continued large increases in foreign dollar holdings. The very heavy June deficit included several special items, including sizable mid-year window-dressing operations; but unfortunately, whereas a reversal of this item in early July might have been looked for, the deficit figures for the first few weeks of July continued unsatisfactorily high. Our discount rate increase was well received abroad and seemed for a day or two to be having useful results in the exchanges. Very soon thereafter, however, this whole tendency was completely obscured by the emergence of grave uncertainties abroad resulting from the interest equalization tax proposal, as well as from the subsequent impression of hasty preparation created by the demonstrated need for prompt amendments to the proposal. I have had and still have serious doubts about the wisdom of this proposal, and these doubts were conveyed to the Treasury while the proposal was in the planning stage. While the tax, or even the proposal thereof, will doubtless have a substantial inhibiting effect on foreign bond offerings, it is too soon to tell whether this result will be offset, or perhaps overshadowed, by adverse side effects on international capital flows--either in the form of a diversion of the flow to direct investment or bank loans or in the form of a capital flight induced by fears that this tax move may be the forerunner of ultimate exchange controls. Such fears have been expressed in financial markets abroad to an increasing degree in the last week or so, and this in turn has found reflection in the delicately balanced position of the dollar in European exchange markets.

My hope would be that after the dust has settled our discount rate action, and the accompanying move on Regulation Q, will have gained us considerable benefits in the way of a diminished drain of short-term capital flows. But the discount rate action can be really effective only if it is translated into a satisfactory firming of short-term market rates--especially the 90-day bill rate. The discount rate action could of course be easily construed as an empty gesture if market rates were to fail to achieve and maintain a healthy increase over levels prevailing prior to the discount rate rise. In view of the state of the exchange markets, and the uncertain and possibly perverse effects of the interest equalization tax proposal, I think it is doubly important that we convey through our policy actions an impression of decisive effort to sustain foreign confidence in the dollar.

Thus, despite the fact that the domestic outlook is not everything we could wish, I believe open market policy should be directed, as soon as the books are closed tomorrow on the new Treasury issue, to the primary objective of achieving a firmer short-term market rate structure to support the new discount rate level. Incidentally, I have been assured by the Treasury that after Wednesday we need not feel any "even keel" restraint in working toward such a rate level, in view of the short maturity of their offering and their avowed intention of pressing for firmer short-term rates. I am thinking of a 90-day bill rate somewhere around 3-3/8 per cent or higher, a Federal funds rate consistently at 3-1/2 per cent, and whatever level of free reserves may be consistent with these aims. My guess would be that they could probably be achieved without dropping free reserves consistently to the zero level; and if free reserves can be kept near their recent level, so much the better. It goes without saying, in view of the importance of our rate objective, that we should make as much use as may be feasible of intermediate and long-term purchases, as well as swaps. While natural factors are likely to continue to exert downward pressure on long-term rates in any case, we need feel no reluctance if some of our operations produce side benefits in the way of a cushioning of the impact of the discount rate rise on long-term rate levels.

I would like to make one side comment on the open market tools that we have at our disposal. For a long time now some of the Committee's staff have had in mind the question whether reverse repurchase agreements might serve a very useful purpose on occasions when we wished to effect a temporary absorption of reserves to prevent unduly sloppy money market conditions. We make frequent use of repurchase agreements to deal with temporary tightness, but we have no comparable technique readily available at present to deal with temporary sloppiness. The experience of last week affords an excellent example of a situation in which this added tool in his kit might have been extremely useful to the Manager of the Account in his efforts to carry out the Committee s policy directive under an unusual set of circumstances. I hope that the Committee will be willing to ask the staff to give this possibility intensive study in the near future.

It seems to me, now that the whole System has moved from a 3 per cent to a 3-1/2 per cent discount rate, that it would be quite appropriate to effect a rather general rewording of the first paragraph of the current policy directive, even though many of the factors mentioned in the existing directive are still very much in our minds; and I would also make a small change in the second paragraph to indicate the need for slightly greater firmness in the money market.

Mr. Ellis commented on developments in the First District, noting in his remarks that the response in New England to the national economic uptrend continued to be less than satisfactory. With respect to nonagricultural employment, the June rate was virtually the same as that for January 1963. Only five groups of manufacturing industries were above year-ago levels in terms of employment. Manufacturing output had remained almost level throughout the first half of the year and showed only a 1.3 per cent increase above a year ago. Shoe production for the first half of this year was about 5 per cent below the level of a year ago, but expectations in this industry for the second half were improved. The output performance, combined with strength in the construction industry, retail spending, and Government spending had been sufficient to stimulate credit demands. Loan figures from weekly reporting banks showed expansion. Bank loan expansion thus far this year had exceeded any recent year, with year-to-year gains in all categories except agriculture and loans to purchase or carry securities.

Mr. Ellis then turned to the recent action of the Comptroller of the Currency in removing buying and selling limitations on Federal funds. Two of the largest banks in the District had called at the discount window last week, but when informed that the Federal funds limitations had been lifted, satisfied their needs in that area. In the week of July 21, District banks were net purchasers of Federal funds at a rate unmatched since December 1962. Judging from this experience, Mr. Ellis thought that borrowings at the discount window could be expected to be somewhat lower. The Comptroller's action seemed also to raise certain related questions; namely, how banks would report Federal funds transactions in their call reports and the relationship between national and State-chartered banks. One large Massachusetts State-chartered bank reportedly had been advised to operate on the same basis as if it were a national bank, but in Connecticut legislative action would be required to remove a limitation on the selling side.

Turning to monetary policy, Mr. Ellis noted that the effect of recent System actions was difficult to appraise in light of the other factors that had exerted an effect on the market, including the President's balance of payments message, the System's action in raising the discount rate, the Comptroller's Federal funds action, and the Treasury's debt management activities. In any event, however, market rates had just about held their own since the discount rate announcement. The unresolved question was how much, if any, action on reserve availability would be desirable in support of the discount rate action.

