A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, October 22, 1963, at 9:30 a.m.

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

Messrs. Hickman, Wayne, and Swan, 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. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hexter, Assistant General Counsel
Messrs. Baughman, Eastburn, Furth, Green, Holland, Koch, and Tow, Associate Economists
Mr. Stone, Manager, System Open Market Account
Mr. Coombs, Special Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Cardon, Legislative Counsel, Board of Governors
Mr. Broida, Assistant Secretary, Board of Governors
Mr. Williams, Adviser, Division of Research and Statistics, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, Secretary, Office of the Secretary, Board of Governors

Mr. Coldwell, First Vice President, Federal Reserve Bank of Dallas
Mr. Rouse, Vice President and Senior Adviser, Federal Reserve Bank of New York
Messrs. Holmes, Mann, Black, and Jones, Vice Presidents of the Federal Reserve Banks of New York, Cleveland, Richmond, and St. Louis, respectively
Messrs. Brandt and Litterer, Assistant Vice Presidents of the Federal Reserve Banks of Atlanta and Minneapolis, respectively
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Meek, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on September 10, 1963, were approved.

Upon motion duly made and seconded, and by unanimous vote, the action of the members of the Federal Open Market Committee taken on October 8, 1963, authorizing extension of the period of the standby reciprocal currency arrangement with the Bank of Italy to six months from three months but not affecting the term of any drawing by either party was approved, ratified, and confirmed.

Before this meeting there had been distributed to the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period October 1 through October 16, 1963, together with a supplementary report covering the period October 17 through October 21, 1963. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Coombs commented that the Treasury gold stock would remain unchanged this week for the tenth week in a row. After deducting gold orders on hand, the Stabilization Fund had $64 million available and this might be further increased by a prospective distribution by the Gold Pool at the end of this month.

On the London market, there had been no significant sign of dishoarding as yet, Mr. Coombs said, with private buying remaining on a moderate scale. Sales of Russian gold, of which $200 million were acquired by the Pool during September, had continued, and the Pool had acquired another $100 million from the same source during the first half of October. So far this year, Russian gold sales had come to $400 million, as compared with annual totals in earlier years of $200 to $250 million. Since the Russian wheat purchase program might increase their dollar exchange needs by $750 million or more above normal, they might be forced to sell gold in sizable volume during coming months.

Mr. Coombs observed that the preliminary September figures showing a deficit of $180 million in the U. S. balance of payments were encouraging and seemed to reflect sharp declines in outflows of both long- and short-term capital. While Canada continued to attract some short-term money, he had the impression that capital outflows to other parts of the world had subsided considerably. New York banks now seemed to be moving to a rate of 3-7/8 per cent on 90-day money and thus were getting into a better competitive position with the Euro-dollar rate of 4-1/8 per cent.

Despite the apparent improvement in the U. S. balance of payments, Mr. Coombs said, exchange markets had been subject to a number of disturbing influences, mainly because of flows of European funds from one money market to another. Perhaps the most serious problem arose out of the speculative flow from the lira through the dollar into the Swiss franc. In Italy, the present caretaker government had been unable so far to deal decisively with a serious inflationary situation. The Bank of Italy had finally made a firm request of the Italian commercial banks to refrain from further borrowing in the Euro-dollar market. For the past year such borrowing had disguised severe deterioration in the Italian balance of payments. It now seemed likely that the Bank of Italy soon would be forced to show heavy reserve losses, with considerable risk that this would further aggravate speculative pressures. In an effort to cushion somewhat the Italian reserve declines, the U. S. Treasury had stepped up its program of acquiring lira balances against its outstanding lira bond indebtedness of $200 million, and by the end of the month these purchases would probably amount to $67 million.

Mr. Coombs thought it likely that the Bank of Italy would want to draw on its reciprocal swap arrangement with the Federal Reserve within a month or so. If correction of the Italian deficit in fact should take longer than the short maturities appropriate to swap drawings, the Bank of Italy would probably move to pay off any drawings under the swap line by recourse to the International Monetary Fund for longer

term credit. At the moment Italy had a sizable creditor position with the Fund and also was negotiating a substantial increase in its Fund quota. There seemed to be a reasonable chance that the increase would be approved before the year end.

Unfortunately, Mr. Coombs continued, as banker to the world financial system the U. S. was involved not only in the Italian deficit but also in its counterpart, the heavy flow of short-term funds from Italy to Switzerland. Last week the Swiss National Bank had to make further sizable purchases of dollars to keep the dollar from going through the floor at 4.3150. To mop up these surplus dollars, the Account had to exhaust the $100 million swap line with the Bank for International Settlements by a further drawing of $20 million, and on the day preceding this meeting the Account had drawn $30 million under the $100 million swap line with the Swiss National Bank. Consequently, there remained only $70 million under the swap line with the Swiss National Bank to deal with possible heavy further flows of dollars to Switzerland before the year end, including forward Treasury contracts of $110 million maturing in that period. He had discussed the situation last week in Basle with representatives of the Swiss National Bank, Mr. Coombs said, and had secured a tentative agreement from that Bank to take on an additional $70 million in Swiss franc bond issues by the U. S. Treasury. He thought the Swiss National Bank would also do its best to help out around the year end by executing swaps with Swiss

commercial banks to take care of year-end inflows for "window-dressing" purposes. But unless the Italian authorities take drastic action to restrain the outflow of funds from Italy, the Account might have to draw heavily on its remaining credit source, the unused $70 million of the swap line with the Swiss National Bank. And in the background was the specter of real trouble on the British side; uncertainties associated with anticipated British elections could result in still further flows to Switzerland. Therefore, it might become desirable to increase still further the System's swap lines with the BIS and Swiss National Bank.

Mr. Coombs said that the System was faced with another troublesome problem in the Netherlands. In late September it had been necessary to draw on the full swap line of $100 million with the Netherlands Bank, and the U. S. Treasury had put out $39 million in one-month guilder forward contracts, to deal with a sizable repatriation of funds by Dutch commercial banks. The main reason for that inflow was rumors of a re-evaluation of the guilder. These rumors had since been officially denied, but a new type of speculative situation had arisen. Dutch commercial banks now expected a severe tightening of credit to deal with the inflationary consequences of an expected wage increase of 8 to 10 per cent. Consequently, the Dutch banks were trying to stay liquid, and so far it had been possible to cover only $13 million of the Treasury's $39 million in one-month forward contracts. It was

paradoxical, Mr. Coombs observed, that a prospective 8 to 10 per cent wage increase should result in a strengthening rather than a weakening of the currency of the country involved. It seemed reasonably likely, however, that the prospective deterioration in the Dutch competitive position would in due course tend to weaken the guilder. But if such a reversal was unduly delayed by restrictive credit policy, it might be necessary to consider funding our swap drawing through a U. S. Treasury issue of guilder bonds to the Netherlands Bank. While the Dutch authorities so far had resisted taking in such bonds, at the last BIS meeting they seemed prepared to consider this possibility more favorably.

In the discussion that followed, Mr. Mills inquired about the nature of the allocation of increments to the stock of gold in the London Gold Pool, and the reasons for the reallocations to other countries of parts of the U. S. share that he understood the Treasury recently had made. Mr. Coombs noted, in replying, that the United States normally received 50 per cent of any allocation by the Pool On the occasion of one allocation, last spring, the Treasury had retained half of its share and reallocated the other half to the German Federal Bank and the Bank of Italy. In another allocation near the end of September, $10 million of the U S. share of $85 million had been reallocated to the German Bank and $10 million to the Italian Bank. In the middle of October, $10 million of a $40 million U. S. allocation had been reallocated to the German Bank.

Mr. Coombs observed that the motive for these reallocations was not simply generosity. Both Germany and Italy, he observed, had rarely bought gold from the United States, but rather had relied on the London market. Thus, when they joined the Pool they were deprived of a source of gold, and in the absence of occasional reallocations both the German Federal Bank and the Bank of Italy would have come under pressure to supplement their gold stocks by purchases from the United States. On balance, Mr. Coombs believed, the U. S. had saved rather than lost gold by the procedure that had been followed.

Mr. Mills then asked whether the public reaction to the announcement of the increase in the Italian swap line to $250 million was favorable or perverse in the sense that it provoked further outflows of funds from Italy. Mr. Coombs replied that, insofar as he could judge, there had been little or no reaction of any sort; he thought matters were now at a stage where the swap network was taken for granted and occasional increases in the size of particular lines were viewed as routine changes. Had there been a reaction, he would have expected it to be favorable.

