A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, July 7, 1964, at 9:30 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Daane
Mr. Hickman
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Shuford
Mr. Swan
Mr. Wayne

Messrs. Bryan and Deming, Alternate Members of the Federal Open Market Committee

Messrs. Bopp, Clay, and Irons, Presidents of the Federal Reserve Banks of Philadelphia, Kansas City, and Dallas, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Broida, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Brill, Furth, Grove, Jones, Koch, and Mann, Associate Economists
Mr. Stone, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Messrs. Partee and Williams, Advisers, Division of Research and Statistics, Board of Governors
Mr. Axilrod, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Miss Eaton, General Assistant, Office of the Secretary, Board of Governors

Messrs. Latham and Helmer, First Vice Presidents of the Federal Reserve Banks of Boston and Chicago, respectively
Messrs. Holmes, Sanford, Baughman, Parsons, Tow, and Green, Vice Presidents of the Federal Reserve Banks of New York, New York, Chicago, Minneapolis, Kansas City, and Dallas, respectively

Messrs. Parthemos and Brandt, Assistant Vice Presidents of the Federal Reserve Banks of Richmond and Atlanta, respectively
Mr. Meek, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Rothwell, Economist, Federal Reserve Bank of Philadelphia

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 17, 1964, were approved.

Before this meeting there had been distributed to the members of 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 June 17 through July 1, 1964, and a supplementary report covering the period July 2 through July 6, 1964. Copies of these reports have been placed in the files of the Committee.

Supplementing the written reports, Mr. Sanford said that no change was expected in the gold stock again this week for the twenty-first consecutive week. The Stabilization Fund now held about $176 million of gold and there were no orders currently in hand, although, of course, it was anticipated that the usual French order for $34 million would be received near the end of the month. In the London gold market, activity picked up a bit as a result of demand from Italy and of events in Cyprus and the Far East, and the fixing price was permitted to ride up slightly. In the past week, however, demand had tapered off again, and the London price had receded to $35.0711. The United States' share of the pool's acquisition in June was nearly $16 million. So far in July, the pool had picked up a further small amount.

The exchange markets continued to be dominated by short-term capital flows, Mr. Sanford reported. It was possible, to a limited extent, to see a reversal of the midyear window-dressing on the Continent, with some outflows from Germany and Switzerland and inflow to the United Kingdom. This normal seasonal pattern had been dampened, however, by the revival of speculation against the Italian lira and by continuing doubts about the future of sterling. Thus, although Swiss banks had begun putting surplus funds abroad, and in the past week the Swiss franc had come off its ceiling, the heavy inflow of capital from Italy had raised the Swiss National Bank's excess dollar holdings still further and had prevented a pronounced decline in the Swiss franc rate. At the same time, although the German mark had eased slightly since midyear, there had not been the normal heavy flow of funds back into sterling, and spot sterling had continued to be quite soft at about $2.7914. These developments, taken together with the weakening in the U. S. balance of payments position during the second quarter, indicated that the summer was beginning with a rather precarious exchange market outlook.

Sterling fell rather sharply during June because of shifts of funds to the Continent and into the Euro-dollar market, but the British let the rate decline without intervening on a very substantial scale because there was little evidence of speculation and, in any event, they expected sterling to rebound sharply after the end of June. The close of the period for midyear positioning did see an immediate small jump in sterling, but there was no sustained advance. Although they were prepared to show the $56 million exchange market loss incurred during June, the British did not want to show the full decline in reserves of some $71 million which would have resulted from last minute unexpected payments, and consequently they drew $15 million on the swap with the System Account. Even the announcement of the smaller reserve loss, however, was followed by a slight weakening in sterling.

Mr. Sanford commented that it would not be unexpected if pressures on sterling continued and it was quite possible that the Bank of England would make additional use of the Federal Reserve swap arrangement in coming months. In their efforts to bolster sterling, the British certainly would keep interest rates firm--as they had in recent weeks. Meanwhile, the net narrowing of forward sterling discounts in the past month had already made U. K. money market instruments more attractive than they had been in some time, and in the past week there had been reports of U. S. funds being invested in British hire-purchase deposits. Similarly in the case of Canada, with the forward Canadian dollar premium holding at about 1/3 per cent, there had been a sizable increase in United States investments in Canadian finance paper.

As Mr. Coombs indicated at the last meeting, Mr. Sanford said, the Swiss situation continued to be troublesome. The flow of Italian funds into Switzerland, as speculation against the lira revived during June, pushed the Swiss National Bank's dollar holdings up even further, to $385 million, some $210 million over their usual limit. Consequently, despite the successful completion of the arrangements to liquidate the System's Swiss franc obligations, it had not yet proved possible to effect further reductions in Treasury forward market Swiss franc contracts, and arrangements along the lines mentioned at the last meeting to take care of some of the Swiss National Bank's excess dollars were still under discussion. Mr. Sanford noted that the recent rise in the Swiss discount rate--like that in the Belgian rate--was not anticipated to have any effect on capital flows and had had very little impact on the exchanges.

In Germany, developments had been somewhat more satisfactory. After the very large reserve gains of early June, the Bundesbank had taken in net only a few dollars in market operations since mid-June, although of course the mark remained quite strong. The planned issue of U. S. Treasury bonds denominated in DM went through on July 1 to the extent of $150 million, $50 million having been held back by the Treasury for possible market intervention during the summer. After this issue the Germans held only about $90 million more than at the beginning of June. Thus, at the moment the upward pressures on the German reserve position were not too great, as German banks were continuing to put some short-term funds abroad. These outflows had driven the forward mark premium close to one per cent and the Account had resumed offering forward marks at that level for Treasury account under the parallel arrangement with the Bundesbank. To date, however, the market had held just below the one per cent level and no sales had proved necessary.

Mr. Sanford commented that he had already noted the revival of speculation against the Italian lira during this period. There was a heavy outflow of funds through the spot market, particularly following the announcement of the resignation of the Italian Government, but since then the pressures had been concentrated in the forward market. The Bank of Italy had now taken a strong stand in the forward market and was giving the New York Bank, as their agent, unlimited orders to support the three-month rate (at 4 per cent discount). The Bank of Italy had also decided to use the Bank of England for the bulk of the support operations in Europe before the opening of the New York market. The practice of placing sizable bids in the market had proved helpful in stabilizing the market for the lira. Mr. Coombs had reported that at the week-end Bank for International Settlements meeting the Italians had given a fairly optimistic account, including a betterment of the trade balance.

Mr. Sanford concluded by noting that, with the completion of the repayment of System swap drawings in Swiss francs, the System Account now had outstanding no drawings initiated by it under any of the swap arrangements. As to drawings by the other party, there was outstanding a $50 million drawing by the Bank of Japan, in addition to the $15 million Bank of England drawing he had mentioned earlier.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period June 17 through July 6, 1964, were approved, ratified, and confirmed.

Mr. Sanford said he had several recommendations, all relating to swap arrangements which would mature in the near future.

First, with respect to the renewal of the $50 million swap arrangement with the Bank of Sweden which matured July 17, that Bank had given further thought to the period of renewal and had now indicated that it was prepared to renew for twelve months, instead of the six-month period approved at the last meeting of the Committee. This would be in line with the general authorization of the Committee for negotiation of extensions for periods not exceeding twelve months.

Renewal of the swap arrangement with the Bank of Sweden, with extension of term for a period up to twelve months, was approved.

On July 20, Mr. Sanford said, the swap arrangements with the Swiss National Bank and the Bank for International Settlements, each in the amount of $150 million, would mature. Mr. Coombs had discussed these arrangements with the respective representatives in Basle and at present they were favorably inclined to renewals for twelve months, although they desired to give further thought to the subject.

Renewals of the swap arrangements with the Swiss National Bank and the Bank for International Settlements, with extension of term for a period up to twelve months, were approved.