His own conclusion, Mr. Ellis said, was that there was something to be said for getting as much positive value as possible out of the discount rate increase, in terms of the effect of rate relationships on short-term capital outflow. However, the market should be given some time to adjust before any further substantial policy moves were made, particularly on reserve availability. For the period immediately ahead, therefore, he would think, for target purposes, in terms of a three-month bill rate of approximately 3-3/8 per cent, with Federal funds frequently at 3-1/2 per cent. Free reserves might be in the general area of $100 million, with any doubts resolved on the side of firmness. Some decline in borrowing might be expected if more reserve needs were met through the Federal funds market as a result of the Comptroller's ruling. He had not thought previously about the possibility of the use of reverse repurchase agreements, as mentioned by Mr. Hayes, for dealing with certain kinds of market situations, but he would urge that this possibility be studied further.

As to the directive, Mr. Ellis said he felt the Committee could get along with the present statement. However, he was concerned about the tendency to keep the directive in a standard form for rather long periods of time and to make only slight changes in wording. He would like to see a reworded version of the first paragraph, and possibly the second paragraph.

Mr. Irons stated that in the Eleventh District most of the major activity indexes showed continued advance during June, and on into July. The industrial production index rose another point, largely due to an increase in durable goods. Nonagricultural employment continued its gradual upward trend, and the crude oil situation showed advances in production and refining over year-ago levels. Construction in the District was at an all-time record level--better than 10 per cent above the same period last year for the first five months--and 21 per cent up for the most recent month. Department store sales were up about 8 per cent in July over year-ago levels and about 4 per cent for the year to date. The situation in general, Mr. Irons noted, was favorable--with no surge of activity but a steady, moderate increase. Agriculture in the District was closely affected by weather conditions and was difficult to appraise. However, the major crops looked quite good at this juncture.

As to financial developments in the District, Mr. Irons noted that loans and deposits were off a bit during the past three weeks, with a moderate increase in investments. The decline in deposits was almost entirely attributable to a corresponding decline in Government deposits. Federal funds activity in the Eleventh District had not yet, apparently, shown the effect of the Comptroller's ruling mentioned by Mr. Ellis. Average purchases had been exceeding sales, and borrowing from the Reserve Bank had moved up somewhat.

Mr. Irons observed that the problem presented for credit policy seemed most difficult. The System apparently was expected to nudge short-term rates up, minimize any increase in long-term rates, and at the same time maintain reserve availability and avoid increased firmness in the market. For the moment, Mr. Irons said, he would not favor any aggressive action by the Committee that would further complicate the whole market situation. Instead, the Committee should "feel its way along," moving in a manner consistent with its objectives and hoping that market forces would work in such a manner as to help make the new discount rate an effective rate. He felt that a bill rate of 3.25 or 3.30 per cent would be in the right direction, but he would not advocate deliberately pushing the rate higher with the market in its present state. He would like to see the Federal funds rate at 3-1/4 or 3-1/2 per cent, with free reserves possibly averaging somewhere around $150 million or a little less. He felt that such a movement would be in the right direction, and about all that could reasonably be expected in light of prevailing forces.

Turning to the directive, Mr. Irons said he, like Mr. Ellis, felt that the directive should be changed at some point to take into account what had transpired during the past few weeks. In his opinion, an entirely new directive probably would be in order in the not too distant future. For the present, however, he would not be strongly adverse to retaining the form of the present directive.

Mr. Hemmings reported that in the Twelfth District business activity showed a modest gain in June, although the occasional bright spots were tempered by sluggish performances in some areas. In the Pacific Coast States, total employment rose a little more than seasonally, with increases in California outweighing declines in Washington and Oregon. However, the aggregate unemployment rate for the three States stood unchanged in June at the 5.9 per cent level of May. Although the current rate of unemployment was higher on the West Coast than for the nation, the Pacific Coast had made a somewhat better showing on a year-to-year basis; the unemployment rate was unchanged on the Coast from June 1962, while it rose slightly in the nation. Employment in the manufacturing industries on the Pacific Coast declined for the fifth consecutive month, largely as a result of decreases in aircraft payrolls in Washington. However, ordnance employment in California turned up in June for the first time since February.

Housing starts in the District fell off in June after a record month in May but were still well above the year-ago pace. Prices of FHA mortgages in the secondary market had been leveling off in the District. Steel production had declined in recent weeks in the District, but by a lesser percentage than in the rest of the nation. The continuing lumber strike in the Pacific Northwest had strengthened lumber prices. District farm receipts set a record for the month of May.

Department store sales (seasonally adjusted) in the District were down slightly in June after a sharp recovery in May. California car registrations ran ahead of sales nationally in the first half of the year. In the Twelfth District as a whole, however, registrations through May apparently did not show as much of a percentage gain over the first five months of last year as did sales nationally.

Total credit extended by District weekly reporting banks declined slightly in the first three weeks of July, with a decrease in loans offsetting a rise in investments. Reserve city banks continued to show a net borrowed reserve position, although daily average net sales of Federal funds increased somewhat over the preceding three weeks.

Mr. Deming said general economic activity in the Ninth District seemed to be roughly paralleling that of the nation. The iron ore situation seemed to be normal, that is, not very good; shipments were 15 per cent less than in the same period of 1962. This decrease was attributable to the high carry-over of inventory from 1962 and was not unexpected. With respect to the demand for credit, District banks were experiencing a somewhat heavier demand than the nation. There was a tendency toward an outflow of funds from the District, and consequently District banks were somewhat less liquid than had been anticipated on the basis of estimated credit demands.