In a further question, Mr. Mills asked about the ultimate employment of the funds that had been moving from Italy to Switzerland, and, in particular, whether the funds were being held in Swiss francs. Mr. Coombs replied that no one really knew the answer to this question, but there was reason to believe that some of the funds remained in

Switzerland and some were reinvested in Italian securities under Swiss names. In response to another question by Mr. Mills, Mr. Coombs commented that the earlier "gentlemen's agreement" between the Swiss Government and Swiss commercial banks limiting the extent to which the latter acquired foreign currencies had recently been abandoned, because the many loopholes in the agreement served to penalize the larger commercial banks. Mr. Mills asked whether the situation with which the agreement had been intended to deal had recently become increasingly serious, and whether it had not been aggravated by the fact that the U. S. was now "picking up the check" under its currency operations. Mr. Coombs replied that problems of this type were unavoidable for any nation, such as the United States or the United Kingdom, that was cast in the role of banker to the world. He thought in the absence of the swap network the United States would have lost about $400 million in gold to Switzerland and the Netherlands in the past two months. More generally, he felt that the whole international payments system had been held together by these swap arrangements and by the so-called Roosa bonds; had they not been developed the system might well have broken down completely by now.

In response to a question by Mr. Mitchell as to why the Swiss authorities did not finance the Italian deficit directly without involving the dollar in such a way as to bring it under pressure in Switzerland, Mr. Coombs reported that on one occasion in the past the

Swiss had acted in this manner for a period of two or three months with respect to the British pound but that they were disinclined to do so at present with respect to the lira on the grounds that the flows involved were large, and they needed to save their ammunition. Nevertheless, he felt the Swiss were moving gradually towards accepting their responsibilities to the international payments system. Mr. Mitchell commented that while he was not interposing an objection to the potential Italian drawing under the newly expanded swap line, he thought the record should show what had been happening in the Italian economy recently. He noted that in the past year there had been a 25 per cent increase in commercial bank credit; an 18 per cent expansion in the money supply; a 30 per cent rise in imports; a 17 per cent increase in hourly wage rates in manufacturing; increases of 6.6 per cent and 5 per cent, respectively, in the consumer and wholesale price indexes; and along with all this, an increase of less than 10 per cent in industrial production. In his view, inflation had a very strong hold in Italy; nevertheless, the System was about to extend them a substantial amount of credit with no strings attached. In reply, Mr. Coombs observed that the essential fact was that the credit being extended was short-term. If the Italians required long-term credit, as he thought they eventually might, they would have to borrow from the International Monetary Fund.

In reply to a question by Mr. Deming about the implications of recently reported Russian gold sales in the Middle East, Mr. Coombs said

that these sales were almost invariably for dollars. Most Russian gold sales were made in London, Zurich, and Paris; however, the Russian Government had recently opened a bank in the Middle East, and might be channeling some gold there.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period October 1 through October 21, 1963, were approved, ratified, and confirmed.

Mr. Coombs said that before making his recommendations he would like to report on several informal conversations he had had recently with foreign central bank officials regarding their attitude towards the present swap arrangements. From conversations with officials of the Bank for International Settlements, he thought they would probably favor a further sizable increase in the $100 million swap line if further heavy flows of funds into Switzerland made this desirable. Secondly, the Swiss National Bank probably would also favor an increase in the System's $100 million swap line with them to perhaps as much as $200 million, if necessary. Third, he gathered that the Bank of France at present would not welcome a suggestion by the Federal Reserve for a further increase in the swap line with them. However, their attitude did not appear to be based on any fundamental philosophical convictions and might change rather quickly.

Mr. Coombs recommended renewal on a three-month basis of the $250 million swap arrangement with the German Federal Bank and of the

$100 million swap line with the Bank of France, both of which were last renewed on August 6, 1963.

Renewal of the swap arrangements for a further three-month period was approved.

Mr. Coombs then referred to the discussion at the preceding meeting of the possibility of a standby swap arrangement with the Bank of Japan, and said he was inclined to recommend a swap in the amount of $100-$150 million. He felt that the memorandum that had been prepared under Mr. Young's direction on the Japanese situation pointed up the effectiveness with which the Japanese authorities had responded in recent years to challenges posed by inflationary pressures and to other problems. (Note: A copy of this memorandum, dated October 18, 1963, has been placed in the files of the Committee.) His conversations with Bank of Japan officials gave Mr. Coombs the impression that they were prepared to move fast to meet any new difficulties. He also had obtained the impression that if they drew on a swap line and had difficulty in reversing it, they would have no hesitancy in approaching the International Monetary Fund. He noted that the Japanese were making further progress in removing restrictions on current account transactions and thought it probable that they would qualify for Article VIII status by next spring. While so far the Committee had refrained from making swap arrangements with countries that did not have Article VIII status, Mr. Coombs thought there were certain advantages in anticipating the

event in the Japanese case. There was apt to be much public discussion of the problem of international liquidity during the coming months, in connection with which the System might be asked to explain the details of its swap arrangements. Accordingly, he thought it advisable to move quickly to round out the swap network.

In response to a question as to whether a condition was contemplated under which drawings under the swap arrangement would not be made until Japan had achieved Article VIII status, Mr. Coombs replied that he thought the Japanese would be fully agreeable to such a condition. The basic advantage of the swap arrangement, he noted in response to another question, was that it would increase Japan's international liquidity. He thought the arrangement would minimize internal pressures on the Japanese authorities to increase their gold ratio from its low present level of 17 per cent.

Mr. Mills said he felt that the staff memorandum on the Japanese situation was somewhat overdrawn as to the extent of Japan's progress and the effectiveness with which the authorities there had dealt with their problems. He thought the Japanese economy had been sustained very largely by borrowing on both short- and long-term, and asked whether drawings under the proposed swap agreement might not serve simply as a substitute for the private capital inflows the Japanese had enjoyed in recent years. Mr. Coombs replied that in his opinion the swap arrangement was not a substitute for long-term capital. It was a short-term

facility, and if the Japanese needed long-term money, they would have to find it elsewhere.

Mr. Mills' second comment related to the suggestion that the swap arrangement be approved on a conditional basis, to be effective only when the Japanese achieved Article VIII status. He doubted that this was wise, and felt that any such arrangement the System might make with the Japanese should be clean-cut and without conditions. Mr. Coombs replied that he had felt hesitant on this point. As he had noted, the Japanese were prepared to accept the condition, but he personally would not urge it. He was interested in knowing how strongly the Committee felt about a foreign country's having Article VIII status as a prerequisite for a swap arrangement with the System. In his view, the main criterion was the importance of the country in world trade and finance, and Article VIII status had served merely as a convenient rule of thumb. On this basis, the Japanese would qualify. Moreover, they were very close to full convertibility, with the main remaining restriction relating to tourist travel, and completion of the swap agreement might encourage them to move more rapidly to Article VIII status.

Mr. Bopp commented that approval of a swap arrangement with a country that had not yet achieved Article VIII status--which to him represented one important criterion out of several--might open the door to negotiations with other countries whose currencies were not convertible. He was inclined to feel that it would be desirable to include the condition,

and perhaps also to postpone announcement of the swap arrangement until the date Japan achieved Article VIII status.

Mr. Robertson received an affirmative reply to his question as to whether a reciprocal currency arrangement with the Japanese would round out the swap network, insofar as Mr. Coombs could judge at the moment. Mr. Coombs said he had thought of informally conveying the impression that the swap network was now complete on a geographic basis. A formal announcement to this effect might prove embarrassing later, if the Committee should decide to broaden the network, but he agreed that a statement with some such qualifying phrase as "complete for the time being" might be desirable. After this discussion, Mr. Robertson commented that the only purpose he could see for including a condition in the Japanese agreement was to lend credence to the notion that the System was prepared to deal only with Article VIII countries, and he did not think this desirable. Moreover, to impose a condition that might not be met until next spring really amounted to accomplishing nothing at present.

Mr. Balderston said that he favored the Japanese swap arrangement for two reasons: Japan was one of this country's best customers in the world market, and could purchase gold from the United States if so inclined. He was troubled, however, on how to draw the line if and when other countries proposed swap arrangements with the System. Mr. Coombs commented that this problem had been in his mind when he suggested

that the Committee should not make Article VIII status a prerequisite for swap arrangements. There were several other countries with such status with whom he thought swap arrangements would be undesirable, because they failed to meet the more basic criteria he had mentioned, and because they did not participate in various other arrangements of major industrialized countries, such as the Organization for Economic Cooperation and Development and the "Group of Ten."

Mr. Scanlon commented that if the Committee approved a swap arrangement with the Japanese without making it conditional on Article VIII status, it seemed to him that the underlying rationale was being changed. As he read the record, the Committee had treated Article VIII status as virtually a requisite for swap arrangements. However, he shared Mr. Robertson's feeling that if the Committee was going to impose conditions it was really accomplishing little in authorizing the arrangement.

Mr. Mitchell observed that the original purpose of the swap arrangements had been to help shore up the dollar, and he felt they had been helpful in this respect. But it now appeared to him that the System was in the position of creating Federal Reserve funds to assist countries with trade deficits supported by short- and long-term borrowing. The Japanese position, in his view, was quite weak. He had no fundamental objection to the act of borrowing on short term for long-term purposes--there were many legitimate instances in which such a

procedure was followed--but he felt the United States had enough problems of its own without undertaking to help the Japanese with theirs. He agreed that there necessarily was a certain element of mutuality in swap arrangements, but felt, nevertheless, that approval of the Japanese swap arrangement would be a mistake. Despite recent gains, the international position of the United States was not strong enough for this country to undertake to solve the problems of Japan and Italy. If the arrangements were truly reciprocal, he would expect to see them developed between pairs of third countries, rather than all emanating from the United States.

