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, April 16, 1963, at 9:30 a.m.

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

Messrs. Fulton, Wayne, Shuford, 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. Hackley, General Counsel
Mr. Noyes, Economist
Messrs. Brill, Garvy, Green, Furth, Holland, and Koch, Associate Economists
Mr. Coombs, Special Manager, System Open Market Account

Mr. Molony, Assistant to the 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

Messrs. Patterson and Helmer, First Vice Presidents of the Federal Reserve Banks of Atlanta and Chicago, respectively
Mr. Hickman, Senior Vice President, Federal Reserve Bank of Cleveland
Messrs. Black, Jones, Parsons, and Grove, Vice Presidents of the Federal Reserve Banks of Richmond, St. Louis, Minneapolis, and San Francisco, respectively
Mr. Marsh, Assistant Vice President, Federal Reserve Bank of New York
Messrs. Willis and Anderson, Economic Advisers, Federal Reserve Banks of Boston and Philadelphia, respectively
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Scheld, Assistant Cashier, Federal Reserve Bank of Chicago

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on March 5, 1963, were approved.

Before this meeting there had been distributed to the Committee a report from the Special Manager of the System Open Market Account on foreign exchange market conditions and on Open Market Account and Treasury operations in foreign currencies for the period March 26 through April 10, 1963, together with a supplementary report covering the period April 11 through April 15, 1963. Copies of these reports have been placed in the files of the Committee.

In comments supplementing the written reports, Mr. Coombs first discussed current and prospective developments with respect to the U. S. gold stock, following which he touched upon the situation in the London gold market, including reference to operations of the gold pool.

Turning to the foreign exchange markets, Mr. Coombs noted that interest had centered in the pound sterling. In a description of recent developments in this connection, based essentially on information contained in the reports that had been distributed to the Committee, he noted that the disclosure by the Chancellor of the Exchequer in his budget message that the Bank of England had received assistance from central banks of other countries to the extent of $250 million during February and March did not appear to have created apprehension. In fact, the announcement seemed to have had the opposite effect of conveying to the market an impression of solidarity in support of sterling. He and other central bank officials in the exchange field, Mr. Coombs said, believed that the repeated instances of central bank cooperation in resisting speculative challenges were contributing to a gradual change in market psychology. The market had become increasingly persuaded that sufficient official funds could be rounded up when necessary to resist speculative attacks on a currency successfully. Thus, some psychological advantage seemed to have accrued from all that had been done in the past two years.

Mr. Coombs also commented on the progress that had been made towards paying off the Federal Reserve drawings of Swiss francs under the swap arrangement with the Bank for International Settlements, again as described in the reports that had been distributed. In the absence of upsetting political developments, he hoped that the System's Swiss franc drawings from the Bank might be substantially paid off in the reasonably near future. Progress likewise was being made by the U. S. Treasury in dealing with its Swiss franc commitments.

Mr. Coombs then reviewed developments with respect to the German mark, which had been under some buying pressure recently for reasons that he described. He reported that selling operations by the German Federal Bank, the U. S. Treasury, and the Federal Reserve seemed to have had some effect in arresting the rise in the mark rate. Comments followed with respect to the Netherlands guilder, including circumstances that had contributed to pushing the guilder to the ceiling against the dollar and led to a drawing by the Federal Reserve under its swap arrangement with the Netherlands Bank to provide additional guilder resources for market operations.

In concluding his remarks on developments since the previous Committee meeting, Mr. Coombs noted that the dollar had continued on or close to the floor against the French franc and the Italian lira. The dollar also had weakened against the German mark and the Netherlands guilder, and the London gold price had been exhibiting a tendency to rise. In this constellation of circumstances, intervention in the mark and guilder markets had seemed advisable.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the System Open Market Account transactions in foreign currencies during the period March 26 through April 15, 1963, were approved, ratified, and confirmed.

Certain recommendations were then presented by Mr. Coombs for the Committee's consideration.

Mr. Coombs first recommended renewal for three months each of the $50 million swap arrangement with the Austrian National Bank, which would mature April 24, 1963; the $100 million swap arrangement with the Bank of France, which would mature May 6, 1963; and $150 million swap arrangement with the German Federal Bank, which also would mature May 6, 1963.

> After discussion, renewal of the aforementioned standby swap arrangements, as recommended by Mr. Coombs, was authorized by unanimous vote.

Mr. Coombs noted that a $20 million equivalent drawing in Swiss francs under the swap arrangement with the Bank for International Settlements would mature April 30, 1963. He recommended renewal of the drawing for another period of three months, adding, however, that he was hopeful that it might be possible to repay the drawing entirely within the relatively near future.

> The proposed renewal of the Swiss franc drawing was noted without objection.

Mr. Coombs recalled that at its meeting on September 11, 1962, the Open Market Committee had authorized outright purchases of sterling up to a total of not more than $25 million equivalent. It had been the thought that if purchases of sterling could be made at favorable rates in the ensuing few months, a period of the year when there is usually some pressure on sterling, such holdings might be used to advantage after the turn of the year, when a seasonal flow of funds to the United Kingdom normally might be expected. Due to subsequent developments, including the breakdown of Common Market negotiations, the general picture had changed considerably. In the present circumstances, however, it appeared that it would be useful to have this authorization available, thus permitting moderate purchases of sterling that might have a desirable effect under certain conditions. Thus, an $8.5 million purchase by the Stabilization Fund on March 29th had had a reassuring effect. Accordingly, Mr. Coombs requested that the action taken by the Committee on September 11, 1962, authorizing outright purchases of sterling up to a total of $25 million equivalent be reconfirmed.

After discussion, the authorization referred to by Mr. Coombs was reconfirmed.

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

Before this meeting there had been distributed to the members of the Committee a report covering open market operations in U. S. Government securities and bankers' acceptances for the period March 26 through April 10, 1963, and a supplementary report covering operations for the period April 11 through April 15, 1963. Copies of these reports have been placed in the files of the Committee.