With respect to policy, Mr. Deming said he agreed with the position taken by Mr. Irons as far as the next three-week period was concerned. The System should move carefully, avoiding any significant lessening of reserve availability, on the one hand, and on the other an over-abundant supply of reserves that would confuse the market regarding System intentions about short-term rates. He did not think steps should be taken to push short-term rates higher at too rapid a pace, although he hoped market forces might work gradually in that direction. Longer term rates were a possible problem, and he was also concerned about possible limitations on the freedom of action of the Federal Reserve System. In present circumstances, for example, the Federal Reserve was somewhat inhibited in taking actions that would affect long-term rates. Likewise, he had already raised with the Account Manager the question whether monthly auctions of one-year bills might have some inhibiting effect. Although Treasury coopera-tion in holding up short-term rates seemed desirable, there might be another side to the picture; namely, that this was a means whereby the Treasury could exercise monetary policy decisions. This was all something the System should continue to watch closely, lest it find itself restricted in taking actions in the future.

Mr. Scanlon reported that recent evidence pointed to further modest business improvement in the Seventh District, and expectations of businessmen as to the remainder of 1963 were generally optimistic. The decline in steel output appeared to be having less effect than had been expected. The seasonally adjusted index of electric power consumption for manufacturing firms in the Detroit area reached a new high in June. Purchasing agents in Chicago reported good levels of activity and some lessening of upward price pressures, although they continued to report increases on balance.

Prospects for the automobile industry remained favorable. Most plants would close at the end of the current week, and all 1963 model production was to cease next week. Total model year production would be over the 7,300,000 mark, a new record and almost 10 per cent above last year. Following the changeover, about 70,000 of the 1964 models would be turned out in August and, barring a railroad strike, another 500,000 in September. It was anticipated that new models would be introduced September 26 and 27 for low priced lines and October 3 and 4 for the higher priced cars.

Preliminary estimates of retail sales for the first half of July showed a continuation of the flat pattern of recent months. District department store sales, however, had remained at the sharply increased June level.

Bank debits in the Seventh District showed a significant rise in June, with almost all of the 46 areas covered reporting increases. At the same time, personal savings deposits in District areas rose faster than in April and May, reflecting mainly an increase in the rate of inflow that reversed the trend of the two previous months. The withdrawal rate had declined through the second quarter, but the reduction in the final month was relatively small.

Net farm income was expected to drop further below the year-ago level during the rest of 1963. Production expenses had continued to increase, and the larger inventory of livestock was being marketed at lower prices. Nevertheless, prices of good farm land continued to increase and rose about 2 per cent during the first half of 1963, according to reports from country bankers.

District bank credit declined seasonally in the first three weeks of July, but for the June-July period as a whole the gains remained substantial. The net growth over the past seven weeks was mainly in loans and "other" (non-Federal) securities. Increases in short-term Governments were also reported in the District, but mainly at one large bank. Business demand for bank credit still appeared very moderate. However, recent declines in business borrowings had been concentrated in the public utility, oil, and chemicals categories, while demand from durable goods manufacturers appeared to have strengthened despite liquidation of steel inventories. The Reserve Bank's June quarterly survey of interest rates indicated that the proportion of loans made at the prime rate was slightly greater than a year ago even though a smaller percentage of loans was in the largest size category. Major District banks were still actively seeking loans and apparently felt little reserve pressure.

As to policy, Mr. Scanlon said he would like to give the market a little time to adjust to the changes that had been made recently. He proposed no major change in the directive and no change in the discount rate. In supplying reserves during the period immediately ahead, it might be appropriate to purchase securities largely in the intermediate sector of the market if it was possible to do so.

Mr. Tow noted that wage and salary employment in the Tenth District had shown only seasonal changes since the first of this year. Among the major industry groups, employment in services and Government had advanced, but those gains had been offset by weakening activity in other categories. This performance was not in keeping with employment developments nationally. Total wage and salary employment in the United States had increased each month since January, and all major industry groups had participated in the advance.

A comparison of the trends of manufacturing in the United States and the Tenth District brought the recent divergent movements into rather sharp focus. Manufacturing employment reached a high in mid-1962 in both areas and subsequently declined. Since early this year, however, recovery had dominated U. S. manufacturing employment, while in the Tenth District the decline had continued.

Weather conditions in June and July had improved crop and feed conditions in the Tenth District, Mr. Tow said. The wheat crop was down from last year's small crop, however, and pasture conditions were substantially below average. Livestock numbers in the District were considerably higher than last year. Drought conditions continued to prevail in parts of the region, notably Colorado. Because of inadequate subsoil moisture, crops in much of the District are vulnerable to periods of deficient moisture and high temperatures, Mr. Tow pointed out, but timely rains in most areas had maintained row crops in generally favorable condition thus far.

Prices of the two major agricultural commodities produced in the Tenth District--wheat and cattle--had been averaging about 6 per cent below year-ago levels in recent months, while prices of feed grains were higher. If weather conditions were favorable, an increased level of marketings would about offset the effects of an anticipated lower level of prices on cash receipts as compared with last year.

Mr. Wayne advised that in the Fifth District manufacturing activity was holding about steady while most other sectors continued to advance. In June seasonally adjusted nonfarm employment again increased slightly. A rise in factory employment contributed to this gain, but because of shorter hours worked in nondurable goods industries, seasonally adjusted factory man-hours declined. In the past four months nonfarm employment and factory man-hours had performed a little less favorably in the District than in the nation as a whole. Rates of insured unemployment rose slightly in the early part of July, ending several months of uninterrupted declines. The Reserve Bank's latest survey recorded a slight further decline in business optimism. Viewing the near future, a majority of the respondents expected business to do no better than maintain present levels. Durable goods producers presented a mixed picture, indicating on balance virtually no net change. Makers of nondurable goods, however, including textiles, reported small declines in orders, shipments, and hours worked. Reports on construction, trade, and bituminous coal showed continued improvement. In some areas, Virginia in particular, drought conditions had seriously affected pastures and crops, but over most of the District the farm outlook remained moderately favorable. District weekly reporting banks had experienced a generally good demand in all major loan categories during the past three weeks.