Mr. Coombs commented in reply that he could visualize the eventual development of a broad network of bilateral swap arrangements of the sort Mr. Mitchell mentioned, and thought that central bankers in some other countries were thinking along this line. He would be pleased to see such a network come about. But, he noted, the United States was cast in a special role as banker to the world. He thought of the proposed Japanese arrangement as providing Japan with the same type of defense as the United States had repeatedly needed. He had continually stressed the two-way street aspect of these arrangements. To him they represented a mutual defense, under which credit would be extended when needed by either party. Mr. Hayes added that capital flows between the United States and Japan could move in either direction, and the existence of a swap arrangement with Japan might prove highly useful to the United States in the future.

Mr. Hickman questioned the proposed size of the swap line, and asked whether $200 million might not be a better figure than $150 million, in view of the possibility of large and violent swings in Japan's external flows. Mr. Coombs agreed that a larger line might be found necessary, but in view of various uncertainties he thought it might be prudent to start with the lower figure, and increase it if experience indicated that it was too small.

Chairman Martin said that he saw a real advantage in rounding out the System's network, although without necessarily saying that it was closed for all time. He saw no particular advantage or disadvantage in this case to Article VIII status as a condition; in any event, the Japanese were close to full convertibility He then proposed that the Committee vote on an arrangement with Japan in the amount of $150 million, without conditions relating to Article VIII status.

Thereupon, upon motion duly made and seconded, approval was granted to the negotiation of a standby reciprocal currency arrangement with the Bank of Japan in the amount of $150 million.

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

Mr. Mills indicated that his reasons for dissenting from this action went beyond the particular case of Japan. They reflected his desire to crystallize within the Committee awareness of what he felt

to be a serious and dangerous drift towards greater laxity in System foreign currency operations.

Mr. Coombs' final recommendations concerned the amounts and form of the dollar limitations specified in the continuing authority directive on foreign currency operations. First, he proposed that the limit on total foreign currency holdings be revised upward to $1.95 billion from its present level of $1.75 billion, to reflect the Committee's action at the meeting of October 1, 1963, authorizing increases in the size of the standby reciprocal currency arrangements with the German Federal Bank and the Bank of Italy, and the Committee's action at this meeting authorizing an arrangement with the Bank of Japan. The figure of $1.95 billion was the sum of the amounts that had been specified by the Committee for all of the individual authorized swap arrangements, and therefore represented the maximum of System covered holdings of foreign currencies under these arrangements, in the remote possibility that they might all simultaneously be fully drawn on. Secondly, he proposed that the Committee specify separately a limit of $150 million for foreign currencies purchased outright, on a spot basis. Finally, he proposed continuation of the limit of $150 million that the Committee had approved at the meeting of October 1, 1963, for forward transactions undertaken for the three purposes specified in the directive.

In response to a question as to whether a $150 million limit was appropriate for spot purchases of foreign currencies, Mr. Coombs

noted that since such transactions were on an uncovered basis there was an exchange risk involved, and he thought the Committee would want to keep them under close control. Asked whether the proposed limit did not represent a loose rather than tight rein, Mr. Coombs indicated that the volume of uncovered holdings in the past had sometimes reached levels of $50 or $60 million. If the Committee wanted to set the limit at $100, or even $75, rather than $150 million, there probably would be no great problem posed in operations. No member, however, pressed for a limit lower than $150 million.

Accordingly, upon motion duly made and seconded, and by unanimous vote, the continuing authority directive for System foreign currency operations was amended, effective immediately, to read as follows:

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines on System Foreign Currency Operations reaffirmed by the Federal Open Market Committee on March 5, 1963, as amended May 28, 1963; provided that the aggregate amount of foreign currencies held under reciprocal currency arrangements shall not exceed $1.95 billion equivalent at any one time, and provided further that the aggregate amount of foreign currencies held as a result of outright purchases shall not exceed $150 million equivalent at any one time:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs
Belgian francs
Canadian dollars

Austrian schillings
Swedish kronor
Japanese yen

The Federal Reserve Bank of New York is also authorized and directed to operate in any or all of the foregoing currencies in accordance with the Guidelines and up to a combined total of $150 million equivalent, by means of:

(a) purchases through forward transactions, for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements;

(b) purchases and sales through forward as well as spot transactions, for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies; and

(c) purchases through spot transactions and sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations.

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 October 1 through October 16, 1963, and a supplementary report covering the period October 17 through October 21, 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:

Perhaps the major development since the last meeting of the Committee has been the note of caution that has crept into the Government securities market and the corporate and municipal bond markets. This more hesitant tone has been

particularly evident in the Treasury bill market, with the rate on three-month bills in the auction yesterday at about 3.49 per cent, up 8 basis points in three weeks, while the six-month issue, which averaged 3.63 per cent yesterday, is up 12 basis points. In considerable measure, of course, the upward pressure on bill rates has been the consequence of the substantial addition the Treasury is making to Treasury bill supplies. Today's auction of a $1 billion bill strip follows the offering earlier this month of $2.0 billion March tax anticipation bills and two earlier monthly auctions of $1 billion one-year bills. Even with the pay off at maturity of the October 15 bills, the Treasury has added $2.5 billion to bill supplies during the past two months, and the market fully expects the monthly offering to add another billion next week. The market has not been prepared to absorb these additional supplies of bills at pre-existing rate levels, and rates have therefore moved up to a range where the additional bills can be absorbed.

At the same time, market participants have become somewhat apprehensive about the general economic background and its implications for interest rates. Continuing signs of strength in the domestic economy, the rise in stock prices to record heights, and a sprinkling of price increases have all contributed to increasing caution. Moreover, the appearance of somewhat lower free reserve figures during the recent period has led some market participants to question whether policy might be undergoing a slight shift toward less ease.

The rise of the bill rate to the neighborhood of 3-1/2 per cent in response to these factors has given rise to some discussion of the possibility of a discount rate increase some time before the end of the year. In the circumstances, dealers have taken advantage of good demand from corporate and other customers at the higher rate levels to reduce their total bill positions by $400 million to $2.1 billion over the three weeks ended last Friday despite their awards of $2.8 billion bills during the period. Given the uncertainties in the background, however, dealers have found investors primarily interested in shorter bills so that their holdings of longer bills have actually increased despite efforts to dispose of them at higher rates.

The prices of Treasury notes and bonds have been sliding for most of the past three weeks in response to the same background factors that have affected the Treasury bill market. Market participants, at the time of the last meeting of the Committee, still expected that prices would move up and that

they could dispose of their large holdings of the issues acquired in the September advance refunding at rising prices. Subsequently, with the development of the more cautious attitude I have already noted, dealers and other short-term holders of the 4 per cent bonds of 1973 and 4-1/8 per cent bonds of 1989-94 sought to take some of the profits they already had in these issues. Large scale purchases by Treasury investment accounts helped to relieve some of the downward price pressures that developed early in the period. Subsequently, with Treasury accounts largely out of the market, prices moved progressively lower as investment buying did not fully take up offerings by dealers and others at existing prices. Over the period, however, dealers were able to reduce their holdings of bonds in the 5- to 10-year area by over $300 million to about $100 million and bonds in the over 20-year area by $125 million to about $150 million.

Prices in the corporate and municipal bond markets have tended slightly downward over the past ten days or so, reflecting the same background factors that have been at work in the Government securities market. A buildup in the calendar of forthcoming corporate issues has exerted a restraining influence in that market, while a sizable volume of offerings and an accumulation of municipal bonds on dealers' shelves has led to a little heavier atmosphere in that sector in the last few days.

The Treasury plans to announce tomorrow the terms on which it will refinance its $7.6 billion of November 15 maturities, of which we hold about $3.9 billion. It also plans to announce tomorrow another issue of $1 billion one-year bills, to be auctioned next week and to be paid for on November 4. For the November 4 refunding, the Treasury is considering whether to offer one or two issues. If it does offer two, the longer option will probably mature within 5 years. We would plan to take the shorter of the two options unless some good reason to the contrary should arise.

At the last meeting the Committee raised the leeway to $1.5 billion since the projections pointed to the possibility that we might have to absorb close to $1 billion of reserves. As it turned out, the projections were considerably wide of the mark, and we absorbed substantially less than the figures suggested would be necessary. Looking ahead, the estimates suggest that we may have to supply nearly $1 billion reserves over the next three weeks. This time, the figures could be right, or could be wide of the mark in the wrong direction. I should therefore like to suggest that the leeway be retained at $1.5 billion for another three weeks.