Mr. Marsh commented in supplementation of the written reports as follows:

The highlight in developments since the last meeting of the Committee was the competitive bidding for Treasury bonds of 1989-94 which took place on April 9. Events leading up to the bidding suggested that the market had discounted the effects of earlier doubts about the future of interest rates and would approach the bidding with reasonable confidence in the rate structure. Prices of longer term issues had declined substantially, producing yields around 4.05 per cent in the longer key maturities, and presumably establishing a viable level of rates for the bidding. There were indications of sizable investor interest in the new issue at yields of 4.10 per cent or higher, but it was believed that the winning syndicate might offer the issue at a yield of 4.07 to 4.09 per cent, at which level reasonably good buying was expected.

As you probably all know, the Salomon Bros. & Hutzler-Devine syndicate won the issue on a bid of 100.55119 for a 4-1/8 per cent coupon at a cost to the Treasury of 4.09 per cent. The bonds were offered to the public at a yield of 4.082 per cent, which resulted in an underwriting spread of $1.98 per bond at the reoffering price.

Investors, however, showed more reluctance in buying the bonds than had been generally anticipated, the principal difficulty being that too many prospective buyers had apparently set their sights on the 4.10 per cent rate. On top of this, there were still many doubts about the rate structure and the action of the market after the bidding was not reassuring, as prices were marked down sharply the day after the bidding, making yields on outstanding issues (4.06 per cent on 4s of 1980, for example) quite attractive compared with the 4.08 per cent yield on the new issue. Market activity subsequent to the bidding has been mostly professional. The announcement by the American Telephone & Telegraph Company of its intention to refund a $250 million 5 per cent issue due in 1983 came as an added blow to the market just after the bidding. The announcement of price increases by Wheeling Steel Corporation, followed by several other steel price increases, also tended to restrain investor demand for the bonds.

All these influences combined to produce an attitude of "wait and see," and although there is reportedly plenty of long-term money to be invested, prospective buyers are still waiting. The situation remains a standoff, with about half the issue sold. We do not know how long the winning group will keep their syndicate open, but progress since the bidding day has been slow and there are no clear signs of give on either side. It looks as though the capital market would remain on dead center until this impasse is resolved one way or another.

While these results are not as happy as in the January offering, we must recognize that the new technique is still on trial as it was not really tested in January, when conditions were almost ideal. The question, of course, is whether a syndicate can successfully distribute an offering of this kind and size under less than ideal conditions. Syndicates will have to learn how to handle both themselves and the Government securities market, for they must worry not only about distributing the new issue but also about the action of the market for the various other Government issues. Thus, they are subject to more pressures than syndicates trying to distribute corporate issues. While the Salomon-Devine syndicate is not optimistic about selling out the account at the reoffering price, they are not greatly distressed about it as the loss potential does not appear excessive at this point. However, the whole performance has started a reappraisal of syndicate attitudes toward the competitive bidding process in terms of combining syndicates and submitting more realistic bids.

Payment for the new bonds will be made on Thursday, April 18. This weekend the Treasury will start its regular meetings with advisory committees to discuss the May refunding of $9.5 billion of three maturing issues of which $6 billion are held by the public. Announcement of the refunding terms will probably be made on Wednesday, April 24, with the books opening on Monday, April 29, possibly for 3 days. The Treasury has in mind trying a new technique suggested some time ago by the Investment Bankers Association involving two stages. First, they would offer on April 29 intermediate or longer term issues in exchange for the maturing issues. A week or 10 days later, perhaps for subscription on May 8, they would offer a short-term anchor issue for cash to cover any attrition which might result from the exchange and also to provide any new money that might be needed at the time. This method, if used, would involve a somewhat longer than normal period over which the Treasury would be seeking subscriptions.

The situation in the bill market has changed little, with rates clinging to the 2.90-2.92 per cent level for three-month bills and 2 97-3.00 per cent for six-month bills. Three weeks ago the Treasury started adding $100 million to each weekly offering of bills and last Wednesday auctioned an additional $500 million of one-year bills in refunding the $2 billion one-year bills maturing April 15. These additions to the bill list have tended to keep bill rates up, especially the one-year bills which the dealers took in size and have not been able to sell readily.

The Cook County (Chicago) tax date was expected to put some pressure on the bill market, but the Chicago banks were able to deal with the situation smoothly and after the tax date found a good market for the bills they had accumulated. The absence of substantial upward pressures on bill rates from these influences suggests that the market is beginning to reflect the effects of the massive shifts of short-term Treasury debt to the longer area in the March advance refunding. In addition, high nonbank liquidity continues to stimulate strong demand for short-term investments.

System open market operations over the past three weeks were relatively moderate and the tone of the money market was moderately firm on the whole, although money conditions did ease noticeably at times as the result of special influences; namely, the March 31 bank statement date, the April 1 Cook County tax date, and efforts of banks to build up accumulations of reserves in anticipation of these and other special drains. On the other hand, the payment for the one-year bills yesterday put considerable pressure on the money market which will probably persist until the dealers are able to reduce their holdings. Although our projections show somewhat higher levels of free reserves for the next two weeks, some part of the additional reserves may be needed to keep the money market fluid up to and during the Treasury's next financing operation.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions in Government securities and bankers' acceptances during the period March 26 through April 15, 1963, were approved, ratified, and confirmed.

At this point the Chairman called for the usual staff economic and financial reports, and Mr. Brill presented the following statement on economic developments:

After months of reporting no change in the current situation or in the outlook, we can at last observe some change, and a change for the better.

Most of the improved economic news has already been widely reported, and I will only list the major items: the production index up a full percentage point in March, after seven months of virtually no change; nonfarm employment up for the second month in a row to a new high, with significant strength in manufacturing industries; a relatively large decline reported in the unemployment rate; personal incomes continuing a rather moderate rise; retail sales up from a February figure that in turn had been revised upward, with continued strength shown in consumer purchases of durable goods and renewed strength in their buying of nondurables; a slight upward revision also in the February figures for new orders for durable goods, accompanied by a sizable rise in order backlogs; and, finally, a crop of fine corporate earnings statements indicating that fourth quarter 1962 profits were at a record level. Over all, gross national product in the first quarter is estimated to have been at an annual rate of $572 billion, some $5 billion higher than it seemed to be running at the height of the winter storms and the accompanying economic pessimism.