Nationally, Mr. Wayne observed, business activity seemed to be continuing its slow advance, but with some tentative signs of slackening. Certain significant indicators of future activity were less encouraging than earlier and did not show the same uniformity of movement as two or three months ago. These signals, like detour signs on the highway, were current and fleeting; they could be removed or reversed next month. But in the absence of signs pointing to significant gains just ahead, they might well be regarded as a caution signal.

Turning to the area of policy, Mr. Wayne commented that there had not yet been sufficient time for the dust to settle following the major moves of two weeks ago. In fact, from time to time additional dust was kicked up as new changes were made in the proposed interest equalization tax. Generally, the psychological reaction to the change in the discount rate had been quite moderate, and the financial markets seemed to have adjusted to it quickly and smoothly. In certain respects they may have overadjusted--on a few days during the past week some short-term rates were well below their levels of a month earlier. In any event, it was too early to tell what the final reaction of the financial markets would be, much less to predict the eventual economic effects. In view of the adjustments to be made, Mr. Wayne concurred in the view that a continuation of present policy was indicated, with the proviso that the low level of certain short-term rates at the middle of last week was an unplanned aberration and not a part of System policy. He was disposed to agree with Messrs. Ellis and Irons with respect to the directive, and he would not desire, of course, any change in the discount rate at this time.

Mr. Mills said he agreed with some of the policy essentials contained in Mr. Hayes' statement. Speaking crudely, and within the framework of interest rates, he (Mr. Mills) had been forced, unhappily, to the conclusion that the Federal Reserve System had reached the point where it must either "put up or shut up." To set forth his case somewhat more formally, Mr. Mills presented the following statement:

> To use a figure of speech, the Federal Open Market Committee crossed the Rubicon and burned its bridges behind it when a majority agreed to a somewhat restrictive credit policy. I continue to believe that policy indefensible from an economic standpoint and that its continuance harbors grave risks of economic damage by way of curtailing the availability of credit and placing downward pressure on the money supply. However, as

matters stand, there is no choice other than to continue the credit policy now in force.

1. Inasmuch as the effectiveness of the Treasury's proposed "interest equalization tax" is open to question, the burden of combatting the balance of payments problem has fallen on the shoulders of the Federal Reserve System through the enforcement of a restrictive credit policy aimed at developing a higher interest rate structure.

2. Inasmuch as interest yields on U. S. Government securities and other interest-bearing securities have not moved into alignment with the 3-1/2 per cent discount rate adopted by the Federal Reserve Banks, it will now be necessary to accomplish that alignment by reducing the supply of reserves at the disposal of the commercial banking system. Otherwise, the financial community will be confused about the Federal Reserve System's policy intentions. Furthermore, the balance of payments interest rate defensive sought after would not be achieved.

In the light of the circumstances described, I am regrettably of the opinion that the Federal Reserve System's policy actions until the next meeting of the Federal Open Market Committee must move in the direction of a still more restrictive credit policy. Judging from the uncertainties in the foreign exchange markets that followed upon the announcement of the "interest equalization tax" proposal, the possibility cannot be ruled out that the Federal Reserve System may shortly be compelled to take emergency action in the field of discount rates in order to drive home in the minds of the general public that the United States is prepared to act decisively in defense of the dollar.

Mr. Mills added that he had been interested in Mr. Hayes' reference to a staff study of the possible use of reverse repurchase agreements. This was a subject worthy of study. Personally, however, he rather hoped that there might develop from the study a recommendation that the possibility be discarded because he was fearful it would be just another gimmick added to the wide range of gimmicks with which the System was already operating. These had resulted in handcuffing the Government securities market and making it a completely artificial and manipulated market.

Mr. Robertson presented the following statement:

It is very clear that financial circles, both here and abroad, are still in process of adjusting to the official actions and statements of the past two weeks. These adjustments are not helped by the unprecedented nature of the steps taken or proposed. Market participants have little in the way of historical experience to guide their responses. Some people, of course, have been telling us that the closest precedent to our recent action was the discount rate increase of 1931; but I am sure all of us hope for more favorable consequences than that. In any event, I am sure our proper role as central bankers at this time is not to panic at some of the gusts and cross winds, but to hold a steady course until the storm of reaction dies down and we can judge more soberly where our navigation has taken us.

I was opposed to the step of raising discount rates at this juncture. But, that action having been taken, I think it is the better part of wisdom to allow it a chance to make whatever contribution it can to the achievement of current policy objectives. These I take to be some elevation of short rates, but without any basic reduction in reserve and credit availability. By all the past precepts of U. S. monetary management, this is very close to a contradiction in terms, and we shall have to move very carefully to avoid having market responses prove that contradiction for all to see. Therefore, I think it is imperative that we speak in very clear terms to the Account Manager today as to what we want him to achieve, and what order of priority we assign to potentially conflicting desires. For example, I would think it essential that we restore the reference to reserve availability which was deleted from the second paragraph of the current directive at the last meeting. I would regard it as a proper posture for the Desk to strive for free reserves in the \$100-\$200 million range, with Federal funds rates ranging between 3 and 3-1/2 per cent and perhaps dealer loans of 3-1/4 - 3-3/4 per cent. I would not expect the Desk always to hit these targets if inadvertent circumstances should develop, but that does not destroy their value as reference points for operations. Now that the discount rate transition is over, we ought to be able to expect a return to a more reasonable relationship between bank reserve positions and these narrow money market rates. But I do not think it is practical for us to go further, and include a particular range of the Treasury bill rate, or even of a covered yield spread against foreign bills, in our communications with the Desk. However much a particular trend in these latter rates is desired around this table, they are being affected these days by many influences beyond the reach of the Account Manager. Depending upon which way market attitudes jell, and what other official actions are taken or withdrawn, the bill rate may end up close to the discount rate or well below it. But the Account Manager should not be asked to fight these kinds of rate movement with open market operations. Our aim should be to hold reserve availability steady, along with the new discount rate, and see where the bill rate, longer term rates, customer lending rates--and bank reserve use--finally settle down. Then we will know better what we have managed to accomplish, and whether or not we like the results.