In the discussion a question was raised as to whether Government securities dealers had suffered losses in connection with the recent Treasury financing operations, and whether any such losses might discourage their participation in the forthcoming Treasury financing. Mr. Stone replied that he did not think dealers had suffered losses. At one point dealers had profits of 3/8 point in the 4-1/8 per cent bonds of 1989-94, acquired in the September advance refunding, and they had taken profits at declining prices as they reduced their positions. As for Treasury bills, while the cost of marginal funds from New York banks had been relatively high, at 3-7/8 per cent, dealers had been able to borrow a good deal of nonbank money at 3-1/2 per cent, and, in his opinion, the average cost of funds was low enough for them to carry their portfolios without loss.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period October 1 through October 21, 1963, were approved, ratified, and confirmed.

The Chairman then called for staff economic and financial reports, supplementing the written reports that had been distributed in advance of the meeting, and copies of which have been placed in the files of the Committee.

Mr. Koch presented the following statement on economic developments:

There have been some surprises in recent economic news, but by and large--taking account of both the good and the bad--developments have been in line with expectations of further moderate expansion in the closing quarter of the year. Pervasive influences making for ups and downs over a wide range of indicators have been steel and auto developments. When discounted for adjustment to earlier stock accumulation in steel and for the model changeover in autos, fluctuations have not been as significant as they appear at first glance.

The bad news for September was a sharp and widespread decline in retail sales, perhaps attributable in part to difficulty in making appropriate adjustments for seasonal influences. The more or less neutral news included little change in the unemployment rate and in industrial production. There was a cessation in the decline in steel activity, little change in output of other materials, a turnup in auto assemblies, and a sharp rise in truck production.

Other good news for September included moderate increases in employment and personal income, a 4 per cent rise in new orders for durable goods, and a jump in housing starts. But the employment increase was heavily concentrated in State and local employment of teachers, reflecting the beginning of the new school year, and in the auto industry. The rise in the average workweek in manufacturing was similar to last year, and reflected mainly the pickup in auto output. The rise in new orders was general, but in quantitative terms much of it represented autos, steel, and defense. The September level of housing starts is very large indeed, but the figure for August has been revised down sharply, and the average of the two months is not much different from that of preceding months.

For the third quarter as a whole, the gross national product is estimated by the Council of Economic Advisers to have increased by about $9 billion, to an annual rate of $588-1/2 billion. This is a significantl_ larger increase than had been generally anticipated. The sharper than expected rise came mainly in the private investment sector, with residential and other construction and producers' durable equipment all up. One surprise here, considering the working off of steel stocks, is the fact that inventory investment is tentatively estimated at about the same rate as in the second quarter. State and local spending showed an unusually large advance, as road construction spurted following a spring decline.

In early October, total retail sales appeared to be well along in recovering the sharp September loss. Auto sales were in very large volume--above a year earlier--but these sales

are still greatly influenced by early model year fleet sales. Press reports suggest, however, that public acceptance of the new models has been highly favorable. Steel production has risen slightly but is still only at a level a little over 60 per cent of capacity. The industrial production index will get some help from auto and steel production this month, but since the direct impact of steel and autos on the total index is small, the course of the total will depend mainly on what happens in the rest of industry, about which as yet we know almost nothing.

Taken together, a sizable further rise in the GNP is likely in the current quarter. Nonetheless, it appears unlikely that the unemployment rate will decline significantly or that much additional pressure will be put on industrial capacity.

Current indications are that expansion will carry over into 1964. First, there is the likelihood of the substantial tax cut to stimulate spending, although legislation may not be enacted until next year. Secondly, the first two surveys of anticipated business plant and equipment outlays in 1964, those by Lionel Edie and McGraw-Hill, the results of which are still confidential and in part incomplete, suggest that expenditures next year are likely to be 5 to 8 per cent higher than those for this year as a whole and also somewhat higher than those for the fourth quarter of this year.

As for the price situation, there have been some obvious stirrings since last spring. Certain important lines of business that have long felt the need but not the ability to raise profit margins now find that the demand for their product is strong enough to enable them to test selective price increases. Thus far, however, stability has persisted in the broad price indices. The real question about the recent stirring is whether the selective price increases that have developed to date are likely to cumulate and to contribute significantly to a price-cost spiral.

The evidence on this question is not yet in, and probably won't be in for some time. While prices of some commodities have increased in recent months, prices of a much larger number have been stable and prices of still others have declined. In a few cases, a price increase was announced by a single producer and then subsequently rescinded when his lead was not followed by competitors. Finally, there are some relevant longer run facts available that suggest that a cumulative upward spiral is not a likelihood unless the economic expansion picks up speed significantly.

In the first place, productivity continues to increase sharply, which is unusual after 30 months of cyclical expansion. Secondly, profits are apparently rising considerably, and there is still ample unutilized plant capacity in most lines. Thirdly, wage increases continue to be moderate. Moreover, for the short run it is important that wage contracts in some of the strategic industries cannot be reopened soon, for example, in autos not until next summer and in steel not until early 1965.

The current level of unemployment is also still apt to be an important restraining factor in wage negotiations. Labor is not likely to attempt to push up wages sharply in a period when it considers its bargaining position unfavorable. All this could, of course, be upset in the longer run, for if prices and profits continue to rise, labor would no doubt seek more aggressively to obtain what it considers its fair share of the over-all gains.

Mr. Holland presented the following statement on financial developments:

In the past month or so, markets have been accommodating themselves to the onset of fall financial pressures, punctuated by significant Treasury financing actions in both the long- and the short-term segments of the market. In the process, interest rates across the board have edged up 5 to 10 basis points, and free reserves have worked lower.

Watching these lower free reserve figures emerge day by day, I could not help but be struck with several factors. First is the tendency among some larger banks to be quicker to cover their marginal reserve needs at the discount window. Such a tendency may reflect the stronger loan demand they are accommodating, the higher level of market interest rates relative to the discount rate, or perhaps some one or a combination of other factors. But the result has been to lower the level of free reserves that is associated with a given degree of tension in the central money market. In addition, the recent lower free reserve figures reflect a succession of misses on the downside in both day-to-day projections and week-to-week estimates of changes at nonreporting banks. Misses are an ever-present problem, but they tended to cumulate in the downward direction unusually often in the past few reserve weeks. Part of this is explicable, however, for in hindsight we can see that private

demands for bank credit and bank deposits were mounting more than seasonally, and increasing bank reserve needs in the process.

These recent developments have been generating some adjustments within the banking system. Bank loan demand from nonfinancial borrowers is proving considerably stronger than seasonal, with business loans showing a brisker pace than earlier this year. An important part of this loan strength is centered outside the major cities. The dimensions of the loan expansion do not approach those of a boom, but they are large enough, given current reserve availability, to compel banks to break the pattern of sizable net purchases of securities that they had maintained so much further through this expansion period than in others. While still participating in successive Treasury financings, banks have been net sellers of Governments in most intervening weeks. They have also cut back on purchases of municipals and agency issues, a fact that probably has a good deal to do with the recent poorer sales of the enlarged volume of new municipal issues. Meanwhile, bank loans to securities dealers and finance companies have dropped back, following the September tax date bulge.

These actions have produced a net slowing of total bank earning asset expansion, and would ordinarily have been accompanied by a slackened rate of private deposit growth. Such tendency has been offset, however, by a more than corresponding drop in U. S. Government deposits at banks from their unusually high summer levels. Bolstered by these net deposit transfers from Government hands, the totals of private demand deposits, time deposits, and the combined reserves required to support such deposits have all been rising. The money supply has moved up to a level some 4 per cent above a year ago. Even this advance, however, has not quite kept pace with the growth in GNP or in the volume of transactions being funneled through the public's checking accounts. As a consequence, money velocity has risen somewhat further, measured on either an income or transactions basis. Should the current business pick-up lead the public to wish to continue adding to money balances at anything like the recent rate, the banking system will be in for some further changes. This is because no further boost to private deposits appears likely from Government deposit reductions; they are already down to a level around which they are projected to oscillate for the remainder of the year. Thus, any continuation of recent money demand would need to be compensated for by slower time deposit growth, or by more intensive bank reserve utilization (probably

including more discounting), or be tranquilized, as it were, by somewhat more attractive rates on near-moneys.

Insofar as time deposits are concerned, banks are hard at work trying to maintain their levels of time certificates of deposit in the face of the fall needs for corporate funds and the increased yields of other money market investments. We hear of active solicitation efforts by some prime-name banks that are serving to stretch the conventional 25 basis point margin of CD rates over Treasury bill rates of comparable maturity.

While the impact of such bank efforts has already been felt in some degree through most of the markets for short-term instruments, the long-term markets may be less far along in the process of responding to the apparent change of pace in bank takings of securities. This is particularly true of the municipal market, which has been heavily dependent upon bank buying over the past year and a half. The absence of any strong market reaction to date may reflect hopes by market participants that banks will reappear as substantial net buyers of intermediate and longer term securities. If those hopes prove unfounded, an appreciable market readjustment would undoubtedly result.