This recent improvement in the economic scene, welcome as it is, comes after a relatively long period of uncertainty and hesitation and is therefore subject to some overinterpretation. In the optimism engendered by the economy's performance in March, one cannot afford to overlook some clouds still on the economic horizon. In the labor area, for example, those close to the data express doubt as to the extent of both the deterioration indicated in the unemployment figures for February and the improvement reported for March. It is not clear whether these fluctuations in the unemployment rate actually occurred or were a product of imperfect adjustment for seasonal variation. The data do indicate little, if any, change in long-duration unemployment, and subsequent figures on filing of unemployment claims do not suggest any further inroads on the unemployment rate since the mid-March observation.

Optimism based on recent developments must also be tempered to the extent that the rise in industrial activity reflects strike-threat-induced stockpiling of steel. The rise in steel production last month accounted for a third of the total rise in the production index; orders received by iron and steel producers were a major factor in the January-February increase in durable goods new orders and backlogs; and steel stockpiling undoubtedly accounts for a large part of the recent rise in the business inventory component of GNP. While as yet far from 1959 proportions, strike hedging is providing some of the current lift to the industrial segment of the economy, and the aftermath of such a stimulus can be painful--as we learned in early 1960 and again in early 1962.

The other economic clouds are in the area of prices, both in equity and goods markets. The rebound in stock prices since last fall has retraced almost all of the spring 1962 decline, bringing current price averages to within 5 per cent of the historic peak reached at the end of 1961. Two factors tend to mitigate alarm about so fast a rise: first, it has been widespread, with no industrial concentration such as proved vulnerable when price advances were mainly in electronic or other "fad" stocks; and second, the rise in corporate profits has been substantial and as yet is keeping price-earnings ratios within the conventionally accepted range. Nevertheless, these ratios are tending upward, and credit in the stock market is rising as rapidly as prices.

The other market developments occasioning concern is the selective price increase announced by several steel producers. If adopted throughout the industry, the announced increases would raise the price index for steel products by about 1-1/2 per cent, and the over-all wholesale price index by less than one tenth of one per cent, but this does not take into account secondary effects on the price structure.

Stability in our industrial costs and prices since 1959, in contrast with rising costs and prices abroad, has been one important element of hope for our balance of payments, and it would indeed be unfortunate if this advantage were to be dissipated. One can sympathize with the steel industry, of course, since profits and margins have lagged somewhat behind those of manufacturing industries generally. Nevertheless, it had been hoped that the solution to the industry's problems would be sought primarily along the lines of increased efficiency through modernization of plant, stable or declining costs, and increased sales, rather than through higher prices which might encourage higher wages and other labor costs, and result in declining sales from the increased competition of other products and other countries.

It is too early to judge whether the steel price increase will stick, and if so whether it will have repercussions on the general price level that such increases had earlier in the postwar period. The current level of steel demand is partly induced by strike threats and therefore may prove ephemeral; more basic supply-demand relationships in the industry, and in the economy generally, are far different than in 1955-57. The steel situation appears as yet too special and too isolated to warrant the use of general instruments of inflation restraint, particularly in a still fragile expansion that, at least at the consumer end, has depended on substantial availability of credit.

Nevertheless, if economic resurgence persists, sooner or later we may have to face up to the possibility that conditions conducive to attempted price boosts will be reached in other commodity areas long before aggregate unemployment approaches a tolerable level and an adequate growth trend is assured. Some prices may respond promptly to rising demand, but the unemployment situation could prove particularly sticky. Productivity has increased substantially since the last boom period, the repressed growth in labor force over the past two years suggests ample reserve labor supply, and new entrants into the labor force may not have the skills most in demand for contemporary industrial technology. Moreover, an increase in hours worked by those already employed usually precedes new hirings. It may therefore require a larger rise in GNP to accomplish a given reduction in unemployment today than was the case in past postwar expansions.

Large rises in GNP, however, increase our exposure to price boosts and we can only hope those that occur will be selective, and offset by decreases where productivity gains or shifting demands permit. The general availability of industrial capacity and material supplies both here and abroad offers some basis for hope, but it is evident that we haven't yet licked the problem of administered prices that plagued us in the last boom. Continued advances in economic activity, welcome as they will be, are likely to test again the statesmanship of businessmen, labor leaders, and central bankers.

Mr. Koch presented the following statement on financial developments:

Since first quarter figures are now relatively firm, I shall focus my remarks this morning on the course of various indicators of monetary policy and the effects of policy thus far this year, commenting along the way on most recent developments since this Committee's last meeting.

Looking first at the immediate effects of policy, bank reserve and money market conditions have probably become a bit more taut since mid-December. Free reserves, for example, averaged about $320 million in the first quarter, as compared with $390 million in the fourth quarter of last year. Borrowings from the Reserve Banks are up a little. Three-month Treasury bill rates have rarely been below 2.90 per cent, and the Federal funds rate has bumped along at or just below the discount rate. New York commercial bank lending rates to Government security dealers have generally ranged between 3 and 3-3/8 per cent.

Since the last meeting, the free reserve average has dropped to about $270 million, but despite this fact money market conditions throughout part of this period were somewhat more comfortable than earlier for a number of short-run technical reasons, particularly bank adjustments just prior to and after the March 31 statement date and the April 1 Cook County tax date.

Turning to the more basic indicators of monetary policy, the total reserves of the banking system rose at a seasonally adjusted annual rate of just under 3 per cent in the first quarter, and required reserves behind private deposits at a 4 per cent rate. Since January, however, the excess of actual required reserves behind private deposits above the 3 per cent growth guideline has been practically eliminated. The excess amounted to a little under $200 million in January and in the latest statement week ending April 10 it had declined to only $10 million.

As for the narrowly defined money supply, it rose at a 2-3/4 per cent seasonally adjusted annual rate in the first quarter. This compares with a 7 per cent rate of increase in the last quarter of 1962. However, practically all of the recent rise occurred very early in the first quarter. Since mid-January, the money supply has shown only a small rise. In the first half of April, it is likely to have increased a little more and over the next six weeks it may get a further boost from a drawing down of cash balances by the Treasury in order to keep within the debt ceiling.

Time and savings deposits continue to perplex us. Their rise in the first quarter was as large as late last year, a rise amounting to a seasonally adjusted annual rate of about 17-1/2 per cent. Thus, the money supply, including time deposits, rose at an 8-1/2 per cent annual rate in the first quarter. This was about the same rate of increase as that in total liquid assets, as defined in our usual more inclusive series. Of course, these liquid assets include many forms of saving held for future spending as well as liquidity held to facilitate current spending. The stimulative effect of the rise in liquid asset holdings on current spending is also offset to some extent by the dampening effect of the sharp rise in private debt, particularly consumer credit and mortgage debit, that has occurred in recent years.