If we are to take this tack, then the second paragraph of the current directive ought, as a minimum, to have restored the phrase concerning reserve expansion that was deleted at the July 9 meeting. I personally would favor giving to reserve needs at least as high priority as money market conditions, by the use of language something like the following:

> "To implement this policy, System open market operations shall be conducted with a view to fostering a moderate pace of reserve expansion, while maintaining reasonably stable money market conditions."

What we can accomplish by this, only time will tell. I, for one, am very skeptical about making any inroads on our capital outflow by this device. In particular, I doubt it can have much effect on bank loans abroad, so long as reserve availability is not cut back enough to slow domestic and international lending alike. If a more discriminating effect on bank loans to foreigners is to be sought, it may have to be done by the exercise of moral suasion on the few banks most directly involved. This is not a procedure I like, but I dislike even more the apparent alternatives of reducing reserve availability across the board or adopting some formal version of capital controls.

Whatever course we take today to steer our way through the market currents of the moment, we cannot afford to lose sight of the underlying problems still plaguing our economy. And let me remind you that, while the Brookings study suggests that fundamental forces are at work that may remedy our balance of payments deficit by the mid-1960's, no similarly optimistic note is cited by studies of our chronic underemployment of resources. It seems obvious to me which of these two basic problems is more in need of additional assistance from monetary policy over the longer run.

Mr. Shepardson observed that the policy proposals made around the table this morning seemed actually to fall within a relatively narrow range, even though they were expressed in numerous ways. At present, he noted, there was a confused and unsettled market situation, and in his opinion the System should do whatever it could to clarify its own position. The approach outlined by Mr. Ellis appeared to him most nearly to reach that point, although the targets cited by Mr. Ellis were not a great deal different from those mentioned by a number of others. As Mr. Shepardson saw it, the Committee's objective should be to refrain from adding to prevailing uncertainties. Insofar as the System could clarify the intent of its discount rate action, that would be helpful. This would mean, according to his view, some move through open market operations to validate the discount rate increase in terms of short-term rates without at the same time deliberately reducing the availability of reserves.

As to the directive, Mr. Shepardson suggested that it might be well, as others had proposed, to consider a rewording.

Mr. Mitchell expressed the view that this was a difficult period for monetary policy, and for those charged with formulating and carrying out monetary policy, with many voices outside the System proclaiming what the System should and would do. In present circumstances, he felt that the economy should be given a chance to let the basic factors of supply and demand operate, and it would be desirable for the Committee to concentrate its attention on the availability of reserves. It should not be forgotten, he noted, that the Committee must formulate policy in advance of the availability of statistics; most of those presently available were for the month of June, with some preliminary figures for the first part of July. If the economy was in the process of going flat, which was possible, and the Committee should decide on the use of rate objectives primarily, it could get into serious availability problems. If it developed later that the economy actually had turned down at a time when the Federal Reserve was contracting the availability of reserves, that would make a poor record. Accordingly, as he had said, he would concentrate attention at this point on the level of free reserves. He would be inclined to use as a target the $100-$200 million range and see how the markets would react. Under these conditions, he would not worry too much about what happened to the bill rate during the next two or three weeks.

Mr. Hickman commented that domestic business activity had moved into the summer slack season with the weight of evidence still pointing to continued economic expansion. The broader measures of economic activity had advanced throughout the second quarter. Several less comprehensive series, which are watched closely for clues or possible omens, had not behaved quite as favorably as earlier, but that did not warrant, in his opinion, a revision of appraisal.

The second quarter increase in gross national product had been in line with characteristic rates of rise during periods of moderate business expansion. Furthermore, the increase was entirely in final demand, with no assistance from the inventory account. The June rise in the index of industrial production, which marked the fifth successive month of gain, reflected an appreciable increase in final product output after a number of months of relative sluggishness; as had been expected, the industrial materials grouping contributed nothing to the increase because of the cutback in steel. In the steel industry, events were proceeding as foreshadowed, with a bottoming out in production expected for late August or early September.

Personal income had risen again in June for the fourth successive month, largely because of a persistent upward trend in wage and salary disbursements typical of expansion periods. Retail sales remained on a high plateau, with no significant change since February.

The latest information on auto sales, covering the first 20 days of July, indicated continued strength in that strategic part of consumer takings.

More complete information for June on the Fourth District confirmed the expansion reported at the previous Committee meeting, Mr. Hickman said, and early reports for July showed that the June gains on balance had been at least sustained. Department store sales continued to improve from their sluggish performance earlier this year. The rate of insured unemployment in mid-July was unchanged from June, and remained at a favorably low level; so far this was true even in the steel centers, contrary to previous experience during steel cutbacks. Widespread improvements in the regional unemployment situation during the past few months had been officially recognized in labor market reclassifications for June, with one-third of the District's major centers being upgraded. Electric power production had risen further in July, except for those areas where primary steel production dominated developments. As expected, steel ingot output in the District declined sharply in the past three weeks; shipments were reported to have been sustained somewhat by the threat of a railroad strike.

Earning assets at District reporting banks had expanded sharply in recent weeks in contrast to the national totals. District member banks had not been borrowing in significant amounts since the time of the discount rate action.