The Government securities market now appears technically in a better position than the municipal market and less dependent upon the banks. Nonetheless, the new issues supplied by the recent advance refunding are still not fully digested. Furthermore, the Government market will have its hands relatively full over the next two to three weeks with new Treasury activity, as outlined by the Manager in his report. The one-year bill issues are becoming semi-routine for the dealers to handle, as are bill strips to a lesser degree. Furthermore, the November 15 refunding offering is not expected to involve any issue sufficiently long to disturb the tenor of the market. But the sum total of such activity argues for maintenance of an "even keel" policy over the next three weeks. A policy of no change would also befit the state of the capital markets more generally viewed. Three weeks from now, with the Treasury financings presumably successfully completed, the Committee should find itself in a better position to evaluate the appropriate posture for monetary policy to assume in dealing with the climactic seasonal pressures that will arise later in November and December.

Mr. Furth presented the following statement with regard to the U. S. balance of payments:

The U. S. payments deficit in September was smaller than forecast on the basis of the tentative weekly figures. The official figure of $170 million includes, as a financing item, the issue of $50 million of so-called convertible nonmarketable Treasury securities to foreign monetary authorities to replace similar so-called nonconvertible bonds of a shorter maturity. Since this exchange does not materially affect the international liquidity position of the U. S., the Board's staff prefers to consider the transaction neutral from the point of view of the U. S. payments balance; accordingly, the deficit would be only $120 million.

Thanks to this unexpectedly good result, the deficit for the third quarter as a whole is also likely to be smaller than forecast. Based on the calculation preferred by the Board's staff, the estimated deficit is at a seasonally adjusted annual rate of less than $2-1/4 billion--and this estimate assumes that the final September figure will be about $25 million higher than the figure mentioned in the beginning. According to the calculation favored by the Commerce Department, the annual rate would be only $1-1/4 billion; and according to the most favorable calculation sometimes used by the Treasury Department, it would be as low as 1/2 of 1 billion dollars.

The table distributed to the Committee shows the derivation of these various figures from their common source. (Note: A copy of this table has been placed in the files of the Committee.)

The improvement of the payments balance since the first half of the year apparently reflected sharp reduction in the net outflow of capital. Foreign security issues have abruptly declined while bank term loans, which would be exempt from the proposed interest equalization tax, may have begun to rise again. This development suggests that part of the improvement has been due to the initial shock effect of the tax proposal, and that capital outflows may increase again once the market becomes cognizant of the loopholes left by the proposed bill. It remains to be seen whether moral suasion or other methods can help to close at least the loophole of bank loan exemptions.

Tentative figures for the first half of October suggest that the deficit may again be on the rise. But the weekly figures are so erratic that data for one or two weeks are not indicative.

Developments abroad are, on the whole, encouraging. Europe seems to continue its upswing. There is some question whether Continental Europe as a whole is reducing or increasing its trade surplus: in the first half, Continental European imports

rose faster than exports but over the summer months imports remained stable while exports, especially from Germany, started again to expand.

Rumors of revaluation of the Netherlands guilder and of devaluation of the Italian lira appear to have produced large inter-European transfers of funds. But the dollar has been affected by these movements as the vehicle currency of most exchange transactions: when there are heavy shifts, say, of Italian lire into Swiss francs, the dollar should, in theory, become stronger against the lira and weaker against the franc, so that the combined impact would be neutral. But if, as has actually happened, the Italian authorities intervene in the market to prevent the lira from weakening, the dollar does not strengthen in Milan but it weakens in Zurich--with unfavorable psychological repercussions. This is one of the inevitable consequences of the international eminence of the dollar.

Beyond their immediate market effect, however, the recent vicissitudes of European currencies suggest that the payments surplus of some European countries may be more vulnerable than many observers realize. The Italian payments balance, for instance, has changed from a surplus of $500 million in 1962 to a deficit in 1963, which may turn out quite as large; in terms of the U. S. economy, this would mean a shift in the payments balance by $10 billion. In the Netherlands, the wage controls, which many of our European friends had strongly recommended as a model for a U. S. income policy, have apparently broken down. In France, wage and price freezes are used to combat inflation, despite the long history of failures of such measures. All these developments seem to indicate that the comparative export advantage of some European countries has an uncertain basis.

If I may be permitted to indulge in some highly tentative forecasting of the U. S. payments position, I should guess that any renewed outflow of long-term capital may well be offset, or perhaps more than offset, by improvement in the trade balance. This assumes that the sale of U. S. wheat to the Soviets is not permitted to founder on excessive U. S. freight rates; that a sizable part of the export proceeds is received in cash; and that the Canadian wheat sale to the Soviets will in turn lead to an increase in Canadian imports from the U. S. Thus, the relatively favorable third-quarter results may well be equalled or perhaps surpassed in the period immediately ahead.

But the third-quarter payments deficit still remains too large, and the United States still has the greater part of the

way to go until the $3-1/2 billion rate prevailing in the past few years is replaced by reasonable equilibrium.

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

The domestic business outlook continues generally favorable. A note of caution is perhaps warranted by the failure of industrial production in September to show any appreciable pick-up after the August dip, and by an unexplained drop in retail sales in September. On the other hand, when retail sales for August and September are viewed together, they are much more satisfactory. New model auto sales appear to be going well, consumer buying plans are better than a year ago, and rising plant and equipment spending by business is in prospect. Optimism is widespread, and has been reinforced in recent days by the rise of stock prices to record levels. Passage of the tax bill around the turn of the year could provide a strong additional stimulant.

While the wholesale price index has been quite steady, there have been a considerable number of significant individual price increases recently. Future developments in this area will certainly bear watching.

September witnessed a sharp gain in bank credit. It is particularly interesting to note that in the first nine months of 1963 most measures of bank credit, bank deposits and bank reserves showed growth rates roughly equal to or a little greater than those in the first nine months of 1962, despite the several modifications of monetary policy in the direction of less ease in the past year and a half. For example, required reserves rose this year at an annual rate of 3.4 per cent as compared with 2.6 per cent a year earlier, total bank credit at 7.4 per cent as against 7.9 per cent and money supply plus time deposits at 7.1 per cent as against 6.1 per cent. While it is true that the level of short-term interest rates rose considerably, the question may legitimately be raised whether the degree of over-all liquidity and credit availability has not remained somewhat higher than the Committee has intended it to be. Even from a domestic point of view, the result may have been a somewhat excessive growth of credit in some areas--and the readiness of banks to lend abroad has continued unabated.

The latest balance of payments developments have been encouraging for the first time in many months. On the basis of preliminary September figures--which may, of course, turn out to be misleading--there was a very sharp improvement in the third quarter over the second quarter. The de facto freeze on foreign bond issues and the beneficial influence of monetary policy moves on short-term capital flows were probably important contributing factors. Trade prospects have been helped importantly by the Russian grain shortage. However, it is certainly too early to say whether a true turning point in our balance of payments position has been reached. In particular we must watch for signs that the freeze on new issues may be causing an unusual bulge in term loans by American banks to foreigners and for signs that nervousness as to possible future controls may be inducing American firms and individuals to place or leave funds abroad. There has been an increasing tendency toward more restrictive credit policies in Europe to counter inflationary threats in several important countries. We cannot overlook the possibility that monetary policy may have to be called upon again in this country to contribute to further progress toward balance of payments equilibrium.

For the time being, the Treasury's active financing program suggests the desirability of our refraining from any significant policy change. And in any case there is something to be said for a wait-and-see attitude for a few weeks, while we try to appraise more accurately both balance of payments and domestic business prospects for the fourth quarter. Fortunately, the prospective offering of $2 billion of Treasury bills before the month-end, in addition to the regular weekly issues, is likely to bring a continuation of the upward pressure on bill rates that has been visible in recent weeks. It seems to me that we should seek to preserve about the kind of general money market atmosphere that has prevailed in the last three weeks. If Treasury activities should tend to put additional pressure on bill rates we should not try very hard to offset it.

The directive can probably be left as it is, except for the inclusion of some reference to the imminent Treasury financing.

There is one area where I believe a policy move could be very useful in the near future. I am thinking of the possibility of further liberalization of the ceiling on time deposit interest rates under Regulation Q. In line with the generally firmer tendency of short-term market interest rates in recent weeks, the rates on time certificates of deposit have risen to levels

where the 4 per cent ceiling is having some restrictive effects. It means that some of the moderate-sized banks outside of the money centers are no longer able to compete for 3-month, 6-month and one-year money. This would not seem to be a healthy situation, either from a domestic point of view or from the standpoint of the balance of payments. In my judgment it would be well to lift the ceiling substantially in order to permit normal competitive factors free play in determining the size and geographical distribution of this important segment of the money market.