As for credit, total loans and investments of all commercial banks rose at a seasonally adjusted annual rate of 12-1/2 per cent in the first quarter. This was even a little larger than the 10 per cent rate of increase in the fourth quarter of last year. However, the composition of the recent expansion was quite different from that in late 1962. Bank holdings of U. S. Government securities increased $2-1/2 billion on a seasonally adjusted basis in the first quarter, compared with a reduction of half a billion in the fourth quarter. Loans, on the other hand, increased about $3 billion in the first quarter, $2 billion less than in the preceding quarter.

The major difference in loan behavior was in the business area. Business loans, which had risen $1-1/2 billion in the fourth quarter, increased less than half a billion in the first quarter. Nevertheless, this was still a 2-1/2 per cent annual rate of rise. Real estate, agriculture, consumer, and security loans, as well as loans to nonbank financial institutions have all continued to increase sharply thus far this year.

To sum up my reactions to first quarter money and banking developments, they indicate a continued high rate of credit expansion consisting primarily of expansion in investments and nonbusiness loans, a credit expansion reflected mainly in the growth of time rather than demand deposits. These developments suggest two things to me. First, there has been less strength in what might be termed the demand oriented sectors of bank portfolios, essentially business loans, although this development may be due in some part at least to inadequate allowance for the usual early year slack in business financing demands and to larger available internal funds. Secondly, there has been little, if any, slowdown in the supply oriented sectors of bank portfolios. This suggests to me that emphasis in the phrase "slightly less easy" as used to characterize monetary policy since mid-December should be on the word "slightly" rather than on the word "less."

As for policy in the next three weeks, it continues to have to recognize the full and substantial Treasury financing program ahead of us. The bonds recently offered at auction are still only partially distributed. Next weekend the Treasury meets with its commercial bank advisory committee to consult on its May refunding. The terms of this offering are likely to be announced a week from tomorrow.

Even aside from Treasury financing considerations, however, recent market developments would seem to me to call for a "steady in the boat" policy. Financial markets are currently characterized by hesitancy and uncertainty. They have been buffeted by rumors of policy changes and rather substantial financing activity in both the corporate and Government sectors of the market. Many long-term interest rates have risen 5 basis points or so since mid-March. Thus, the market itself has achieved a somewhat less easy tone, with credit still readily available but at a slightly higher cost. This is a situation in which both the Treasury and the Federal Reserve might well afford to bide their time and await further market developments.

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

The hopes for a significant improvement in the U. S. payments balance guardedly expressed three weeks ago have not been fulfilled.

First, the March deficit turned out to be somewhat larger than was expected on the basis of the fragmentary weekly reports. The deficit for the first quarter must now be estimated at $700 million.

Second, and more important, transfers of dollars to foreigners in the first two weeks of April seem to have been unusually large. For the week ending April 10, the amount was in excess of $200 million (if an increase in the so-called nonliquid foreign debt of the U. S. Treasury is added to the official figure).

Obviously, extrapolation of figures tentatively reported for one or two weeks would be even less justified than extrapolation of the results for one month or even one quarter. Nevertheless, it seems disturbing that the dollar was simultaneously weak in London and in Montreal, in Frankfurt and in Amsterdam.

It is true that dollar weakness in London could be explained by the relative moderation of the British budget; dollar weakness in Montreal by the election victory of the Liberal Party; dollar weakness in Frankfurt by the restrictive policies of the German Federal Bank and the attractiveness to foreign capital of a recent 6 per cent German Government bond issue; and dollar weakness in Amsterdam by investments of U. S. oil firms. Nevertheless, while there always are particular reasons for a currency's weakness in a particular market, such explanations do not sound convincing when the weakness is universal.

Third, and most important, the increase in steel prices open disquieting perspectives. The companies may have excellent reasons for announcing the increase, and the Administration may have excellent reasons for not trying to oppose it. But the U. S. payments balance has probably suffered a heavy blow.

Steel prices are rightly considered the pivot of the U. S. price and wage system. Experience has shown that increases in steel prices and wages tend to spread rapidly throughout the economy. Moreover, steel and steel products, including machinery and vehicles, account for nearly 40 per cent of total U. S. exports and 15 per cent of total U. S. imports.

Optimists still may hope that the price rise will not be followed by the rest of the industry, and that it will not induce labor to reopen wage negotiations. But even an optimist would have to concede heavy odds against the probability of such a development. Thus, last week's action may well mean the end of the hitherto successful efforts to keep prices and costs stable in the United States while they are rising abroad.

Economists widely differ in their views about the best methods to eliminate the payments deficit. But they are united in the conviction that stability of prices and wage costs is a necessary though perhaps not sufficient condition for any successful attack on the problem.

By coincidence, a large German steel plant, August Thyssen, has just distributed its report for 1962. It proudly states that in spite of wage increases of 7 per cent it was able to reduce steel prices by 7 per cent and still show a good profit. The contrast between Continental Europe, where steel prices have been reduced in the face of overall employment and large wage increases, and the United States, where steel prices are being raised in the face of underemployment and stable or falling wage costs, explains better than any learned treatise the contrast between Europe's domestic expansion and international balance, and our own domestic lag and international deficit.

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

Since the last meeting of the Committee there has been an improvement in the business outlook. To some extent, of course, the better tone merely reflects the fact that a number of indicators that had declined in January, for temporary reasons, ended up on the plus side in February. But the good increase in industrial production, and the other information that we do have for March, indicate that the pickup of February has been extended. The major element of recent strength--consumer buying--has continued upward each month this year.

Prices generally continue to be stable. However, the rise in steel prices recently posted by several steel companies raises questions. What effect will the increase have on the steel industry and on other segments of the economy? What effect will it have on prices in general and on wage demands? Developments in this area will need careful watching for their implications for future monetary policy.

It is encouraging to see that in March total employment moved up sharply and the rate of unemployment dropped back to 5.6 per cent. Thus the present rate of unemployment is about in line with the rate of a year ago and with the average rate for 1962. Nevertheless, a significantly faster uptrend in economic activity will be needed to provide enough new jobs to keep up with the growing labor force and to reduce unemployment.