Turning now to System policy, Mr. Hickman said he found it impossible to isolate the impact of the recent discount rate action because of other pronouncements and proposals dealing with the balance of payments situation. To the extent that the behavior of financial markets both here and overseas told a story in this short period, recent developments did not appear to have been consistent with national policy objectives. Probably the best the System could do under these circumstances was to wait for the dust to settle, making sure in the interim that there was no excessive ease in the money market. He would think in terms of a 3-3/8 per cent bill rate, with Federal funds trading at 3-1/2 per cent most of the time and free reserves allowed to fluctuate more or less as they would in the short run. He would not be disturbed if free reserves went to zero, or changed to net borrowed reserves temporarily. The situation could be re-examined, if, to hold up the bill rate, free reserves fell below $100 million for an extended period of time.

At the same time, Mr. Hickman added, he was unhappy about recent attempts to commit the System to maintain, or reduce, the level of long-term interest rates. There was, in his opinion, a potentially dangerous situation, which could lead to a de facto restoration of the pre-1951 pegging. As Chairman Martin has stated recently, ". . . it is essential that monetary policy remain flexible and uncommitted--free to move either to check an unwanted and inappropriate tightening of credit, should it develop, or to defend more aggressively the international position of the dollar, should that be necessary." It seemed to Mr. Hickman that the System had an obligation to speak out forthrightly on this matter on every appropriate occasion.

Mr. Bopp reported that the economic situation in the Third District had improved somewhat during the past several weeks. Three labor market areas had been upgraded, although their ranking was still poor. Increases in unemployment were no worse than expected with the influx of school graduates into the labor market. He also noted an improvement in department store sales, cutting into the District's year-to-year deficit. Some of these gains may disappear as steel production declines become reflected in other indicators. On balance, however, the picture looked a bit brighter than usual.

Total bank credit showed a decline, and business loans were still lagging behind last year, but there continued to be some pressure on bank reserve positions.

Mr. Bopp stated that he had voted favorably on the policy directive at the July 9 meeting because it seemed to him that the use of the different instruments of monetary policy should be consistent and an increase in the discount rate was then imminent. Under such circumstances, it had seemed undesirable to reverse what had taken place in terms of yields only to reverse again. His vote, therefore, was essentially a vote on tactics. As to the future, it was still an open question whether short-term rates could be maintained at the new levels, and reserve availability at the old. Under these conditions, he agreed with the view that it would be desirable to maintain essentially an even keel for the time being, and to supply reserves through purchases of coupon issues, selling bills if necessary. In his opinion, emphasis should be placed on the availability of reserves.

Mr. Bryan reported that developments in the Sixth District were going along about in line with the national economy with a slight tendency for nonfarm employment to rise less than nationally. Differences from the national averages were chiefly in financial statistics; the District had had a sharp rise in bank debits and in bank loans and investments. The Reserve Bank's agricultural economist had reviewed the sharp expansion in lending to farmers in all sectors and had presented the view that this lending was sound and creditworthy, but Mr. Bryan remained skeptical.

Mr. Bryan stated that he was uncertain about any recommendations he might make at this juncture regarding national monetary policy. Without doubt, the System was confronted with some thorny problems. If, after raising the discount rate, the System did not follow through, at some reasonable interval, toward making the new discount rate effective, the System would be inconsistent. On the other hand, the System ran a considerable risk, in making the rate effective, of doing injury to the economy because in his belief it would not be possible to make the discount rate effective without working to some appreciable degree in the field of reserve availability. Of the two alternatives, he would prefer, for the immediate future, to allow the dust to settle and to maintain reserve availability, measured in free reserves at approximately $100-$200 million, or somewhere in that range.

Mr. Bryan also mentioned the concern he felt about the yield curve on Government bonds, which was quite flat. He felt the time was gone when either the Federal Reserve System or the Treasury could appropriately manipulate the yield curve. There was the real danger of an unfunding of the public debt, which would be tragic for both the Treasury and the System. He hoped that neither the System nor the Treasury would make further efforts to manipulate the rate curve.

Mr. Bryan then turned to the dealings of the System and the Treasury in foreign currencies and expressed concern. The System had a short position of about $150 million in foreign currencies, to which must be added the Treasury's short position (estimated at $650 million). Altogether, this got up to a fairly high level.

Mr. Shuford reported that in the Eighth District month-to-month improvements had not been particularly noticeable. However, in evaluating conditions in the District, it was evident that there had been rather significant improvement since the first of the year. In the major metropolitan areas, employment had increased about 2 per cent since late 1962. Industrial use of electric power had risen sharply, with gains registered in all seven metropolitan areas. After an early lull, department store sales, bank debits, and business loans had all shown improvement. As to the agricultural picture for the District, farming conditions so far this year had been good. Corn and soy beans were developing ahead of schedule; cotton prospects were quite good; and rice and tobacco crops were above average. Prices of major agricultural commodities seemed to be holding at about the same levels as last year. In the area of livestock (mainly hog and beef) prices, there had been a recovery since the first of the year.

Turning to monetary policy, Mr. Shuford noted the continuance and persistence of uncertainties, which the Committee had discussed. Among these uncertainties, there was the steel situation, the unsettled railroad wage dispute, the question of public acceptance of the new-model autos, and the reaction to the President's recent balance of payments message to Congress. All of these things had introduced uncertainty into the picture. In these circumstances, he favored no change in policy at this meeting. Even though there was the possibility of seeming inconsistent by not following through with some action in support of the discount rate change, he did not feel that he or the System were alone insofar as inconsistency was concerned. He would favor, if possible, no lessening in the rate of monetary expansion, and he believed that the money supply should, if possible, continue to increase at about the same rate that had prevailed during the past several months. With respect to the bill rate, he believed it would be desirable if that rate could continue in the range that had prevailed since the last meeting. Some emphasis should be given to the matter of reserve availability, but at this time it might be inappropriate to focus on any specific level of free reserves. With the changed relationships between the discount rate and market rates, it might be misleading to compare the new levels of free reserves with those that had prevailed prior to the discount rate change.