Looking a little further ahead, it occurs to me that the Board might wish to consider injecting a few hundred million dollars of needed seasonal reserves by making another reduction in reserve requirements, preferably those applicable to reserve city banks. If last year's experience is any criterion, the danger that this might be interpreted as a move toward greater ease is not very great, and it should have beneficial results in the short-term rate area. It also seems logical to use this instrument to provide at least part of the country's long-term needs for additional bank reserves.

Mr. Ellis said that it was difficult to interpret the various conflicting economic indicators for New England. Nonfarm employment was virtually unchanged from a year ago, and employment and manhours worked in manufacturing were down. However, there had been a slight pickup in weekly earnings, and personal incomes were about 3 per cent higher. Department store sales were running about 9 per cent above year-ago levels. Automobile sales were strengthening, and there was a more widespread use of consumer credit. By the end of August, total new credit extensions were sufficient to bring the 12 months gain to 6.7 per cent. Automobile credit extensions also picked up in September after a pause in August. In September, 78 per cent of District instalment loans on new automobiles had maturities in excess of 30

months, as compared with 75-1/2 per cent last year.

Turning to the national economy, Mr. Ellis observed that the recent new highs in stock market price indexes had been achieved at a time when margin requirements were 50 per cent. Customer credit had risen about 18 per cent above its high before the May 1962 decline in stock prices. He also noted that banks had been stepping up loans to brokers, with a rise of about 50 per cent in the 12 months ending in September. Another category showing a large gain was foreign loans, up about 25 per cent, and it was natural to anticipate that banks would be under more pressure to grant foreign loans, in view of the decline in foreign long-term capital issues in this country. He sensed that the pressure to make foreign loans was extending beyond the New York banks; Boston banks showed sharp increases.

These observations were offered, Mr. Ellis said, to highlight the degree of credit availability that had been provided in recent weeks. He felt the domestic economy did not need the liquidity, and banks did not need the degree of credit availability, that the Committee had been providing. He was pleased by the recent firming in the money market. The initiative lay with the market. If and when credit demands strengthened this fall, he would expect required reserves to exceed the staff's guidelines even with no net change in free reserves.

As to policy, Mr. Ellis thought it would be appropriate to confirm the recent firmness in the money market, and probable further

firmness that might develop. As targets of monetary policy actions he would suggest a short-term bill rate fluctuating around the discount rate, but not falling below 3.4 per cent. Net free reserves might best be in the lower part of the range from zero to $100 million. He would not favor any immediate action on discount rates. While he believed this policy was consistent with the present directive and he would not urge a change in the directive, he thought it would be desirable to update the wording of the directive soon.

Mr. Coldwell reported that the Eleventh District economy slowed a little in August and September, with industrial production down slightly. On the other hand, construction contract awards in August were at their highest levels since May, with residential, public works, and utilities construction leading the way. Cumulatively for the year to date, construction activity was 10 per cent above a year ago.

Employment conditions in the Eleventh District were fairly stable, Mr. Coldwell said. Retail sales were down a little in some sectors and up in others. Except for a good cotton crop, the agricultural situation in the District had been affected adversely by the lack of rain in some areas. The drought in the area east of San Antonio was creating forced cattle sales, with resulting downward pressures on cattle prices.

In the banking and financial area, data for weekly reporting banks indicated strong loan demand, particularly in real estate,

consumer and security categories, and a slight rise in bank investments. Total bank credit, therefore, was expanding rather sharply in the District, and there was some pressure on reserve positions. Federal funds purchases by District banks had risen markedly, and borrowings from the Federal Reserve Bank had increased considerably in the past few weeks.

Mr. Swan reported that business activity in the Twelfth District had continued to advance in September, although somewhat unevenly. Employment was up slightly more than seasonally but the unemployment rate remained unchanged at a level above that for the nation as a whole, as the labor force continued to expand. It was encouraging that employment had increased despite nine successive months of declines in defense-related employment, which currently was 4 per cent below the peak reached in December 1962. The larger banks in the District, as a group, had swung back to being net sellers of Federal funds, but the pattern was uneven as some banks were borrowing in considerable amounts in the Federal funds market and from the Reserve Bank.

Mr. Swan noted that some savings and loan associations in the District had announced increases in rates paid to shareholders effective October 1. These seemed to fall in two groups: some that had reduced rates in the middle of the year and were now returning them to earlier levels; and a second group, consisting mainly of smaller institutions, that had not made earlier reductions. He thought the typical prevailing rate continued at 4.8 or 4.85 per cent. Some of the associations were

increasing the frequency with which they compounded interest, and were emphasizing this fact in their advertising. This was one of the factors that had led some of the smaller institutions to offer higher rates on a quarterly compounding basis. The effect of the September announcement of higher rates was not yet known. District savings and loan associations did not do too well in attracting funds in July, but in August the inflow of funds was twice that of July.

With respect to policy, Mr. Swan believed that both the Treasury financing program and the economic situation in general suggested a position for the next three weeks of even keel, or no change. He was a little concerned, however, about exactly what "no change" meant now that the bill rate was about equal to, rather than slightly below, the discount rate. It seemed to him that the situation that had developed during the last three weeks was a little different from the one anticipated at the last meeting. He agreed that in the past the Committee may have over-emphasized the significance of small changes in bill rates, but he thought such changes took on increasing importance as the bill rate approached the discount rate. He shared the opinion Mr. Mitchell had expressed at the last meeting that when the bill rate rises to a point where it is fluctuating around the discount rate it becomes increasingly difficult to avoid action on the discount rate. He thought this might not be a real problem for the next three weeks, but it was something that soon was going to confront the Committee more strongly than it had in the past.

Mr. Deming reported that the agricultural situation in the Ninth District was good this year. The direct effect the Russian wheat deal would have on the economy of the District was not entirely clear, but it was evident that it would at least have pronounced indirect effects, by making wheat prices firmer. Sentiment in the wheat country was overwhelmingly in favor of the deal. Nonagricultural activity seemed to be moving just about the same way in the District as in the nation, and confidence with respect to the immediate future of the economy seemed quite high in the District.

Banking conditions in the District were somewhat mixed, Mr. Deming said. At country banks, which apparently were under no liquidity pressure, loans were expanding, whereas loans at city banks continued to seesaw from week to week. City banks were on the buying side of the Federal funds market fairly consistently. Occasionally there would be a scramble for Federal funds, and occasionally a city member bank would borrow from the Reserve Bank.

Mr. Deming said he would subscribe to an even keel policy, in view of the imminent Treasury refunding, and a change in the directive to refer to the Treasury financing seemed all that was needed. He saw no reason to change the discount rate at this time. In a concluding observation, Mr. Deming said that he thought the Desk had done well during the past three weeks. As to the reserve projections, he supposed they presented a problem that could not be licked completely.

Mr. Scanlon reported that economic activity in the Seventh District apparently had moved to new high levels in October as steel output continued to rise from the August low, production of 1964 autos increased sharply, and output of machinery and equipment rose further. Business optimism in the District had strengthened further and there was widespread confidence that economic activity would continue to rise well into next year. Sentiment had not been dampened by declines in the national data on industrial production in August and retail sales in September. However, many individuals predicated their optimism on a tax cut to take place early next year.

Some business firms had been encouraged by an improvement in their profit margins, Mr. Scanlon said, particularly when allowance was made for higher depreciation taken under the new guidelines. While some price markups had not held, others had, in such varied lines as steel and steel products, chemicals, and hot water heaters, and were expected to have a favorable impact on profits of the firms involved.

Labor market conditions appeared to have improved further in most District centers when allowance was made for recent fluctuations in steel and autos. Preliminary October figures suggested that retail sales had increased from the somewhat depressed September level.

Cash receipts from farm marketings in the District in the first seven months of this year equaled receipts in the comparable year-ago period, Mr. Scanlon said. Larger sales of corn and soybeans

at higher prices had offset smaller receipts from livestock sales. As of October 1, farm land values in the District were estimated by country bankers to average 3 per cent above last year. The future trend of land values was expected to be stable or to continue upward.

Mr. Scanlon said that the most significant banking development in the District in recent weeks had been the strength in business loans. The recent surge of loan demand seemed to be concentrated at the large banks, however. Virtually all of the rise at weekly reporting banks in the third quarter was in the Chicago money market banks. For the third quarter as a whole, reporting banks in the District showed an increase of almost 4 per cent in commercial and industrial loans, a rise nearly twice as large as for the country as a whole. The basic deficit position of the Chicago banks remained somewhat in excess of $200 million, but they had been able to cover most of this with Federal funds.

As to policy, Mr. Scanlon said he would favor maintaining the prevailing degree of firmness in the money market, and noted that he was referring to the rates that had prevailed during the preceding few days. He did not favor a change in the discount rate and would change the directive only insofar as necessary to reflect the Treasury financing.