Seasonally adjusted commercial bank credit expanded sharply in March, following an even larger rise in February. It will be interesting to see the March figures on stock market credit, which will be released soon, for such credit has continued to expand over recent months. While the money supply advanced only moderately in March, there was a substantial further rise in time deposits and a continued increase in Government deposits in connection with the large Treasury financing operations. While business loans were not strong in March, a number of corporations apparently obtained needed funds by reducing their holdings of commercial paper rather than by borrowing directly from the banks. There appears to have been somewhat greater corporate borrowing in the capital markets. These developments suggest that demands by business concerns for bank loans might increase fairly rapidly if there were a pronounced upturn in business activity accompanied by a narrowing in the differential between open market borrowing rates and the prime bank lending rate. The banks still appear to have ample liquidity to meet increased loan demands.

Our balance of payments deficit in 1963 continues to run at a rate not much different from that of 1962. Preliminary data indicate a $120 million deficit in March, with a deficit of about $700 million for the first three months of 1963. The statistics may have been influenced, however, by special favorable factors, such as (i) increased capital flows from sterling due to the recent weakening of sterling; (ii) a greater interest in our stock market on the part of Europeans; and (iii) a more rapid increase (which is probably temporary) in our exports compared with our imports, following the end of the dock strike. Capital outflows from the United States have been heavy as Americans have purchased large amounts of new issues of foreign securities. There is no doubt that there will be substantial drains on our gold stock as the year progresses. Our balance of payments problem continues to be most serious.

The $300 million of Treasury bonds of 1989-94 are to be paid for the day after tomorrow, but their distribution is far from complete. In the middle of next week the Treasury presumably will be announcing the terms of its May financing. Thus, "even keel" considerations would rule out any major change in Federal Reserve policy prior to the next meeting of the Federal Open Market Committee; but "even keel" considerations should not, I believe, preclude some probing toward a firmer money market.

It seems to me that the ample liquidity visible in the economy, coupled with the recent somewhat improved rate of business expansion, counsel placing more emphasis on our stubborn balance of payments problem. While a change in the discount rate would seem inadvisable at this time, I suggest a further modest move through open market operations toward somewhat less ease. Such a move would bring important benefits, both technical and psychological. Such a move would be evidenced by a Federal funds rate consistently at the 3 per cent discount rate, a three-month Treasury bill rate at nearly 3 per cent, and probably a modest reduction in free reserves and a modest increase in member bank borrowing. While our scope for policy change is quite limited as to timing and magnitude in view of the Treasury's financing program, I submit that open market operations should probe by modest steps toward a bit less ease, and that the directive should be modified to show such a change in policy.

Mr. Shuford noted that the period since mid-1962 had been marked by a succession of minor changes, some upward and some downward, in the economic statistics. Over all, the word "plateau" seemed quite descriptive of the situation. Recently it had been encouraging to find more strength in the economic indicators. The improvement that was noted at the March 26 meeting of the Committee appeared to have continued to a desirable degree during the most recent period. It seemed to him, however, that it would be premature to conclude that a definite trend had been established.

The situation in the Eighth District remained substantially unchanged, Mr. Shuford said. Offsetting movements in the more important indicators had been occurring. Construction was up slightly in the major metropolitan centers during the past few months as compared with the same period in 1962. Employment appeared to be increasing from the reduced level of November and December, while industrial use of electric power in the first quarter was about 6 per cent higher than in the last quarter of 1962. On the other hand, there had been some decline in department store sales, and business loans had declined for the past two months. Farm income prospects had deteriorated somewhat due to a decline in average prices received for farm commodities, which were down 10 per cent in the District since mid-January. Prices of beef cattle and hogs were down 12 and 13 per cent, respectively during that period.

Turning to the national picture, Mr. Shuford pointed out that the recent increases in bank credit and total deposits apparently were due in large measure to increases in bank investments and in time deposits, respectively. The picture of monetary expansion would appear to have been less stimulative in the past few months than previously, certainly when viewed in terms of demand forces. Reserves available in support of private deposits had increased at only a 1 per cent annual rate since January, he noted, compared with a 3 per cent rate for the past year as a whole. Reserves available against private demand deposits declined at a 2.5 per cent annual rate from January to March, compared with a slight increase from March 1962 to March 1963. Since January the increase in the money supply had been at an annual rate of 1 per cent, and since March last year the money supply had increased at a 2.2 per cent rate.

Mr. Shuford indicated that he would not favor any change in monetary policy at this time. The short-term rate did not appear inappropriate in relation to short-term rates in Britain and Canada. There was evidence of some strengthening in the domestic economic situation, which was in accord with the objectives of Federal Reserve policy. For the next three weeks, therefore, he would recommend continuation of about the same degree of money market firmness that had prevailed recently. Before any probing was done in the direction of less ease, there should at least be an opportunity to take a further look at the picture. Accordingly, he would not change the policy directive; in fact, he doubted the necessity of making even technical changes at this time.

Mr. Bryan, after noting the favorable tone of most economic indicators, expressed apprehension about signs of speculation that he detected in the economy. In Atlanta, for example, there were substantial speculative developments in the form of construction of high-rise apartments and office buildings. Also, he did not view with complacency the rapid rise of equity prices. His inclination was to feel that there might be a vigorous economic expansion ahead, and that developments should be carefully observed.

The Committee might be faced with an even keel problem for some time, Mr. Bryan observed. This seemed to him an appropriate time for the Committee to continue, in fixing the supply of reserves, to adjust for seasonal variations and to provide for some growth increment. In his opinion, however, the growth guideline might well be revised from 3 per cent annual rate to something more nearly approaching 2 per cent. He would be particularly cautious at this time about relying on free reserves as a guideline; the maintenance of a constant level of free reserves would permit indefinite expansion of the money supply and the financing of inflation.

Mr. Bopp reported that Third District business indices were somewhat more encouraging than they had been for several months. There were some small rises in place of former declines, and some greater-than-seasonal improvements. The level of unemployment remained unacceptably high, and although recent declines in unemployment claims had exceeded seasonal expectations the indicated impact on total unemployment rates was not great. Incomplete returns from the Reserve Bank's spring re-check of capital spending estimates for 1963 indicated widespread increases, to levels about 1962 expenditures.