Mr. Balderston observed that now, 29 months past the last cyclical low, domestic business still seemed to be moving upward. Accordingly, he felt that the foreign dangers to the future health of the economy should be the principal concern of this Committee at the moment. This was not to deny the possibility that the domestic economy might even now be topping off, which would present still further complications. While he would not refer to the many measures of economic strength, he was heartened by a couple of characteristics that surprised him. One was that individual saving in relation to disposable income was holding up. Another was that manufacturing productivity in the second quarter of this year was 4.9 per cent above the year-ago figure.

But according to a recent tally the first half year wage settlements showed a larger average increase than in the corresponding period a year ago. The over-all median settlement was 8 cents an hour compared with 7.7 cents for the same period last year, and the manufacturing median climbed even more, from 6.8 cents in the first half of 1962 to 7.3 cents in the first half of 1963. Moreover, deferred increases continued to show up in one of every two settlements, and despite the unemployment of one out of every five inexperienced and unskilled workers, the minimum wage was to be raised again in another month. This would complete the third of such raises since 1950.

It was little wonder that this country's failures to reduce labor costs and export prices did not go unnoted abroad. In his report to the shareholders of the Netherlands Bank, Dr. Holtrop noted that in the last four years labor costs per unit of industrial production fell by about 3 per cent, while they were rising in the Netherlands by 14 per cent and in Germany by 21 per cent. But the total wages paid per person employed rose by 17 per cent; and so Dr. Holtrop noted that a reduction in the cost of American industrial production would have been perfectly possible in those years. However, the index of prices for American exports rose by 4 per cent and that for industrial finished products by as much as 9 per cent. Dr. Holtrop added that none of this would concern Europe if there were no balance of payments problem; however, Europe became involved if it was asked to join the United States in adopting measures to safeguard stability in the international system of payments.

Mr. Balderston went on to say that the President's balance of payments package encouraged him a little but not much. Specifically, he would apply selective controls at the point where he thought they would work, and the best place to use them was on the Government's own spending and lending. He hoped that the Government would make some one individual responsible for slowing down on payments against current commitments to place dollars abroad and to ride herd on future commitments resulting from dollar diplomacy.

As to the right policy for the System at this particular juncture, Mr. Balderston pointed out that the System has continued to feed to the commercial banks at a 3 per cent annual growth rate the reserves required to support private deposits. Bank credit, that is loans and investments, are continuing to rise at an annual rate of about 10 per cent, which is about the same as last year's rate of 9 per cent. As compared with the last half of 1962, excess reserves are about $100 million lower, and discountings about $200 million higher. Nonborrowed reserves have remained about constant since the turn of the year, but it is significant that the use by banks of reserves made available to them has continued to rise at a vigorous rate. The ratio of loans to total deposits at all commercial banks has been above 54.5 per cent ever since 1960 and is currently over 57 per cent, whereas when he came to the Board of Governors nine years ago, it was below 40 per cent. Of course the strong flow of savings into commercial banks now added to their desire to invest whatever they could not lend. Last year they took one out of six dollars of the increase in mortgages and four out of five dollars of the net gain in State and local securities. The fact that bankers have not seen fit to curb their investments so far meant to him that they must not be feeling restraint. The aggressive efforts of bankers to put their funds to work not only at home but abroad led him to wonder whether the System had a good answer to the editor of Barron's when he said: "The Federal Reserve and Treasury have poured forth *a flood of easy credit and a sea of red ink.* Excessive liquidity has now become a mounting threat to the dollar."

With respect to short-run monetary policy, Mr. Balderston said that he felt it would be desirable to try to hold steady for the next three weeks until market developments could be seen and analyzed more clearly. However, he anticipated that the next move, when it came, should be on the side of greater firmness.

Mr. Balderston concluded with the comment that the Federal Reserve System must do in its best judgment the job it had to do, that is, to make the right decisions at the right time with regard to monetary policy. It could not afford to be bound by commitments, whatever they may happen to be. If the time should come for greater or lesser monetary ease, that was the System's job and responsibility.

Chairman Martin observed that he was glad Mr. Balderston had concluded his remarks on the note he had, for it reminded him (the Chairman) that he wanted to take a minute to set the record straight in one respect. In all of the discussions incident to the President's balance of payments message, he (Chairman Martin) had refused to make any commitment with regard to Federal Reserve policy. The quotation Mr. Hickman had read (which was from Chairman Martin's testimony before a Congressional committee on July 22) reflected the position he had taken consistently. He felt sure that his record was completely clear in that regard.

Chairman Martin went on to express the view that the System was not following in any way a restrictive policy, and had not in recent years. It had recently been following a slightly less stimulative policy, but he happened to be one of those who believed that too much stimulation was self-defeating. He also believed that a good deal of the chronic unemployment in this country might be related to the balance of payments situation, and that until the balance of payments problem was brought better into line the country was likely to be faced with increasing rather than diminishing unemployment.

The Chairman noted, as one element in the current situation, that the demand for bank credit continued to be less than many had anticipated. At the same time there had developed a large volume of savings, encouraged by the payment of higher interest rates, that had made available for certain types of operations a quantity of money far in excess of what he would like to see. He doubted that the cost and the availability of money could clearly be separated. Nevertheless, in certain circumstances--and he thought they currently prevailed--it was his opinion that a fairly good case could be made, for a limited time, for only modest adjustments, if any, in short or long-term rates. He was inclined to feel that rate stability should be sought until such time as it could be seen whether the business situation was likely to improve further in the fall and whether there was improvement or further deterioration in the balance of payments. Factors overhanding the markets at present included not only the balance of payments problem but the possibility of a railroad strike and various other considerations that had been mentioned during today's discussion.