In the case of the Austrian National Bank swap arrangement for $50 million, maturing July 24, a renewal for twelve months would be welcomed by that Bank, Mr. Sanford reported.

Renewal of the swap arrangement with the Austrian National Bank, with extension of term for a period up to twelve months, was approved.

Mr. Sanford also noted that the swap arrangement with the Bank of Japan for $150 million would mature July 30 and their representative had indicated that they would like to renew for twelve months. The $50 million outstanding swap drawing also would mature on July 30 and it was proposed to renew it for three months, at the end of which period the Bank of Japan would hope to pay it off.

Renewal of the swap arrangement with the Bank of Japan, with extension of term for a period up to twelve months, was approved.

Renewal of the drawing on the swap with the Bank of Japan was noted without objection.

Concerning the $250 million swap arrangement with the Bundesbank maturing August 6, Mr. Sanford observed that the subject of renewal for as long as twelve months had been raised with their representative and the Account was to hear in due course. One other swap arrangement matured August 6, Mr. Sanford noted; namely, the $100 million facility with the Bank of France. Renewal of this arrangement had not yet been discussed with that Bank, but this would be done by telephone before the next meeting of the Committee.

Before this meeting there had been distributed to the members of the Committee a report from the Manager of the System Open Market Account covering open market operations in U. S. Government securities and bankers' acceptances for the period June 17 through July 1, 1964, and a supplementary report covering the period July 2 through July 6, 1964. Copies of these reports have been placed in the files of the Committee.

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

> The money market has been generally firm since the last meeting of the Committee. The special pressures associated with the June 15 corporate tax date were unwound without difficulty and the reserve drains associated with the July 4 holiday produced no undue stress. Banks in the major money centers experienced a few pressures around June 15 and the July 4 holiday, but a good flow of Federal funds enabled them to balance their positions with a relatively low level of borrowing from the Reserve Banks.
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> Rates on short-term Treasury bills have edged somewhat lower since the mid-June tax date, while rates on longer bills have fallen by as much as 10 basis points. The spread between the 3- and 6-month bills narrowed sharply to a record low of 2 basis points at last night's close. The downward movement in rates, which occurred despite the rise in the Belgian and Swiss bank rates, reflects heavy demand for Treasury bills by public bodies, foreign central banks, and other investors as well as by the System over the period since the last meeting, while the decline in the spread between short and long bills reflects the particular popularity of the December bill maturities. The question of the size of the spread between the 3- and 6-month bills has come under considerable discussion in recent days, since the new 6-month bill auctioned yesterday matures in 1965, when the corporate income tax rate declines from 50 to 48 per cent. This means, of course, that the excess of the after-tax yield on 6-month bills over 3-month bills has now increased. This in turn is expected to attract buyers to the 6-month area, perhaps putting enough downward pressure on that rate to keep it quite

close to the 3-month rate. There was not much evidence of this tendency at work in the auction yesterday, however, for the new 3- and 6-month bills were auctioned at average rates of 3.49 and 3.54 per cent, respectively--the same spread as occurred the week before.

The market for Treasury notes and bonds is marking time this week, expecting the Treasury to announce at any moment a financing operation designed to achieve some debt extension. According to present plans, the Treasury will announce a major advance refunding operation after the close of the market tomorrow.

As you know, most participants in the Government securities market tended to expect, at the beginning of the year, that yields would work higher as the year unfolded. The rise in the British Bank rate in late February and the passage of the tax cut at about the same time sparked a conviction among nearly all participants that yields were going to move higher immediately. The resultant bandwagon psychology led to considerable selling of coupon securities and put yields on 3- to 5-year issues in the neighborhood of 4-1/4 per cent by late March. Subsequently, however, as no indications of a surge in consumer spending or credit demands appeared and evidence accumulated that monetary policy was not changing, the expectation of higher rates began to relax its hold. Indeed, since early April, the prices of Treasury notes and bonds have moved irregularly upward until most issues are now at or near the highest levels of the year. In its early stages, this rise in prices was taken as a technical reaction to the overselling of late February and March. As prices continued to improve through much of May and early June, many market professionals were concerned as to whether the market was really as good or as solid as it appeared. In the past two or three weeks, however, a further rise in prices in the face of a general expectation that the Treasury would soon add to the supply of intermediate- and long-term issues has generated a new conviction that current interest rate levels accurately reflect supply and demand forces operating in the credit markets and can be sustained for perhaps a considerable period. In these circumstances, the Treasury might well be able to achieve a worthwhile measure of debt extension in its forthcoming operation.

It now appears that the Treasury ended the fiscal year with a cash balance of $10.2 billion, considerably above earlier expectations. While there remain some uncertainties with regard to the rate at which these balances will be drawn down, particularly in early July, it now appears that the Treasury should be able to get by at least until August 15 without any new cash financing, except for the sale of a one-year bill at the end of this month and the increase of three weekly bill offerings to the $2.1 billion level of surrounding issues. Should the bill rate come under what the Treasury regards as undesirable downward pressure, however, it would be prepared to sell additional Treasury bills at any time to deal with the situation. By the time the Committee again meets, the outlook for Treasury financing over the balance of the summer should be a good deal clearer than it is now.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period June 17 through July 6, 1964, were approved, ratified, and confirmed.

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

Mr. Brill presented a statement on economic conditions as follows:

The state of the domestic economy continues to be good, with activity maintained at a high level, prices remaining stable, and both business and consumer behavior characterized by cautious optimism. True, the most recent statistics suggest some hesitation in the expansion, but hopefully nothing more than "a pause that refreshes," a temporary leveling off of the sort we have experienced from time to time in this upswing. To cite just a few developments: retail sales in June appear to have slipped a bit from May's record volume; the unemployment rate moved back up again, as was widely expected; and employment declined substantially, which is more puzzling. There is not enough information available yet to provide a clue to the June production index, but it is unlikely to show more than a minor advance from the May level.

Newly available data for May suggest that a slowdown in some economic areas may have begun two months ago. Thus, the May rise in personal income was much less than in preceding months; manufacturers' inventories declined in May, after a larger than average increase in April; manufacturers' new orders also edged off after their large April spurt; and housing starts fell again.

It is certainly premature to voice any alarm about such a one- or even two-month letup in the pace of expansion, particularly when recent surveys of spending plans portend further gains ahead. Nevertheless, it is worth noting that a number of demand sectors which played an important role in earlier phases of the cyclical upswing appear to have lost some of their vigor over the past 6 to 12 months. Federal Government expenditures for goods and services, for example, reached a peak in the summer of 1963, after a very sharp run-up in 1961 and a more moderate but persistent increase over the next year and a half. Since the third quarter of 1963, Federal spending has risen very little. Also, residential construction has shown little further gain since last fall, after a rapid advance earlier last year. Housing starts have remained in the 1.5 to 1.6 million range, high but about one-tenth below the fall peak, and dollar outlays on residential construction have hardly budged from the fourth-quarter rate.

More recently, business spending for inventories has slowed. Additions to inventories seemed to be picking up some steam toward the end of 1963, but the rate of accumulation has dropped sharply this year. A flurry in April was reversed in May; in fact, manufacturers' inventories declined in that month. Unless the statistics for June change the picture markedly, total inventory accumulation in the first two quarters of this year might not be much more than half the rate of the last two quarters of 1963.

There is a hint, too, that consumer spending for durable goods may be losing rather than gaining momentum. Such spending rose at a $3 billion rate in late 1963, a $2 billion rate in the first quarter of this year, and is estimated to have increased by only $1 billion in the spring quarter. Sales of domestic autos appear to have reached either a demand peak or a supply limit at about 7-3/4 million units, and a slowdown also is apparent in the furniture and appliance areas, which had risen spectacularly earlier.