Loans at District reporting banks had recovered somewhat from the normal seasonal decline at the beginning of the year. Whether they would continue to expand--as they did in 1962--or stabilize--as they did for most of 1961--was now in question. In recent weeks, loans had not increased to the same extent as last year, and for the year to date they had declined by a larger amount than a year ago. The chief reason for the poor showing for the year to date was the slump in business loans and a decline in loans to financial institutions during the first quarter. Real estate loans continued to increase. Bank credit had increased in the past few weeks mainly because of an expansion in investments. Except for short-term changes, there was no evidence of increasing tightness or pressure on bank reserve positions since the beginning of the year.

While the recent evidence that business activity might be turning upward was encouraging, along with the improvement in business psychology, in Mr. Bopp's judgment this did not justify any shift toward less ease. In fact, the upward creep in market rates, especially intermediate and long-term rates, served as a warning that as long as there was considerable economic slack the System should be on guard against permitting credit tightness and rising rates to retard or thwart a continued rise in business activity. The balance of payments continued to be a problem, but at present the covered spread between domestic and foreign short-term market rates did not encourage an outflow of short-term funds.

Mr. Bopp's appraisal of these various factors, together with the forthcoming Treasury refunding, led him to the conclusion that about the same degree of ease should be maintained for the next three weeks. In view of the upward creep in intermediate and long-term rates, he believed such additional reserves as might be needed should be supplied largely by purchases of intermediate and longer maturities. Whatever effect such purchases would have in retarding a rise in intermediate and long-term rates would be helpful in terms of the domestic situation without significant harmful effects on the balance of payments. The present directive afforded sufficient leeway for the policy suggested; hence, he recommended no change in the directive. Neither would he recommend a change in the discount rate.

Mr. Fulton said the faint signs of improvement in business in the Fourth District that were reported earlier had strengthened in the last half of March and early April. Unfortunately, the greatly increased activity in the steel and rubber industries was due in good part to anticipation of labor strikes. More favorable weather was also a factor.

Department store sales had moved up fairly rapidly in the last half of March and the first two weeks of April and appeared to have recovered the level of last December. The strength of auto sales in the major centers of the District had not abated; such sales were maintaining a margin over the comparable period of a year ago. A spot check of auto dealers indicated that credit terms were not being extended beyond 36 months for new or used cars, and it was stated that dealers, banks, and finance companies would resist such a trend. However, rates had been reduced, with 5 per cent being the prevailing rate among banks.

Only a partial recovery from the sharp decline in January had been noted in construction contracts. A greater-than-seasonal decline in the rate of insured unemployment from the mid-March position was shown in all major labor markets in the District, especially in the steel-producing centers. In fact, the improvement seemed to have been better than for the nation as a whole.

The rubber industry was currently producing at a high rate. New car tires, replacements, and mechanical rubber goods were all going very well. Auto manufacturers were stockpiling in anticipation of a strike that might begin on April 20. Union demands were high, with extended vacations as part of the package, and management was resisting such demands.

Orders for machine tools had picked up sharply. Foreign orders had revived somewhat, and domestic orders were substantially higher.

Management expected 10 to 15 per cent more business this year, with demand and production looking particularly good for the third and fourth quarters. The tax credit allowed for new equipment was said to be a factor, as well as a demand for machines that would cut labor costs while increasing production.

In the steel industry the rush to acquire inventory had created a surge of orders and boosted output substantially. It was estimated that already 3 million tons had been added to inventory. April output was at the rate of 123 million tons annually, and an increase to a rate of 133 million tons was anticipated in May. With price increases being announced by at least three mills, it seemed certain that the labor contract would be reopened, and an early settlement was not anticipated. The companies had spent, and were currently spending, millions of dollars to install modern equipment to reduce costs. However, with each labor contract adding more to costs, profits had declined consistently.

Referring to the comment by Mr. Furth concerning the announcement by a German steel company of its ability to absorb higher wage costs without increasing prices, Mr. Fulton noted that the prices of German finished goods apparently were similar to U. S. prices for comparable products, while wages and fringe benefits were less than half as high. Therefore, it would seem logical that German companies could make a profit even if substantial wage increases were granted. Unless the U. S. Government took a stand against excessive wage increases in this country, it was Mr. Fulton's opinion that the steel companies might well be given the privilege of increasing prices despite possible adverse effects on the economy. He observed that the present surge of production was costly for the steel companies because they had to increase their labor forces, with the attendant increase in employment costs, following which the workers would be entitled to benefit payments if laid off when work slackened. It was realized generally that inventories now being created must eventually be used, with adverse effects from the standpoint of both the mills and labor. The middle level of labor leaders was said to be frustrated by continued unemployment and the realization that many long-term unemployed workers would never return to the mills.

In light of the improved business atmosphere, Mr. Fulton felt that at least the same degree of money market firmness that had prevailed in the past three weeks should be continued. He saw no need to change the directive, and he would not recommend changing the discount rate at this time.

Mr. Mitchell noted that despite the steel situation, which was unsettling, the performance of the economy in other respects was encouraging. If the right Governmental policies were pursued, including an appropriate monetary policy, he foresaw the possibility of a domestic revival that would push the economy to considerably higher levels in 1963 than had been anticipated.

As to the balance of payments, short-run considerations seemed to require that nothing be done to charge the short-term rate significantly at this time. The covered rate differential was now favorable to the United States, and nothing should be done that would make the situation more difficult for the British. The consequences in terms of the dollar were too great to risk taking any actions that might make the sterling problem more difficult.

From the longer run standpoint, the balance of payments problem seemed to center around the rate of capital outflow. Basically, if time was available, the way to deal with the capital outflow would be to improve the rates of return on investments in this country. This would require a substantial increase in economic activity. Therefore, it would seem desirable to encourage the domestic economy to move ahead more vigorously. It now seemed doubtful whether there would be a tax cut as a prop for the economy. Accordingly, it appeared quite important from the point of view of longer run balance of payments considerations, as well as from the standpoint of the domestic economy, to follow a monetary policy that would accommodate and encourage expansion.

For the moment, Mr. Mitchell said, he would accept the prescription of Mr. Bopp: no change in the discount rate, no change in the directive, and no significant change in current monetary policy.