Mr. Clay said that economic developments in the Tenth District continued to differ from those in the country as a whole. District

nonfarm employment, seasonally adjusted, had dipped slightly from the advanced level reached early this year. This followed a period of rising employment during the last half of 1962 and of stability in early 1963. Nationally, scarcely any uptrend was evident in employment during the last half of 1962, but marked improvement had developed this year. Tenth District manufacturing employment had shown little change during 1963 and was about 1-1/2 per cent less than year-earlier levels, while nationally, manufacturing employment was nearly 1 per cent higher than in comparable months of 1962.

Mr. Clay reported that farm income prospects in the Tenth District relative to last year were slightly less favorable than in the nation. He attributed this in part to smaller crop production this year in contrast with record production nationally, and in part to substantially lower prices on meat animals, which are relatively more important in Tenth District agriculture than in the nation. Higher costs of production were expected to bring a decline in net farm income nationally as well as in the Tenth District, but the decline would be more marked in the District for the reasons he had mentioned.

Mr. Clay noted that interest rates had moved to higher levels than the Committee had set as its goal three weeks ago, with the 90-day Treasury bill rate even reaching 3-1/2 per cent at one time. In his opinion various factors, including Treasury financing activities, public statements, and misses in financial data projections, had worked

to that end. It was important, Mr. Clay said, that this recent development should not be viewed as a monetary posture that the Committee would become committed to maintain. This was particularly important inasmuch as it had been suggested in previous meetings that market developments leading to a Treasury bill rate in line with the Federal Reserve discount rate might be used as the base for another upward movement in the discount rate.

Monetary policy had moved to a point, Mr. Clay said, where further actions in this same direction must be evaluated critically in terms of the effectiveness of policy in sustaining economic expansion. While the over-all output performance of the economy in the third quarter was encouraging, questions remained as to the sustaining character of the composition of demand growth achieved in this upswing. Moreover, the relationship of monetary policy to the lagging elements in the expansion became of crucial importance at this stage of the cycle. Such an analysis did not lead easily, in his opinion, to acceptance of the present market position as the base for a change in monetary policy resulting in another round of interest rate increases and lessened credit availability.

At the present time, Mr. Clay said, the Committee should continue to provide additional reserves to the banking system for credit expansion and should not feel constrained to prevent the 90-day bill rate from falling somewhat below its recent level. Treasury financing presumably

would be a factor in the conduct of open market operations in the period immediately ahead.

Mr. Wayne said that signs of further improvement continued to mark most sectors of Fifth District business. Factors indicating current strength included a sharp rise in building permits to a new high in September, sustained high-level demand for bituminous coal, and strong and apparently improving markets for textiles and furniture. These trends were supported by the latest Reserve Bank survey, which indicated a continuation of general optimism, strength in construction, and further rises in manufacturing new orders, shipments, employment, and hours.

With respect to national conditions, Mr. Wayne said the behavior of the economy in September and thus far in October suggested that earlier signs of hesitation were temporary and probably the result of special factors. It seemed reasonably clear that the current strength was greater than seasonal. In the international area, there had been substantial improvements in nearly all segments of the balance of payments, at least for the time being. The problem was by no means solved, but was a little less urgent than three months ago.

Mr. Wayne said that he found himself in almost complete agreement with Messrs. Ellis and Scanlon on policy. He favored maintaining an "even keel" for the next three weeks, interpreting this to mean a bill rate pressing rather firmly against the discount rate and free reserves

between zero and $100 million. He shared Mr. Ellis' concern regarding the degree of liquidity the Committee had maintained in the economy. He thought developments in the near future might suggest it was more than needed.

Mr. Mills said that, in his view, the Committee was tied to a continuing commitment to follow a monetary and credit policy meant to combat the balance of payments problem. If such was the case, the policy followed since the last meeting of the Committee appeared to him appropriate. This policy was exemplified in the technical results revealed in the supply of reserves available to the banking system and in the movements of interest rates.

Mr. Robertson presented the following statement:

> I take it that the cluttered Treasury financing calendar over the next three weeks effectively precludes our making any change in monetary policy. Even keel considerations in this respect are reinforced by the sensitive state of the capital markets in general. I would want us to do nothing that would send a serious ripple of tightening through the financial markets at this stage, and this implies that we should be trying to achieve a little more comfortable level of free reserves during the coming weeks of peak seasonal pressure than the low figures down to which we slid unintentionally over the past month. Certainly the improvement appearing in our balance of payments statistics would seem to preclude any contention that there exists a need for further tightening on that ground alone.
>
> On the other hand, I would not want to advocate any overt easing of policy, at least until it is clear that the developments now taking place in the price area have no cumulative inflationary potential. It cost us a great deal of effort and anguish to break the wage-price spiral in this country five years ago, and that is a victory I would dislike to see reversed. Consequently, my prescription

would be for no change in either the consensus or the directive today, apart from a recognition of the Treasury financing.

Mr. Shepardson said that he thought the general outlook was on the favorable side. He was concerned, however, about what seemed to him to be a continuing excessive buildup of credit and money that could lead to increases in the price level, a development he was sure the Committee did not favor. As to policy, he thought that Treasury financing activities precluded any change during the coming three weeks He was concerned about the future but did not advocate any change in policy at the present time.

Mr. Mitchell said that it seemed to him there had been a dramatic improvement in the balance of payments situation. The deficit had declined from an annual rate of over $4 billion in the first half of the year to $2-1/4 billion in the third quarter, despite a substantial increase in foreign lending by U. S. banks. He thought further improvement was in prospect, because of the impact of grain sales to Russia and other Eastern European countries. He did not believe that the recent discount rate increase had very much to do with the improvement, although it might have had some effect.

In Mr. Mitchell's opinion, the domestic economy was performing well, and certainly better than he had expected earlier in the year. Still, he thought the Committee was not making a dent in the long-run problem, and until it did so he did not believe the Committee should

abandon efforts to use monetary policy to achieve greater resource utilization. He thought the Committee was now coming into a fairly significant period, since it had generated expectations in the capital market of an increase in long-term interest rates. Also, the expected large increase in municipal offerings would come into the capital market at a time when commercial banks had become less interested in such securities. This could mean only one thing--a rise in rates on tax-exempt securities. This struck him as unfortunate, since the economy needed every source of strength that could be mustered.

Mr. Mitchell felt that the Desk had not done quite what the Committee had wanted in the period since the last meeting. He appreciated that present money market circumstances had come about partly as a result of erroneous estimates of factors affecting reserves. He urged, however, that technical work be undertaken to improve the quality of the estimates on which the Desk relied. He agreed with Mr. Clay on policy for the next three weeks.

Mr. Hickman noted that the major series showed gains from the second to the third quarters, even though the third quarter ended on a somewhat subdued note. Thus, the index of industrial production on average was up 1.3 per cent from the second quarter, retail sales were up 1.1 per cent despite a weak September showing, and gross national product showed an unexpectedly large gain of 1-1/2 per cent.

What was now known about October's performance, Mr. Hickman

said, indicated clear-cut forward movement. He found reports of auto sales particularly noteworthy, with the first 10 days of the month establishing a new record for the period. Largely as a result, total retail sales, seasonally adjusted, thus far in October had been running at a rate comparable to the record of last August. Auto production was expected to reach 800,000 units in October, for a considerably larger than seasonal gain. Steel output in the nation had risen moderately for eight of the past nine weeks, but little change was expected for the remainder of the year. In the steel-consuming industries, information from Fourth District machinery producers indicated a strong order backlog, supplementing the most recent national report indicating a rise in new orders received by durable goods manufacturers. Thus, there were grounds for expecting that October would see a further rise in the production index, following a temporary standstill in September.

Mr. Hickman said that developments in the Fourth District in some respects had not been quite so favorable as in the nation as a whole. Steel output in the Cleveland-Lorain area, after having compared favorably with U. S. rates for a considerable period, had recently shown some tendency to lag. The unemployment claims figures, which had been improving markedly, had undergone a slight setback in most of the District's labor market areas. Auto sales in the Fourth District, however, were sharing fully in the national upsweep, with Pittsburgh figures especially strong. Construction activity also appeared to be

relatively strong in the District; in Cleveland, the year-to-date volume of permits by mid-September had topped the 12-month totals for all previous years of record, due in part to urban renewal.

Mr. Hickman observed that changes in assets and liabilities of all reporting banks in recent weeks had been dominated by Treasury financing operations and by related changes in securities loans and in the Treasury cash balance. Looking behind the figures, however, there appeared to have been more than seasonal expansion in business loan demand, a trend that was particularly observable in the Fourth District.

Required reserves held against private deposits were again running disconcertingly ahead of the staff's guideline projection, which was adjusted in late September in such a way as to lock in the effects of the 4.3 per cent annual rate of expansion that had occurred between May and July. Successive projections at a 3 per cent rate had been made with four different base periods beginning June 13, 1962, despite several policy decisions by the Committee towards lesser ease. At the time of each revision in the base, actual annual rates of monetary expansion had been running in excess of projected rates. Under the circumstances, Mr. Hickman felt that there was a real question as to whether the staff guidelines were consistent with the intent of the Committee.