There have been offsets, of course, which have kept aggregate activity on an upward path. While consumers may have reached a temporary saturation point at advanced levels of spending for housing and durable goods, there has been no lack of vigor in their spending for nondurables, particularly apparel, general merchandise, and food. After a somewhat sluggish performance in the latter half of 1963, expenditures for nondurables have risen at a phenomenal $4 billion, or 9 per cent, annual rate in each quarter of this year. In the business area, spending for plant and equipment is picking up part of the slack resulting from cautious inventory buying. Fixed capital outlays have been rising fairly steadily since early 1963, and the latest surveys indicate a continuation of the advance at a steady pace over the balance of this year. In the governmental area, State and local spending continues to mount rapidly. While Federal purchases of goods and services have increased by $1-1/2 billion over the past four quarters, State and local purchases have increased $5-1/2 billion.

Thus, in the context of over-all expansion, we have been experiencing a sort of rolling readjustment over the past 12 months, with increased private and local government spending compensating for the leveling off in Federal spending, and within the private total, consumption outlays--initially for durables and more recently for nondurable goods--filling the gap left by the decline in housing activity. Throughout the period, business capital outlays have proceeded on a steady and substantial upward course.

Such readjustments have much to commend them in permitting orderly expansion. First, resources have been freed to meet shifts in public preferences, in contrast to the 1955 situation of rising demands. Second, the economy has been able to absorb the consequences of excesses in some areas--multi-family construction, for example--in an atmosphere of sustained employment and incomes. Third, by avoiding a concentration of expenditures, it has minimized bottleneck effects which in the past have been the origin of more general upward price pressures.

On the other hand, it also has resulted in a more leisurely pace in making inroads into unutilized resources than some would desire. The unemployment rate in June was, after all, still above 5 per cent, only moderately below that a year earlier, and marked by continued heavy long-term unemployment. Capacity use among producers of major materials is still well below the 90 per cent mark--86 is the best current guess--and capacity is growing.

Obviously, we can do better. Nevertheless, it is hard to fault a record that includes continued cost and price stability, soaring profits, and a five per cent rate of growth in real GNP. The wisest Governmental policy would seem to be to let well enough alone, at least until imbalances on one side or another give signs of developing.

Mr. Noyes made the following statement concerning financial developments:

One of the things that we have noted frequently throughout the course of this recovery and expansion has been the phenomenal capacity of the economy for self-adjustment. As one or another of the many financial or physical components of total economic activity has moved out of line with the generally steady expansion that has characterized the 40 months of upward thrust, we have noted these aberrations with concern. But so far, at least, our concern has been short-lived--we have had only to wait for another month of data and it has been allayed.

Recently there have been misgivings about the behavior of some key financial variables, especially the money supply and other measures closely related to it. For the first five months of 1964, the money supply increased at an annual rate of only 2 per cent, total reserves at a rate of only 1.3 per cent, and reserves required for private demand deposits showed a small decline.

When we add our preliminary estimates for June, however, there is quite a change, which brings the rate of monetary expansion more nearly into line with the recent behavior of other financial and nonfinancial variables. For the first half, we are now estimating the money supply up at an annual rate of 3.1 per cent, and total reserves up 3.9 per cent; and reserves required for private demand deposits shift from a decline to a gain of about 1/2 of 1 per cent.

The gain in the money supply in June is all the more notable because it occurred in the face of a further substantial increase in U. S. Government deposits. In fact, the large run-up in the Government's balance during the whole first half has unquestionably tended to distort the money supply data, for the period as a whole, on the low side.

Including estimates for June, time and savings deposits at commercial banks are up at an annual rate of 11 per cent for the first half, and total bank credit increased at about a 6-1/2 per cent rate--both lower rates than prevailed in 1963. However, bank loans were up a little more than in either 1962 or 1963, and the second quarter rate of 12.2 per cent was slightly above the first quarter rate.

I should emphasize that these numbers for the first half are all subject to revision when more complete data are available, but the bank credit figures are especially fragile at this early date after the end of the period.

Nothing need be added to the Manager's report on developments in the Government securities market except to say that, while it was less pronounced, the firming of prices and the downdrift in yields since the last meeting extended to almost all segments of the capital market. State and local government issues were an exception. In this market new issues were large, and despite investor response to the upward adjustment of yields, dealer inventories remained high at the end of June.

The stock market continued buoyant through yesterday's close, with market sentiment dominated by favorable earnings reports and estimates.

Turning to Government finance, we are now estimating the cash deficit for fiscal 1964 at only $4.5 billion. When one remembers that we were looking somewhat skeptically at an estimated cash deficit of over $8 billion in January, when half the fiscal year was already behind us, the change is striking. The Treasury's favorable cash position of over $10 billion, which has resulted from this extraordinary budget performance, has made it possible for the Treasury to plan for the major advance refunding operation, mentioned by Mr. Stone. It has also meant, of course, that the supply of bills in the market is already somewhat less than might have been anticipated, and it may be that shifting out of "rights" into bills in connection with the refunding will put bill rates under downward pressure. We understand that the Treasury has this very much in mind and is prepared to sell bills, despite its high cash balance, if this is necessary to prevent excessive downward pressure on bill rates.

Since the last meeting, current weekly estimates of free reserves have been in a very narrow range--126, 126, and 123--and the figure for the week ending tomorrow also now appears likely to be in the vicinity of that range. As indicated earlier, in connection with the discussion of money supply developments, the various measures of aggregate reserves all moved up in the month of June, but this has tended generally to put them more nearly in line, rather than to push them out of line, with the moderate expansion called for in the directive.

Quite apart from the prospective Treasury financing, a continuation of the present directive would seem to be consistent with the broad objectives of policy.

Mr. Furth presented the following statement on the balance of payments:

The U. S. payments deficit for June may be tentatively estimated at $100 million. This estimate is based on the preliminary weekly data and the final figures may turn out to be quite different. But our tentative estimate would mean that, on a seasonally adjusted basis, the deficit was smaller than in May and April, although still larger than the average of the first quarter.

Our tentative estimate also would imply a deficit for the second quarter of $700 million before seasonal adjustment, and of perhaps $800 million after seasonal adjustment. This would compare with a seasonally adjusted deficit of less than $200 million for the first quarter.

Nearly half of the deterioration between the first and the second quarter may be attributed to a decline in the trade surplus, due to the absence of some temporary factors that favored exports in the first quarter (Soviet wheat sales) and to the anticipated rise in imports. The surplus on service account seems to have declined, too, with investment income probably receding from its unusually high level of the first quarter and travel expenditures reaching record peaks, perhaps accentuated by the reduction in Atlantic air fares.

Government expenditures and direct investments abroad apparently rose from unusually low first-quarter levels. The monetary policies of many European countries not only favor new participations of U. S. firms in European concerns squeezed by credit restrictions but also force U. S. firms to shift the financing of their existing European subsidiaries back to the United States.

The aggregate net outflow of funds on portfolio and short-term account may not have changed much. A rise in foreign bond placements and probably also in the outflow of money-market funds was apparently offset by a reduction in long- and short-term bank lending to foreigners, which reached extraordinarily high levels in the first quarter.

It should be stressed, however, that all these interpretations are based either on incomplete data or on guesswork.

While the deterioration in our payments balance from the first to the second quarter was disappointingly large, it is encouraging that within the second quarter there seems to have been steady improvement from month to month. Unfortunately, we have no way of knowing whether this improvement is going to continue in the period ahead.

The most ominous factor may well remain the continuing tendency of European central banks to combat real or imagined inflationary threats by restrictive monetary policies, which are bound directly and indirectly to hurt our efforts to reduce the U. S. payments deficit. Last week, Belgium and Switzerland increased their discount rates: Belgium for the third time since last summer, Switzerland for the first time in seven years.

The Swiss action probably is designed to foster a general increase in long-term interest-rate levels, which the authorities believe necessary in order to stem the construction boom. Since Switzerland prohibits the payment of interest on foreign-owned short-term assets, the move will not directly attract U. S. short-term funds. But it will certainly do nothing to slow the influx of funds, which led in June to a rise in Swiss reserves of $150 million.