Mr. King commented that for some time the System had walked a relatively narrow path in terms of policy. In his opinion it had followed quite a good course. Recently there were indications of solid improvement in the economy, not in all sectors but in quite a few. In general, conditions looked better than they had for a long while. Gross national product, of course, was only now reaching a level that it had been hoped to achieve some time ago. He foresaw the likelihood of a fairly substantial and lengthy upswing in the economy if the move was not nipped in the bud too soon.

Mr. King indicated that he would be inclined to favor a slight reduction in the degree of market ease, without creating any serious pressure on the bill rate. He would not favor a change in the discount rate at this time, but he would like to suggest for the Committee's consideration a modification of the policy directive intended to carry forward the modest type of policy change reflected in the directive adopted December 18, 1962, which he thought had probably been quite favorably received by the financial community, particularly the international financial community, when published in the Board's Annual Report for 1962. The suggested policy directive read as follows:

> It is the Committee's current policy to allow some further growth in bank credit, while aiming at money market conditions that would minimize capital outflows. This policy takes into account the continuing adverse U. S. balance of payments position and at the same time recognizes the progress of the domestic economy.
>
> To implement this policy, System open market operations during the next three weeks shall be conducted with a view to effecting a small reduction in net free reserves through open market operations.

Mr. King added that he would not vote against a renewal of the existing directive if the majority of the Committee was so inclined. However, he believed an opportunity was afforded to modify the directive somewhat in light of the most recent statistical evidence.

Mr. Shepardson commented that the available economic information seemed certainly to indicate some increase in economic activity. This was gratifying. On the other hand, the continuing rise in stock market prices and the pending increase in steel prices gave cause for concern. There was additional reason for concern, of course, in the statistics on the balance of payments. Except for the continuing problem of Treasury financing, he would be inclined to follow the suggestion of Mr. Treiber. In view of that situation, he would favor a continuation of present policy, though with any deviations on the side of less ease.

Turning to the policy directive, Mr. Shepardson referred to comments he had made at recent Committee meetings regarding the phrase in the directive that alluded to an absence of general inflationary pressures. He continued to believe that inflationary pressures in fact existed and that the evidence of them was increasing. If there should be any change in the directive, he would like to see that phrase deleted. However, there might be an advantage, in terms of stability of policy, in making no change in the directive at this meeting.

Mr. Robertson said that his views were in line with those expressed by Mr. Bopp and Mr. Mitchell. Encouragement could be derived from economic developments in recent weeks, and he would like to see everything possible done to encourage the furtherance of such developments. He would suggest, therefore, waiting quietly and watching carefully the trends that might develop over the next three weeks, with no change in policy. Such a course would recognize the problems that flowed from the undigested overhang of the recent auction of Treasury bonds and would take into account the financing operations to be carried out by the Treasury over the forthcoming period.

Mr. Robertson expressed the view that the policy directive was adequate in its present form and said he would recommend making no change in it. In summary, he would not change policy in any respect at this particular time.

Mr. Mills said he was convinced, particularly after hearing Mr. Koch's presentation, that financial developments were resulting in undesirable downward pressure on the money supply. If so, a situation was arising that required the attention of the Open Market Committee. Considering the lag that occurs before policy actions can take effect and be reflected in financial markets, it was not too early, in his opinion, to alter the tone and direction of monetary policy toward slightly greater ease. In elaboration of this line of reasoning, Mr. Mills presented the following statement:

Money supply problems are likely to become an increasingly important issue in the System Open Market Committee's formulation of monetary and credit policy throughout 1963.

The vast expansion of commercial bank credit that occurred in 1962 was financed largely by a phenomenal increase in time and savings deposits and was based to a much smaller degree on a rise in credit-created demand deposits. Credit expansion in 1963 is proceeding along similar lines, but because of a sluggish demand for commercial and industrial loans, demand deposits have not risen appreciably.

The modest statistical increase that has been recorded in the money supply thus far in 1963 is a reflection of the passive demand for commercial and industrial loans and the unwillingness of the Treasury to finance any of its security offerings through the commercial banking system and tax and loan account procedures. If this situation continues, growth in the money supply will fall short of the amount needed to foster a rising gross national product and over-all economic activity will have been retarded. Tangible indications of such possibilities can even now be traced to a declining trend in required reserves which, if it gathers momentum, conceivably can result in a harmful reduction in the money supply that would represent a contraction of the means of payment in the hands of the public.

Developments of this nature, both actual and potential, pose serious problems to the formulation of Federal Reserve System monetary and credit policy. Commercial bank time and savings deposits go on increasing and have found employment principally in the areas of real estate mortgage and consumer credit and investment in tax exempt municipal obligations. In fact, the plethora of such funds seeking employment, both in the hands of the commercial banks and related financial intermediaries such as mutual savings banks and savings and loan associations, has prompted discussion of a competitively inspired deterioration in the quality of the credits being handled. This in turn leads to the question whether monetary and credit policy actions aimed at fostering the money supply would exhaust their intended usefulness in uneconomic and undesirable credit usages. A correct answer to the question must be found!

The vast increase in commercial bank time and savings deposits has made apparent the very important fact that the nature of these funds is identical whether in the hand of the commercial banks or the various financial intermediaries, and that in every case they must be defined as "near money" and not as a "substitute for money," or as a segment of the circulating medium as in the case of commercial bank demand deposits. The clear distinction that exists between commercial bank demand and time and savings deposits is crucial to the formulation of Federal Reserve System monetary and credit policy as it bears on money supply problems. This is so because open market policy actions exert their influence on the creation or extinction of demand deposits and only remotely on the accumulation or dispersal of time and savings deposits with their concomitant credit usages. Therefore, it follows that open market policy actions cannot be taken that will directly exert a restraining influence on the credit employment of commercial bank time and savings deposits, and that if they were erroneously attempted, a harmful downward pressure would be put on the money supply. In that latter event, a contraction in the means of payment in the hands of the public occurring at a time when economic stimulation is sought after, would have unfortunate consequences.