Mr. Hickman indicated that he thought monetary policy in recent weeks had, on the whole, worked out fairly well, with free

reserves ranging well below $100 million. With recent help from the Treasury's strip of bills, the 91-day bill rate had moved close to the discount rate, and international interest rate differentials had moved favorably to the U. S. He recommended encouragement of further movement in these same directions; free reserves should be allowed to fluctuate around the zero level as soon as Treasury financing permitted. Mr. Hickman concluded by saying the Desk was to be commended for its skill in a difficult period and particularly for conducting open market operations in the short-term area.

Mr. Bopp said that weekly indicators, plus incomplete September data, showed the Third District in a state of economic backing and filling The year-end seasonal upswing in unemployment claims was just beginning; output was not strong in total, despite strength in steel production; and sales in department stores remained rather slow, although they had exhibited strength enough to pull even with 1962.

The tightness evident at the last meeting of the Committee increased at Third District commercial banks during the last three weeks, Mr. Bopp said. The basic reserve deficit of reserve city banks was a little over $50 million on a weekly average basis. This figure had been exceeded on only six other occasions this year and only about eight times in 1962. Country bank borrowing at the discount window also rose. Business loans at weekly reporting member banks of the Third District continued to display weakness, declining $5 million

during the two weeks ending October 16. Net loans adjusted fell by $39 million and investments by $8 million.

Mr. Hopp said he would agree with Messrs. Swan and Clay as to operations for the next three weeks. He expressed concern that the Treasury planned an announcement on the day following this meeting of a financing operation that would not take place for three weeks. He felt that such a long lead time might, on occasion, unduly tie the Committee's hands with respect to policy changes.

Mr. Bryan said that what few new economic statistics were available for the Sixth District were mainly in the financial area. Bank debits, deposits and currency, and the money supply were all up sharply. Loans and investments at member banks also were up, notably business loans, and borrowings from the Federal Reserve Bank had risen. He did not know what to make of the sharp increase in business loans or the news of small but pervasive price increases. These might portend a general price inflation, or they might simply reflect an inventory buildup. Business sentiment seemed highly optimistic.

Mr. Bryan felt that the Treasury financing precluded any change in policy at this meeting. He believed that the business situation warranted careful watching, as indeed it always did. The money supply seemed to be progressing satisfactorily. Liquid assets in the hands of the public were continuing their nearly vertical climb. Required reserves continued substantially above the staff's guidelines, even

as amended. He saw no reason to change the discount rate at this time nor to change the Committee's policy. If there was any policy change, however, he felt it should be in the direction of zero free reserves, with the thought in mind that even zero free reserves can finance inflation.

Mr. Bryan said that, if at all possible, the next move in the discount rate should be premeditated and not determined by expectational forces in the market. He shared Mr. Hickman's views about the staff reserve projections, but did not take the matter too seriously.

Mr. Shuford said that since the first of the year economic activity in the Eighth District had generally paralleled that of the country as a whole. During the first part of the year the District had had a marked expansion, and since mid-year business had expanded only moderately. Employment in the District's major labor markets and the volume of bank debits had both been unchanged since June, and department store sales had drifted lower since May. On the other hand, industrial use of electric power, business loans at reporting banks, and bank deposits had all continued to expand. Member bank borrowings from the Federal Reserve Bank had not been large this fall. While there was a lack of moisture in the District this year, agricultural production for the District as a whole probably would exceed that of last year by a significant margin.

As to policy, Mr. Shuford said that he would favor no change,

particularly in view of the Treasury financing. He was not thinking in terms of any particular level of free reserves; he thought reserves and other measures such as money supply were more meaningful. Short-term rates should fluctuate around 3.45 per cent. He thought the policy the Committee had been following was reasonably satisfactory under the circumstances. Short-term rates had moved up to a 3.45 level and then gone higher but had dropped back down to 3.48. There had been sustainable and reasonable growth in the economy. The Committee's interest in providing reserves had facilitated a desirable continuing monetary expansion. He was alert to the situation that seemed to be developing with respect to prices. He did not feel that the growth in liquidity had been excessive, but both of these areas deserved close watching. He would make no change in policy, and would not change the directive except to recognize the Treasury financing.

Mr. Balderston said he was gratified by the elimination of the differential between U. S. bill rates and those of Canada and England. He noted, however, that rates on commercial paper in both countries were higher than in the U. S. He was encouraged by the balance of payments projections for the fourth quarter, but doubted that the improvement in the balance of payments for the year as a whole would be adequate to satisfy the nation's creditors. He shared with Mr. Robertson and Mr. Bryan their concern about recent price behavior, and was worried that the liquidity that had been made available was

being misapplied in the stock market and elsewhere. Over the past year, he noted, available reserves had risen by over $800 million and nonborrowed reserves by over $500 million. He felt the Committee might have built up an inflationary potential that was greater than current price movements had indicated. Mr. Balderston concluded by saying that, in view of the Treasury financing, he favored no change in policy at this time.

Chairman Martin said he had nothing to add to the observations that had already been made. He thought that it was easier to formulate the consensus at this meeting than at any in a long time; the Committee clearly favored no change in policy. He felt that the only problem concerned the wording of the current policy directive. Mr. Young had some alternative variants for both paragraphs of the directive which the Committee might like to consider.

In discussing the various alternatives proposed for the first paragraph, Mr. Young said that the first involved no change, and the second a modest change affecting the first sentence. The proposed new first sentence put emphasis "on maintaining conditions in the money market that would contribute to continued improvement in the capital account of the U. S. balance of payments." Suggestions had also been received for recasting the first paragraph as a whole to update the language, and an attempt had been made to do so in the third alternative.

With respect to the second paragraph, Mr. Young noted that the

first alternative differed from the one issued at the previous meeting only by the addition of a reference to the imminent Treasury financing, and continued to call for operations to be conducted with "a view to maintaining the prevailing degree of firmness in the money market...." The second alternative also included the Treasury financing reference, but substituted the wording "the degree of firmness in the money market that has prevailed in recent weeks" for the earlier wording.

In the course of the discussion, it became evident that the Committee unanimously favored the third of the proposed alternatives for the first paragraph. It was agreed that the change in language was intended simply to reflect recent developments in the domestic economy and in the balance of payments and not to signify any change in policy.

There were differences of views, however, as to which of the two proposed alternatives for the second paragraph better reflected the Committee's consensus for no change in policy. Mr. Mitchell expressed a preference for the second alternative, on grounds of both substance and degree of clarity. He felt that the word "prevailing" by itself could mean either prevailing in recent weeks or at the time of this meeting, and since he believed the former was the Committee's intent, he considered it desirable to be explicit on the point. Messrs. Hayes and Shepardson spoke in favor of the first alternative. Mr. Hayes found the phrase "in recent weeks" ambiguous since the number of weeks was not specified. If taken to mean the last three weeks, he thought the

substance of the second alternative was the same as the first; but if taken to apply to a longer period, he felt it would imply that the Committee wanted to back off from the degree of firmness that had been achieved, and he did not think this was the case. Mr. Shepardson said the word "prevailing" was perfectly explicit to him; it meant prevailing at the time of the meeting.

Chairman Martin observed that, while others might feel differently, to his mind there was no substantive difference between the alternatives. The problem, as he saw it, was a semantic one of a type the Committee had to struggle with continually. He suggested that the Committee members be polled on their preference, on the assumption that the two alternatives were substantially equivalent in meaning. The results of the poll indicated that a majority preferred the second alternative.

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

It is the Federal Open Market Committee's current policy to accommodate moderate growth in bank credit, while maintaining conditions in the money market that would contribute to continued improvement in the capital account of the U. S. balance of payments. This policy takes into consideration the fact that domestic economic activity is expanding further, although with a margin of underutilized resources; and the fact that the balance of payments position is still adverse despite a tendency to reduced deficits. It also recognizes the increases in bank credit, money supply, and the reserve base of recent months.

To implement this policy, and taking into account the imminent Treasury refinancing, System open market operations shall be conducted with a view to maintaining the degree of firmness in the money market that has prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Clay, Mills, Mitchell, Robertson, Scanlon, Shepardson, and Shuford. Votes against this action: None.

Chairman Martin noted the Account Manager's earlier suggestion that the continuing authority directive be left unchanged for another three weeks with respect to the limitation of $1.5 billion for changes in the aggregate amount of U. S. Government securities held in the System Open Market Account during any period between meetings of the Committee. No objection was made to leaving this directive unchanged.

The Chairman suggested that in view of the lateness of the hour the Committee once again hold over until the next meeting its discussion of the memorandum on the question of making available minutes of the Federal Open Market Committee for some past period for use of scholars and others, and there was no objection.

At this point there were distributed copies of a list of possible dates for meetings of the Committee through 1964 for consideration by the members of the Committee.

It was agreed that the next meeting of the Federal Open Market Committee would be held on November 12, 1963.

The meeting then adjourned.

Ralph A. Young

Secretary