The Belgian step is more difficult to understand. Belgium has suffered less from price increases than most other European countries. Government budget and bank credit are well under control, and there have been no signs of an unsustainable industrial boom. It is true that the basic money-market rate, the yield on four-month government funds, has for some time been higher than the discount rate and has recently advanced from 4.75 to 4.80 per cent. But it seems reasonable to assume that this change was a result rather than a cause of central bank policy.

It is perhaps only a coincidence that the Belgian step was taken at the same time at which the Belgian Executive Director in the International Monetary Fund led an unprecedented protest of the directors of the Common-Market members against what he considered the "soft" position taken by the Fund management in its Annual Report draft, which took the U. S. side in the controversy on international liquidity. Or did the Europeans want to demonstrate by both word and action that they favor everywhere a tightening rather than an easing of liquidity?

If their aim is merely the restoration of internal and external financial stability, they seem to have succeeded pretty well in France and Italy. In fact, France again has achieved a payments surplus close to an annual rate of

$2 billion. Italy's payments deficit has nearly disappeared, and its international position has so improved, despite recurrent rumors of an impending lira devaluation, that the fall of its government has caused hardly more than a ripple in exchange markets.

Germany still has taken no action on the modest government proposals to stem the inflow of foreign capital; its recent tariff reductions will benefit its Common-Market partners rather than the rest of the world, including the United States. The latest wage agreement, in the all-important metal industry, was quite moderate, contrary to the perennial fears of wage-push earlier expressed by the German authorities.

How seriously we should take the threat of inflation in Germany may be illustrated by a few figures, taken from the May report of the German Federal Bank. Between the first quarters of 1963 and 1964, industrial wages rose 7 per cent. But industrial production rose nearly 10 per cent. Wholesale as well as retail prices rose less than 1 per cent. But German net reserves rose from March to March by nearly $700 million, in spite of substantial prepayments on military purchases.

In spite of these accomplishments, the authorities in all three countries still talk and act as if their only problem was inflation. In France and Italy, industrial production seems to have stopped rising, if it has not actually declined. Under conditions of full employment, such a pause is harmless and perhaps even welcome. But the question remains whether these countries will modify their restrictionist attitudes in time to avoid damaging not only their economies but--more important from our own point of view--also the U. S. payments balance.

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

The business picture has remained essentially unchanged since our last meeting. Prospects continue excellent for further upward movements, but there are no signs at this point of any acceleration in the pace of the advance. Indeed, some of the statistics suggest just a little less vigor than those becoming available a few weeks ago. In particular, leading indicators of construction activity suggest the possibility of some easing off in this sector of the economy. Continued price stability is evidenced both by the performance of the major indices and by the latest purchasing agents' report.

In contrast with this generally satisfactory domestic situation, the balance of payments again shows signs of becoming a serious problem. This problem has a number of rather distinct aspects. In the first place, there is the real possibility of a sharply adverse public and market reaction, here and abroad, to the eventual publication of the poor second quarter statistics. Second, there is a possibility that there will be a further deterioration in our payments position in the months ahead. Third, it is a sobering thought that we may be nearing the limit of our capacity to finance our deficits through further accumulation of official dollar holdings or the extension of longer term bilateral credit facilities--granted that our swap lines remain fully available to deal with temporary reversible flows and that the drawing rights on the Fund remain virtually intact. And this third factor can, of course, be influenced importantly by the first two.

While June data are, of course, preliminary, the second quarter is likely to show an annual rate of deficit in excess of $3 billion--close to the large average deficit of the past six years. The public has, of course, been prepared for some worsening in our payments position, but it is questionable whether so sharp a deterioration has been discounted in advance. Some of the deterioration between the first and second quarters reflect the reflow of funds from Canada in March, and their return in April; even after a rough adjustment for this factor, the annual rate of deficit in the second quarter would be well above $2 billion, which I find disturbing. For the past two months, however, the deficit has been running at a more moderate rate, though it is still too high.

In analyzing our current position we have to remain aware that while the midyear window dressing period has just come to a close, we are getting into a period of heavy seasonal pressures, mainly reflecting tourist spending abroad. There is uncertainty as to how well our trade surplus will hold up, with the continuing rise in our GNP--although preliminary data for May are encouraging. New foreign issues may well grow in the third quarter, and interest rates are rising in several major foreign countries, with some acceleration of short-term flows to Canada apparent in recent weeks. At the same time the Euro-dollar market may feel the impact of some of the credit tightening moves in Europe and may in turn exert an attraction for American funds. Moreover, in an election year and with a variety of political uncertainties abroad, together with inflationary pressures in much of Europe, there is always a possibility of market disturbances that could have adverse repercussions on the dollar.

In the credit area, the Wednesday-to-Wednesday figures available for weekly reporting banks for four weeks through June 24 do not reveal any unusual strength in bank loan demand--despite a rather sharp temporary bulge over the tax date. Apparently corporate liquidity is still high. The new proxy series for bank credit does, however, point to a good gain in June on a daily average basis; and if we inspect the rates of growth in credit and deposits for the past six months we find less evidence than we did a month or so ago for a substantial slowing of such growth as compared with last year. The money supply proper, for example, rose in the first six months at a 3.1 per cent annual rate, not far out of line with the 3.6 per cent gain in the first half of 1963. For money supply plus time deposits the comparable figures are 6.5 per cent this year and 7.6 per cent last year. We can hardly be accused of having prevented continuing ample growth of credit and liquidity.

With respect to policy for the next three weeks our path seems clearly marked, in view of the likelihood that the Treasury will undertake important financing operations in this period. I would therefore favor no change in policy at this time. The directive might appropriately be left as it is, except for some recognition of the further confirmation of a weakened balance of payments position in the second quarter and recognition of the sizable increase in bank credit as well as money supply in the past month.

Whether we will still be inhibited by "even keel" considerations by the time of the next meeting is now uncertain but should be amply clear by that time.

As I pointed out at the last meeting, it is none too soon to give serious thought to our longer-range policy problems and thus to be prepared to move promptly toward an appropriate stance when we are free to implement our judgment, provided, of course, that conditions then warrant a change of policy. While it is by no means certain, we may be entering a period when the dollar's international position may be seriously threatened by disillusionment and weakened confidence abroad. In any event, we cannot avoid giving the balance of payments heavy weight in our policy decisions from now on. There may be a few members of the Committee who would like to reserve monetary policy to deal with purely domestic considerations, and to use so-called "specific measures" (including capital controls) to deal with the balance of payments. Hopes of disposing so neatly of our problems are, I believe, built on illusion. Our domestic and international economic well-being are inextricably interwoven, and at a time of unprecedented domestic prosperity we should be especially alert to the obligations of monetary policy for the preservation of a strong international financial system based on the dollar. To put it another way, a world of convertible currencies and freely-moving trade and investment is the kind of world we believe in, and it is the kind of world where each country's monetary policy must take careful account of what is occurring beyond the national borders. For many months now the trend in Europe has been toward greater credit restraint, almost exclusively because of domestic inflationary pressures. Most European countries have tried hard and are still trying to blunt the international effects of their actions. We can hardly expect to remain immune to all these developments. It would be one thing if we were faced with depressed domestic conditions--then the argument for looking mainly inward would be strong indeed. But instead we are confronted with record domestic highs in sector after sector, and with an economy which shows no sign of being seriously vulnerable to moderate policy moves in the direction of greater restraint.

Apart from the question of our own deliberations, we face a real problem in helping the public to see more clearly both the risks and the necessities of our balance of payments position. In this process of education the System should be playing a leading role, matched perhaps only by that of the Treasury.

Now, to touch on a more specific matter, I would hope that serious consideration would be given to the use of a cut in reserve requirements to provide some of the reserves needed to take care of seasonal credit expansion this fall. Just as an example, a 1 per cent reduction in reserve city bank requirements, a 1/2 per cent reduction for country banks, and a 1/4 per cent cut for time deposits might together provide a major part of the season's needs. In the absence of such a move the gold reserve ratio problem could become acute around the end of the year; and the move would obviate substantial bill purchases that could put undesirable downward pressure on short-term interest rates.