At the Chairman's request, there were distributed at this point alternative formulations of a possible current policy directive that had been drafted by the staff for the Committee's consideration. According to one alternative, the second paragraph of the directive would call for open market operations to be conducted with a view to continuing the present degree of firmness in the money market, while accommodating moderate expansion in aggregate bank reserves. According to the other alternative, operations would be conducted with a view to attaining a slightly greater degree of firmness in the money market, while accommodating moderate expansion in aggregate bank reserves.

In commenting on the directive, Chairman Martin indicated that he was inclined to agree with the view expressed by some during today's discussion that perhaps at some point a general rewording of the directive should be attempted. As to the next three weeks, however, it appeared to him that the differences of opinion as to policy expressed around the table had been so slight that there was little immediate need for any substantial change in the directive.

Mr. Mills commented that he would like the record to show that, although it was distasteful to him, he would be obliged to dissent from any consensus in favor of continuing only the present degree of market firmness. He felt that the System had made a mistake some years ago, in 1957, by not making the discount rate change at that time an effective rate, and that the System could not afford to repeat the mistake. At that time it had confused the market as to its intentions and objectives. In his view the Committee was inevitably moving toward a more restrictive policy. The majority had made a basic decision, and this having been done there was an obligation on the part of the Committee to carry through on the course it had set.

Chairman Martin responded that it was quite appropriate for Mr. Mills' comment to be included in the record. Also, for the record, however, he (Chairman Martin) would like to say that he did not agree with the view that a mistake was made several years ago on the occasion mentioned by Mr. Mills.

Mr. Hayes said he agreed strongly with Mr. Mills as to the need for supporting the recent discount rate action at the present time.

Chairman Martin then inquired whether it would seem appropriate to put the question in terms of a further substantial reduction in the level of reserve availability, if necessary, in order to keep the Federal funds rate at, say, 3-1/2 per cent and the bill rate around 3-3/8 per cent. Mr. Hayes replied that he would prefer to put the question in terms of conducting open market operations in a way that would tend to support a Federal funds rate of 3-1/2 per cent and a bill rate close to 3-3/8 per cent, and taking the consequences in terms of reserve availability, hoping that reserves could remain about where they were but making that a subordinate consideration. Mr. Mills stated that this would be his position. Mr. Mitchell suggested, however, that the question be put in terms of making the availability of reserves a primary consideration rather than a residual factor. The question could be stated simply on the basis of maintaining free reserves between $100 and $200 million for the next three weeks.

In discussion of this point, Mr. Mills said he felt that the concept of a level of free reserves as a primary objective had long since been rejected. Under certain conditions there could be movements of interest rates that would not conform at all to the free reserve level. As had been stated on many occasions, it was the tone and feel of the market that must take precedence. It would seem to him that the instruction to the Manager for the next three weeks would have to be conditioned largely on the tone and feel of the market, consistent with whatever consensus was arrived at by the Committee.

Chairman Martin expressed agreement with the view that the level of free reserves was not a proper sole target, just one guide.

Mr. Ellis, who was asked to restate at this juncture the targets he had suggested earlier during the meeting, indicated that they would include a bill rate in the area of 3-3/8 per cent and a Federal funds rate between 3-1/4 and 3-1/2 per cent, with a free reserve target level at $100 million, subject to some variation in either direction. His general thought had been to follow a course that would allow the market to find its own footing again. If doubts arose in the conduct of open market operations, he would resolve them on the side of firmness rather than ease.

Mr. Mitchell indicated that he considered that the real issue related to what course the Account Manager would follow if the several targets became mutually inconsistent. If the Committee wanted to instruct the Manager to protect the bill rate even at the expense of net free reserves turning into net borrowed reserves, that was one policy. If the Committee wanted to instruct the Manager to aim at some target of free reserves, say, $100-$150 million, and see how the market reacted, that would be an entirely different policy.

Mr. Hayes noted that the targets expressed by Mr. Ellis included a bill rate of around 3-3/8 per cent. Actually, the bill rate had not been close to that level during the past three weeks. Therefore, while he rather liked the targets embodied in Mr. Ellis' suggested policy, he did not think such a policy could be regarded as one of no material change.

After further discussion as to how the policy question for the next three weeks might best be expressed, Mr. Hayes commented that in light of all of the discussion that had taken place, he was inclined to revert to an earlier suggestion that the question be decided in terms of the alternatives included in the draft directive material that had been distributed.

Upon further consideration, there was general agreement with a suggestion that a vote be taken on a policy directive that would call, in the second paragraph, for policy to be implemented, in the context of a higher discount rate, by open market operations conducted with a view to attaining a slightly greater degree of firmness in the money market, while accommodating moderate expansion in aggregate bank reserves.

Accordingly, 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 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 high level of domestic business activity, 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 in the context of a higher discount rate, System open market operations shall be conducted with a view to attaining a slightly greater degree of firmness in the money market, while accommodating moderate expansion in aggregate bank reserves.

Votes for this action: Messrs. Martin, Hayes, Balderston, Irons, Mills, and Shepardson. Votes against this action: Messrs. Bopp, Mitchell, Robertson, and Scanlon.

It was noted that the Account Manager had suggested, in his oral report today, that the continuing authority directive to the Federal Reserve Bank of New York, which had been amended on June 18, 1963, to raise from $1 billion to $1.5 billion the limit on changes in the System Open Market Account in the period between Committee meetings, might be changed again to reduce the leeway to the former figure of $1 billion.

Upon motion duly made and seconded, and by unanimous vote, section 1(a) of the continuing authority directive was amended so as to authorize and direct the Federal Reserve Bank of New York, to the extent necessary to carry out the current economic policy directive:

To buy or sell United States Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing United States Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account (including forward commitments, but not including such special short-term certificates of indebtedness as may be purchased from the Treasury under paragraph 2 hereof) shall not be increased or decreased by more than $1 billion during any period between meetings of the Committee.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, August 20, 1963.

The meeting then adjourned.

Ralph A. Young

Secretary