Mr. Shuford said that national economic activity had continued to rise at a rapid but orderly rate in recent months. Production had shown substantial gains since March and retail sales remained favorable. Employment increases since March indicated greater use of productive capacity. While the expansion was rather rapid, it seemed well-balanced and there was little evidence of price inflation.

Activity in the Eighth District had been on a plateau during the first four months of the year but might have shown some improvement since April. Business loans at weekly reporting banks rose markedly from April to June, after remaining unchanged for about half a year. Bank deposits had continued to rise at about a 9 per cent annual rate, with most of the gain in time deposits. Value added in manufacturing also had continued to rise. On the other hand, total payroll employment in the major labor markets of the District had shown little change since January and the volume of debits at District reporting banks had been unchanged for nine months.

Mr. Shuford reported that the outlook for construction activity in the St. Louis Metropolitan Area was favorable. The projects included in the Downtown Riverfront Redevelopment Program were beginning to take shape. Chrysler Corporation recently had announced a major expansion in its St. Louis assembly plant which was expected to be completed by January.

Turning to policy, Mr. Shuford said he favored maintaining current market conditions because it was likely that the Treasury would be conducting a major financing. The economy seemed to be at a high level and moving forward satisfactorily, with no large imbalances.

Mr. Shuford said he found some of the financial indicators a bit puzzling in view of the strong economic situation. Market interest rates had shown some weakness since March; yields on three-month Treasury bills were lower in June and in early July than in March and rates on Government securities in the six-month to five-year range had shown a pronounced decline. In previous business expansions, the demand for funds usually had outpaced the supply, with upward pressure on interest rates. The opposite seemed to be occurring this time, and this development deserved study.

Mr. Shuford noted that from September 1962 to November 1963 the money supply rose at a relatively rapid 4.5 per cent rate, and this expansion probably had contributed to the current strength of the economy. From November to May, however, growth was at the much lower rate of 2 per cent. Such a decline in the rate of monetary expansion would appear to be somewhat restrictive unless there was reason to believe that the demand for money had declined. He was pleased to see that the preliminary figure for the money supply in June was up considerably, and, as had been reported this morning, the growth rate so far this year was a little above 3 per cent.

In view of the interest rate situation, which might indicate some weakening of demand for loan funds, and of the moderate rates of increase in the money supply, bank reserves, and bank credit of recent months, Mr. Shuford preferred to see no tightening in monetary policy. On the other hand, in light of the strong rise in business activity and the weakening of the balance of payments position, he did not advocate easing. Specifically, Mr. Shuford said, he would prefer to see the three-month Treasury bill rate remain near the 3.50 per cent discount rate. This might be consistent with free reserves fluctuating around the $100 million level. He was inclined to think that these market conditions during July would lead to moderate rates of expansion in bank reserves, bank credit, and money.

Mr. Shuford did not favor changing the discount rate. He agreed with Mr. Hayes' observations concerning the kinds of changes that should be made in the present directive, and he thought that the draft which the staff had prepared would accomplish this purpose.

Mr. Bryan reported that a number of new figures for the Sixth District economy had become available since the last meeting. There had been sharp increases in nonfarm employment, retail trade, and construction contract awards. Personal income also had risen and insured unemployment was at the record low level of 3 per cent. In the financial area the money supply, however defined, and both loans and investments at banks had risen sharply.

Nationally, Mr. Bryan said, the economy seemed to be moving along at a satisfactory pace, and there did not appear at this time to be any significant elements of inflation or instability. He took note of the point already made that in June most of the reserve series had moved up and now showed a more satisfactory rate of growth. Total reserves had come up sharply, with part of the gain absorbed by an increase in excess reserves from their previously extraordinarily low level and part offset by a reduction in borrowings at the Federal Reserve Banks in recent weeks.

Mr. Bryan believed that no change in policy was called for under the circumstances. Specifically, for the longer term he favored a rate of increase in total reserves of approximately 3 per cent or a little higher. For the shorter term he would set a central target for free reserves at the $100 million level.

Mr. Bopp said the major indicators of business conditions in the Third District depicted a rather good year for a region that contained many areas of labor redundancy. Unemployment claims were low; unemployment rates were declining; employment was up in the growing regions of the District and steady in the declining ones. Manufacturing output was moving ahead and so were construction awards. Electric power consumption in manufacturing industries and construction contract awards in the Third District stood at favorable levels, compared with recent years.

Since the last meeting of the Committee, Mr. Bopp observed, reserve pressures on District member banks had continued to diminish and loans had continued to better their year-ago performance. In two out of the last three weeks, reserve city banks experienced a slight basic reserve surplus, averaging around $9 million. The surplus, however, appeared to be largely seasonal in nature. The latest statement week (ending July 1) showed a slight swing back to the deficit side. There was no reserve city bank borrowing at the discount window in June, and country bank borrowing continued at a low level. Business loans at weekly reporting member banks rose $12 million in the three weeks ending July 1, compared to an $8 million increase last year.

In Mr. Bopp's opinion, business and financial developments, as well as the probable forthcoming Treasury financing, called for no change in policy during the next three weeks. Recent data indicated that the rise in consumer demand, especially for durables, was tapering off rather than accelerating. Also, the economy was entering the season when there was usually a lull in demand and business activity. Prices continued generally stable. The margin of unused resources seemed sufficient to meet any likely increase in demand in the next few weeks without upward pressure on prices. In his view, the domestic situation clearly did not call for any firming or tightening of policy.

The balance of payments deficit, Mr Bopp noted, was larger in the second than in the first quarter. However, the deterioration was not in the short-term capital sector which was more sensitive to interest rate differentials. Moreover, it did not appear likely that the recent rate increases by the central banks of Switzerland and Belgium would exert any strong pull on United States funds. Although he would not like to see short-term rates decline, he did not favor action at this time to bring about an increase.

Mr. Bopp recommended no change in policy. He believed, however, that the proposed changes in the description of the economic background in the directive drafted by the staff were appropriate.

Mr. Hickman said that, on the basis of preliminary data, domestic business activity in June continued along the path of moderate and apparently sustainable rise. Retail trade leveled, or may have declined a shade, from the advanced May rate. At this early stage, it appeared that production advanced fractionally in June, with industrial groups other than autos and steel providing most or all of the push. The production index in most of the remaining months of 1964 was not expected to receive much help from further advances in steel and autos.

One element of relative weakness in the economy might be construction, judging by housing starts and construction contracts. The recent softness in these figures suggested a possible decline in future construction put in place. It was arguable, however, that the recent behavior of the foreshadowing construction series was only a return to a sustainable position and an indication that construction activity was leveling off.

Mr. Hickman continued to see evidences of potential "sectoral inflation" in a number of the specialized capital goods industries in the Cleveland District. At the last meeting of the Committee, he had mentioned that one of the Cleveland Bank's directors indicated that he was having difficulty in obtaining skilled people for work in the machine tool industry. It now appeared, from a survey of 50 Fourth District industrialists, that about half were experiencing similar difficulties, insofar as both skilled labor and professional personnel were concerned. As he saw it, the problem seemed to be concentrated in the metal-working industries where new orders had been exceptionally strong.

Insofar as policy was concerned, Mr Hickman thought that with a large-scale Treasury financing ahead, an even-keel policy was clearly indicated over the next few weeks. This would presumably call for resolving doubts on the side of ease, which was probably no more than the market would expect under the circumstances. In his opinion, the Desk had followed very closely the intent of the Committee within the last few weeks, maintaining a generally comfortable tone in the market. The bill rate had held steady within a narrow range, but yields on intermediate- and long-term Government securities had continued to edge downward

Mr. Hickman's personal view was that the tone of the market was too easy, and that a continuation of this tone would be undesirable if it were not for the impending Treasury financing. With spreads widening between interest rates here and abroad, and with bank credit readily available, he suspected that the Committee was creating difficulties for itself later on. Some banks in the Fourth District reported confidentially that they were studying opportunities to earn higher rates abroad, and were seriously considering getting their feet wet in this area.

Mr. Hickman observed that the opinion expressed by some members of the Committee at the last meeting in favor of outright control of bank lending abroad did not appear to be acceptable to some members of the academic community and to the U. S. Treasury. Also, foreign rates, as predicted, continued to inch upward. Thus, it seemed to him that an environment was gradually developing that would call for a more restrictive U. S. monetary policy. For the near term, however, Mr. Hickman recommended no change in policy and no substantive change in the directive. He approved of the language revisions in the staff draft.

Mr. Daane said that with the Treasury on the eve of a major effort to achieve some debt extension--an effort that was as much in the System's interest as in the Treasury's--the situation clearly called for no change in policy, either overtly or otherwise. It was his understanding that the Treasury announcement to be made tomorrow would indicate that there still was a need to raise some cash, although the amount needed had lessened, and that the Treasury was poised to borrow in the bill area whenever it seemed desirable for balance of payments reasons. If the Treasury did accomplish a significant amount of debt extension, Mr. Daane thought their borrowing over the rest of the year would be largely in the short-term area. In the light of this, he felt Mr. Hayes' suggestion that some of the seasonal need for reserves be met by reducing requirements should be examined pretty carefully. He agreed fully with the objective of avoiding downward pressure on bill rates. It was his impression from past experience, however, that while the open market instrument was not perfect, it was more difficult to maintain the same monetary posture with a change in reserve requirements than through utilizing open market operations.

Mr. Daane said he approved of the staff draft of the directive except for the modification that had been made in the description of the international payments position from "less favorable" to "adverse." He did not think that what had been learned since the last meeting clearly indicated a change in the situation, and he preferred language reading "the country's less favorable international payments position in the second quarter."

Mr. Hayes said that he did not fully understand the reason for Mr. Daane's concern over his suggestion regarding reserve requirements. By way of clarification, Mr. Daane said that in his opinion the use of the reserve requirement instrument did not afford the same degree of control as did the open market instrument. To attempt to meet seasonal needs by reducing reserve requirements would mean providing reserves in relatively large blocks, and this might create undesired market conditions, particularly because of possible uneven distribution of reserves. Thus, there were greater risks involved than when seasonal needs were met by open market operations, and it seemed unnecessary to incur them as long as the Treasury was prepared to combat any downward pressures on bill rates.

Mr. Hayes commented that he did not go along with this reasoning; he thought the System's experience with reserve requirement changes had been satisfactory. Mr. Daane agreed that there had not been difficulties at the time of the most recent reduction in requirements, but problems had been encountered on earlier occasions. Chairman Martin remarked that the matter deserved careful study.

Mr. Shepardson commented that as the staff report had indicated, the domestic expansion had been moving in a satisfactory fashion, and hopefully at a sustainable rate in most areas. There had been some fluctuations and deviations from this pattern. In that connection, he found the recent behavior of the money supply to be interesting. There had not been any significant change in policy for some time; yet for a few months the money supply had grown less rapidly than in the latter part of 1963, and in the past month there had been an upturn. This seemed to indicate to Mr. Shepardson that the Committee could create a climate favorable to monetary growth but it could not necessarily produce any given growth rate automatically.

In his judgment, Mr. Shepardson continued, there had been an adequate expansion of the money supply over the longer run, and the fear of the last few months that the growth rate was inadequate was without foundation. The Committee was providing the climate for growth that the economy needed, and it should not be too concerned about short-run deviations from the trend lines when it was following a general policy of expanding reserves.

With reference to the balance of payments situation, Mr. Shepardson said, it seemed that there was basis for more concern--not particularly on account of recent European rate changes, although they perhaps pointed to a problem at some point--but in what he read concerning international trade negotiations. Developments in these negotiations were not encouraging for the U. S. trade outlook.

Having said that, Mr. Shepardson remarked, he thought the situation at this time justified continuation of the Committee's present policy. He approved of the revised directive that had been proposed by the staff.

Mr. Robertson said that in his judgment there was nothing in the domestic picture or in the international situation that would justify a change in policy. The forthcoming Treasury financing also argued for reaffirming present policy and for maintaining about the same money market conditions as had prevailed in the past few weeks. He agreed with Mr. Daane's suggestion as to the directive proposed by the staff; "less favorable" was preferable to "adverse" in describing the balance of payments situation. Otherwise, he found the draft acceptable.

Mr. Mills made the following statement:

> Generally stable and prosperous conditions mark the midyear of 1964, with the usual summer business letdown to be expected. These summer doldrums offer a breathing space during which policy preparation can be made to conform with whatever new turn in direction the economy may take. There is no reason to use this interval for posting economic guards against imagined inflationary pressures deemed to call for anticipatory restrictive monetary and credit policy actions. A move at this time toward credit restraint, either by way of positive actions or the utterance of unofficial warning statements, could damage the business community's belief in unimpeded economic progress at a time when the economy still requires nurturing by a moderately relaxed Federal Reserve System monetary and credit policy.
>
> As to the domestic scene, the spreading contraction in the construction industry must be scrutinized closely as to its economic ramifications if momentum gathers in reduction in the construction of multiple housing units and commercial

> buildings and in a slowing-down of housing starts. As the construction industry holds a key position in the national economy, any slowing-down in the pace of its activity could produce such far-flung results as a shrinkage of employment which, by having an unfavorable effect on the sale of new model 1965 automobiles, could thereby transmit a depressive influence to that likewise critical industry and in the debt service of the consumer credit obligations identified with it. If any serious weakness should develop in the construction and automobile manufacturing industries, business activity could decline if there should not be a new surge of activity in some other areas of the national economy.
>
> In the light of the above, there are better reasons for following a Federal Reserve System monetary and credit policy aimed at encouraging reasonable credit expansion than to adopt a policy intended to head off anticipated inflationary pressures, of which there are presently no serious indications. The advent of the usual summer business letdown is a good time for surveying unemotionally the probable trend of future business activity and for designing a credit policy that will help to maintain and advance the general prosperity now being enjoyed.
>
> I must reiterate my conviction that domestic considerations must have a first claim in making credit policy decisions, with balance of payments problems set to one side for treatment, if needed, by appropriate fiscal measures.

In that connection, Mr. Mills added, he wanted to call attention to an editorial in the New York Times for June 25 which repeated its opinion that creation of a capital issues committee provided an appropriate approach to the correction of balance of payments problems. Also, an editorial in the Washington Post this morning took a similar position.

Mr. Mills said he was satisfied with the administration of the Account since the last meeting. It had produced a constructive margin of free reserves, which he thought was appropriate and desirable. However, he had an unconfirmed feeling that the Account had been handled more in the light of the Treasury financing than to reflect the attitude of some Committee members and that conditions otherwise would have been more restrictive.

Mr. Mills concluded by observing that in light of expectations for the next three weeks he would not suggest any change in policy and he did not believe that any change was in the minds of other Committee members.

Mr. Wayne said that Fifth District business continued to advance, although some uncertainties persisted. Among the broad statistical indicators, seasonally adjusted nonfarm employment and man-hours rose in May but failed to regain March levels. Seasonally adjusted department store sales declined a little in June from all-time highs reached in May. On the other hand, insured unemployment dropped sharply from late May through the middle of June, when Virginia had the lowest rate in the nation. Construction activity continued at high levels, with building permits rising sharply in May to a new 1964 high. Respondents in the Richmond Bank's latest survey generally regarded the business outlook with somewhat more optimism than they had three weeks earlier. Manufacturers reporting on their own industries, however, showed a little less optimism than last time. On balance they reported increases in shipments and employment but little if any change in weekly hours, prices, or the outlook for profits.

Business, real estate, and consumer loans at District weekly reporting banks rose considerably more than seasonally during the first three weeks of June and appeared to be substantially stronger locally than in the nation as a whole. Nevertheless, the money market banks switched during the period from heavy net buyers to moderate net sellers of Federal funds.

At the national level, Mr. Wayne said, the latest information appeared to support earlier impressions that the current expansion in activity posed little immediate threat to price stability. The latest monthly gains in some of the important coincident indicators were more moderate than earlier in the spring, and the leading indicators were somewhat less favorable than they had been for some months. Inventories and capital outlays were being kept in bounds and recent Department of Commerce surveys suggested little in the way of excess from either of these quarters. At the moment, the advance seemed altogether moderate and orderly.

As to policy, Mr. Wayne believed that current rates of expansion in reserves, bank credit, and the money supply were generally appropriate to the present domestic environment. While the external situation might provide some cause for concern, especially in view of recent rate developments abroad, he did not feel that it justified any change at the present time. For these reasons, plus the probability of significant Treasury financing operations over the coming period, he favored maintaining the present policy. Mr. Wayne would keep the discount rate at its present level. The draft directive appeared appropriate to him, with the change suggested by Mr. Daane.

Mr. Clay said the domestic situation continued, in his opinion, to call for the stimulative effect of an expansive monetary policy. In the aggregate, the economy was moving ahead, but there was no evidence of over-exuberance. On the contrary, the pace was one of moderation and orderly development.

The overheating of the economy about which concern often had been expressed just was not showing up, Mr. Clay commented. With the lessened impact of Federal Government outlays and residential construction, the economy was dependent upon consumer and business spending as the principal sectors of expansion. These sectors were advancing, but within bounds that did not show pressure on resources and prices. There was a strong likelihood that expansion of the economy could continue in the months ahead without a price inflation problem.

The economy continued to have a problem of sticky unemployment of manpower. At the same time, it had the other necessary productive resources for expanding economic activity. While the unemployment problem was of a fairly concentrated variety that existed side by side with essentially full employment of many types of workers, the necessary shifting and upgrading of employees, as well as the required increase in total jobs, required an expanding economy for developing and putting that manpower and other resources to use.

In view of these domestic conditions and developments, Mr. Clay said, monetary policy should remain on the expansive side, in line with the Committee's recent policy objectives. While the international payments deficit was larger in the second quarter than in the first quarter of the year, continuation of the current monetary policy also appeared appropriate when account was taken of the international payments situation. In addition, the probability of Treasury financing led to a presumption of no basic change in monetary policy for the period immediately ahead.

Mr. Clay thought that the staff draft for the economic policy directive, with the change suggested by Mr. Daane, would be suitable for the period immediately ahead. In his judgment, no change should be made in the Reserve Bank discount rate.

Mr. Helmer reported that economic activity in the Seventh District in recent weeks was showing greater similarity to that for the nation than in many months. While there were some indications of slower rise, it was still widely expected that activity would continue upward and that further progress would be made in utilizing unused resources. Information recently available on retail sales, debits to demand deposits, and housing starts indicated these were all down somewhat in the District, but analysts associated with the major Midwest industries continued to be optimistic.

The June 30-July 2 period saw the opening of new labor contract negotiations at the big three auto firms, Mr. Helmer noted. A settlement was not expected before the August 31 deadline, and, when achieved, seemed certain to exceed the Council of Economic Advisers' 3.2 per cent guideline.

The recent partial recovery of prices for the top grade of slaughter cattle had been beneficial to some areas of the District. Crop prospects were generally good and the current indication was that farmers would realize favorable prices for hogs this fall. However, farm machinery manufacturers were now reporting some indications of weakening demand in livestock areas and distributors of various kinds of farm supplies indicated that payment terms were being eased further in order to make sales.

The net inflow of personal savings and time deposits at banks in District urban areas increased sharply in May, largely because of a decline in the rate of withdrawals. At these banks, excluding Indiana where interest rates were raised early this year, the net inflow in April and May had been nearly one-fourth larger than in the same months last year. At savings and loan associations in the same four States the net inflow rose well above the year-ago level in May after being below year-ago in earlier months.

Mr. Helmer noted that loan expansion at District weekly reporting banks in June was strong but less than the rise in the same month of 1963. The June banking figures suggested that consumers were increasing their use of credit somewhat. The quarterly interest rate survey showed that business loan rates in the District were higher in June than in March and also higher than in June 1963. Major District banks had liquidated Governments in the last month but had increased their holdings of other securities. Chicago banks were covering their reserve needs in the Federal funds market.

Mr. Deming said that Ninth District personal income in May moved to a new high in terms of annual rate, completely offsetting the weakness shown for the previous two or three months and bringing the figure back on the trend line running since January 1962. The average District income gain in this period had been slightly higher than that for the nation.

The agricultural picture was quite good for this time of year, Mr. Deming continued. There had been unusually heavy rains and current soil moisture and early crop prospects were better than usual. Despite a 2 per cent acreage cutback, winter wheat output as of June 1 was expected to be 2 per cent larger than last year.

Mr. Deming observed that two recent opinion surveys taken by the Minneapolis Reserve Bank showed some interesting results. The regular six-week survey of major industrial concerns showed that activity, as reflected by orders, production, shipments, employment, and hours worked, generally expanded or remained about the same in May and June. Such declines as were noted were mainly seasonal although some reflected phasing out of Government orders. Only one company reported a slight increase in prices of its finished products; all others reported prices generally unchanged. The concerns were quite optimistic about the third quarter outlook, with three-fourths expecting output gains and half expecting higher employment and improved profits. Those companies who foresaw declines in the third quarter regarded them as mainly seasonal. Two concerns expected some price increases in their products, one expected a decline, and the others expected stable prices.

The second survey was a quarterly survey of agricultural banks, both member and nonmember. They reported a drift to slightly lower net farm income; and that farmers currently were spending no more, and perhaps a bit less, on all items and definitely less on major items such as machinery. They also noted fairly strong farm loan demand and some firming in farm loan rates as their loan-deposit ratios grew. Some stated they were becoming less aggressive in seeking loans and were more selective in granting them.

Mr. Deming said member bank loans continued to expand rapidly during June following a strong advance in May, bringing the gain for the first six months of the year to a point comparable with the pronounced increases of 1963 and 1962 and well above the average for recent years. In the last two months, city banks had shown gains comparable to country banks but the six-month record showed a much stronger expansion at country banks since loan demand at city banks lagged during early 1964. The increases shown by the city banks were concentrated in loans to nonbank financial institutions and "all other" loans. Business loans at the close of June actually were lower than six months earlier, a very unusual development, although there was some pickup in this category in June

Bank investments showed virtually no change in June, following a slight decline in May, Mr. Deming observed. For the first half as a whole, however, District member bank investments had shown a smaller decline than was typical. Thus, total bank credit expansion had been larger than usual and was exceeded in recent years only in the comparable period of 1962.

Deposit changes in June were about in line with seasonal expectations and for the first six months of 1964 had been stronger than usual. Time deposit growth in June was weaker than usual, with city banks showing a rather pronounced drop in negotiable time deposits. In part this might reflect tax and dividend requirements of corporations, but in part it seemed to reflect some flows into Canadian time deposits by some big District corporations.

Banks in the District had been on the buying side of Federal funds transactions for the past four months. City bank borrowing at the discount window remained rare and minimal but country bank borrowing, while still relatively light, had stepped up in recent weeks.

Mr. Deming said he thought that it was obviously undersirable for the Committee to change policy in view of the Treasury financing, and that policy over the next three weeks could stand unchanged even apart from the financing. He agreed with Mr. Brill's comment that it might be best to let well enough alone. He was concerned, however, with the second quarter balance of payments developments, and he thought it was necessary to keep in mind the points Mr. Hayes had mentioned. As to the directive, Mr. Deming said he favored the change suggested by Mr. Daane but he thought the staff draft was fine otherwise.

Mr. Swan said that more complete figures for all States in the Twelfth District confirmed the increase in unemployment in May that he had mentioned at the last meeting and reflected declines in both construction contract awards and housing starts that were substantially greater in the District than in the country as a whole. On the other hand, employment had held up quite well considering the continued layoffs in defense- and space-related industries. Retail sales appeared to have continued favorable into June.

The larger banks continued to be net sellers of Federal funds in June, although the margin was quite small. Borrowings from the Reserve Bank were much lower in June than in May, but during the week ending July 1 they rose substantially--both absolutely and in relation to borrowings for the country as a whole. In the three weeks ending June 24, covering the tax date, total bank credit, total loans, and total commercial and industrial loans at weekly reporting banks all increased much less than in the same period a year ago. For the year to date commercial and industrial loans increased more this year than in the comparable period of last year. The increase this year in total loans, however, was somewhat less than in 1963.

Mr. Swan said the Treasury financing clearly dictated no change in policy, but, the financing apart, he agreed with those who advocated no change at this time in light of both the domestic and international situations. To him "no change" implied continuation of the situation that had existed in the last three weeks which, he thought, quite accurately reflected the position desired by the Committee three weeks ago. He would accept the directive proposed by the staff with the change suggested by Mr. Daane.

Mr. Irons said there was little new with regard to conditions in the Eleventh District. He could typify the movements of most major indicators over the past three weeks by saying slight or moderate advances were occurring generally, and the indications were that these advances would carry into the next month. Production had inched up; construction continued strong; department store sales were good. There was a steady, slight upward pull on District activity, but nothing sensational or striking. The economic picture showed no inflationary signs. Unemployment was not a problem in the District; the unemployment rate was small relative to that in the nation as a whole.

Mr. Irons noted that conditions in agriculture were reported to be generally satisfactory. Some sections of the District needed rain but that was always true at this time of the year. Prices received by farmers were up slightly.

On the financial side, Mr. Irons said, in the past three weeks loans were up fairly substantially in most categories. Consumer loans were running some 22 per cent above a year ago. Demand deposits were up, but time and savings deposits were down a bit.

Mr. Irons thought that District banks generally were less liquid than a year ago. Banks were seeking funds actively, including some of the small ones. Loan-deposit ratios in the District had increased to about 58 per cent from 52 per cent a year ago. City banks were active buyers of Federal funds. Member bank borrowings had risen somewhat, and an increasing number of country banks were coming into the discount window.

One District trend that gave Mr. Irons concern related to the volume and quality of debt that was being created. Occasional references were heard at the Reserve Bank to cases in which debtors were not carrying out the terms of their loan contracts. Some of the new country banks in the District were taking the view that in order to make money they had to expand loans, and in some cases their loans were in excess of their deposits. There might be problems ahead in settling some of the debt that now was being created.

On the policy side, Mr. Irons said, with the Treasury about to undertake a financing there was not much the Committee could do at this time. He would not advocate a policy change even if a financing was not in prospect. Despite a feeling that the Committee might have been maintaining too much ease for too long a period and might later regret it, for the present he would follow an even-keel policy, continuing the posture of the past three weeks, with average free reserves around $100 million, the bill rate and the Federal funds rate at about 3.50 per cent, and the discount rate unchanged. The international situation was a source of some concern, but in his judgment it did not require action at this time. He would accept the directive drafted by the staff with the modification suggested by Mr. Daane.

Mr. Latham reported that the New England economy continued to evidence steady but unspectacular growth. Business sentiment was generally optimistic but conservative, with no apparent evidence of speculation in inventory or bank credit.

District manufacturing employment rose slightly in May to reach the best seasonally adjusted total since August 1963. However, with the trends varying by industry, the twelve-month net change was only slightly improved. Nonmanufacturing employment also bettered the seasonally anticipated rise. The preliminary manufacturing production index for May showed a slight improvement for the month. Shoe production continued to reflect a downward trend compared with a year ago.

Mr. Latham said construction contracts, which had been a strong factor in the otherwise staid upward trend in New England, slipped below the 1963 pace with a decrease in nonresidential building. Residential building continued to show on the plus side, particularly in the apartment building category, which apparently reflected a delayed trend compared with other sections of the country. Department store sales were strong in May, and during the four weeks ended June 27, they averaged 5 per cent above a year ago with a cumulative gain of 6 per cent for the year to date.

Deposit balances at mutual savings banks continued to show an annual growth rate of 8.6 per cent. A strong credit demand had been in evidence, business loan growth continued at a rapid rate, and loan-deposit ratios were on a rising trend. Liquidity had been maintained nevertheless by a reduction in long-term Government holdings.

Mr. Latham commented that competition for deposits was keen. Special savings deposits seemed to be the order of the day. One large commercial bank had instituted a special savings account limited to amounts over $10,000. Interest was paid on a daily basis and was subject to change upon ten days' notice. Currently, the rate was 3-1/2 per cent or was tied to the discount rate. Savings banks vying for funds had resorted to various types of enticing accounts. For example, a savings bank in New Hampshire offered regular savings accounts at 4-1/2 per cent, investment savings accounts at 4-1/2 per cent, and a bonus savings account at 5 per cent. Mr. Latham noted that mortgage money was in ample supply.

Mr. Balderston observed that he was impressed by two observations that Mr. Brill had made. First, the construction boom apparently was flattening out. Second, within the advance occurring in the private sector of the economy a rolling readjustment seemed to be under way. In Mr. Balderston's opinion these developments should not occasion alarm; on the contrary, they increased the assurance that the economy would continue in a healthy state for a while.

The Treasury financing clearly indicated no change in policy today, Mr. Balderston said. He would accept the draft directive submitted by the staff.

Chairman Martin commented that everyone seemed to agree that the Treasury financing was the primary consideration today, and that no change should be made in policy. The members also seemed to agree that the economic policy directive prepared by the staff was acceptable with the modification suggested by Mr. Daane. The Chairman proposed that a vote be taken on such a directive.

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

It is the Federal Open Market Committee's current policy to accommodate moderate growth in the reserve base, bank credit, and the money supply for the purpose of facilitating continued expansion of the economy, while fostering improvement in the capital account of U. S. international payments, and seeking to avoid the emergence of inflationary pressures. This policy takes into account the continued orderly expansion in economic activity, accompanied recently by a more rapid expansion in money supply and some decline in interest rates. It also gives consideration to the relative stability in average commodity prices; the underutilization of manpower and other resources; the country's less favorable international payments position in the second quarter; and the further interest rate advances in important markets abroad.

To implement this policy, and taking into account probable Treasury financing activity, System open market operations shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves.

Chairman Martin then noted that Messrs. Daane, Balderston, and Young recently had returned from Europe. At the Chairman's invitation, Mr. Daane brought the Committee up to date on procedural and substantive aspects of the Group of Ten Deputies' discussions concerning arrangements to meet future international liquidity needs.

Mr. Balderston commented that he had been struck by the construction boom in many European countries, and the resulting difficulties in Switzerland and Austria; and by the widespread scarcity of labor. He had been particularly suprised by the economic progress being made in Finland, although a considerable degree of inflation had occurred there. Bankers in Germany and Austria had expressed the hope that the United States would not let its costs get out of hand. Such a development, they thought, would lead to difficulties both for the U. S. and for them. In Scandinavia he had heard a considerable amount of talk about the need to restore the balance there between equity and debt, and about the possibility of shifting to a value-added basis for taxes.

Mr. Young remarked that for part of his trip he had been on vacation in Portugal and southern Italy, and had been pleased to note the progress those countries were making. He also reported briefly on meetings he had attended in Paris of Working Party 3 and of the Economic Policy Committee of the Organization for Economic Cooperation and Development.

It was agreed that the next meeting of the Committee would be held on Tuesday, July 28, 1964, at 9:30 a.m.

Thereupon the meeting adjourned.

Ralph A. Young
Secretary