All of these circumstances face the System Open Market Committee with a dilemma that cannot be easily resolved. In my opinion, the state of the domestic economy deserves policy priority over balance of payments considerations. Monetary and credit policy should, therefore aim at fostering the expansion of commercial bank credit which, by the same token, would support needed growth in the money supply. Such a policy would recognize that aberrations in the use of credit financed out of commercial bank time and savings deposits are not susceptible to the direct influence of open market policy actions, but can only be controlled by other means. It would also conceive that in the absence of a demand for commercial and industrial loans, the Treasury would grant the commercial banks a judicious use of tax and loan privileges as a means for creating new demand deposits and supporting the money supply. I do not believe that the interest rate objectives that have been sought for would suffer from the kind of policy proposed, even though free market principles for determining interest rates have been rejected in favor of an artificially manipulated United States Government securities market that has made the interest rate structure a subject of deliberate policy attention. Judging from recent experience, I have a suspicion that the level of free reserves has been brought down to a point that is putting the money supply under pressure, and that the free reserve level pertaining may not represent as much credit leeway as the figures suggest, in that the fluctuations in vault cash, as they enter and leave the free reserves total, are too temporary in their influence as to affect the credit base. Similarly, the hard core of Federal funds in constant use does no more than support the outstanding use of commercial bank credit and due to its shifting ownership adds little or no support to credit expansion.

Mr. Mills said he saw no occasion to change the discount rate at this time. However, the position he had taken as to policy would require deleting from the second paragraph of the directive the phrase that called for maintaining the same degree of money market firmness. As indicated by his statement, he felt that there should be a lesser degree of firmness.

Mr. Wayne said the latest information indicated that Fifth District business activity was improving at about the same rate as the national economy. Retail trade was strong; the coal business had improved a little; construction contract awards had spurted; and a substantial number of reporting manufacturers had been experiencing increased orders, backlogs, shipments, employment, and hours. In addition, loan demand at weekly reporting banks had recently shown greater-than-seasonal strength. The most striking shift noticed by the Reserve Bank, however, was a sharp rise in optimism among its grass roots contacts. During the period covered by the Bank's latest survey, general business sentiment rose substantially. About two-thirds of the respondents now felt that further gains were likely, and a number of these considered more improvement fairly certain. Three weeks earlier, only a few thought a pick-up was probable, and almost half expected no change.

The national business situation had definitely taken a turn for the better, Mr. Wayne noted, and there were some signs that the improvement might be more than temporary. He was particularly encouraged by the strengthening in leading indicators--especially new orders for durable goods--and by the scattered signs that plant and equipment outlays might be rising. No doubt the favorable weather and strike hedge buying had played an important role, however, so it might be some time before one knew how solid the improvement really was.

Turning to questions of policy, Mr. Wayne commented that the existing degree of liquidity seemed adequate to finance any likely expansion without undue upward pressure on rates. Despite the recent steel price increases and the more general signs of strength in the economy, excess capacity still seemed sufficiently large to preclude any general upward pressure on prices. Accordingly, he felt that domestic developments did not as yet justify any shift in policy. While he believed there was room for further correction in this country's international accounts, he had not yet been persuaded that monetary policy could make a further contribution in this area without a more abrupt shift than he would be prepared to risk. Consequently, he would favor maintaining about the same degree of ease as in the past three weeks, with due regard to problems occasioned for the Desk by the post-Easter seasonal swing in reserves. He favored renewing the directive, and he would be opposed to a change in the discount rate at this time.

Mr. Clay observed that the latest available information on production, personal incomes and retail sales, and business spending clearly was encouraging. The evidence also appeared to promise that some additional expansion would be forthcoming in subsequent months. The significance of these signs of higher activity for the formulation of monetary policy would be read differently depending upon the weight one assigned to domestic versus balance of payments considerations.

From the standpoint of the domestic economy, the latest improvement was no greater than had been expected earlier; it did not reflect, in Mr. Clay's view, an expansion so robust as to warrant a less stimulating policy. Moreover, the gains should not be interpreted as being independent of the favorable influences monetary policy had generated through expansion of bank reserves. Commercial bank data suggested that total private spending for consumption and investment was receiving significant support from the efforts of lenders to find outlets for their expanding resources.

If this interpretation of domestic developments was reasonably accurate, Mr. Clay continued, the implications for the balance of payments problem might be evaluated in two ways. On the one hand, it might be argued that the domestic capital market was made more receptive to foreign security issues. On the other hand, the domestic economy was becoming more attractive for business investment--a trend reinforced by signs that the boom in a number of European economies was losing forward momentum.

Mr. Clay pointed out that the foregoing observations with respect to the current importance of monetary policy favored a continuation of the recent moderate expansion of bank reserves and approximately the same level of bill rates. If a temporary decline in bill rates should occur, it did not appear to him that any serious consequences would result if free reserves were allowed to decline temporarily to somewhat lower levels. In his view, the directive was satisfactory as now stated and the discount rate should not be changed.

Mr. Scanlon reported that developments in the Seventh District appeared to support the more confident tone of business and banking expectations. Retail sales and new orders for manufacturers' durable goods had shown substantial gains. There were some signs that employment and production were breaking out of their long plateau on the up side.

The rise in manufacturers' orders and the acceleration of inventory building reflected partly, of course, hedge buying of steel and products containing steel, Mr. Scanlon noted. To the extent that this was true, a reaction later in the year was inevitable. However, he did not think that hedge buying was the whole story. Inventories of many types of goods had been at minimum levels relative to output, partly because business managements commonly had been expecting a moderate recession in early 1963. However, instead of declining, orders had moved upwards. Although order backlogs of most firms remained very low relative to earlier postwar years, there had been a stretch-out of delivery dates in some instances. Lead times on certain types of steel in strong demand, such as galvanized sheets, had lengthened appreciably.

Information received from capital goods producers indicated that the rate of new orders from a large variety of customers had been very strong in recent months, suggesting that the 5 per cent rise in capital expenditures projected for 1963 might prove to be an understatement. (However, there had been some slowing in shipments of farm machinery, probably reflecting the prospect for lower farm income.) Increasingly, the tax credit and the new depreciation guidelines were credited with stimulating capital goods purchases.

One auto company estimated that car and truck sales had been at annual rates of 7.5 million and 1.2 million, respectively, for the first quarter. If these rates continued for the entire year, sales of both cars and trucks would be at a record in 1963. (For cars the record year was 1955, for trucks, 1950.) The manufacturers still maintained that the sales pace will slow down in the second half. Meanwhile, however, production schedules for autos were being raised rather than reduced.

For the most part, Seventh District banking developments had paralleled the national picture. Lending to nonfinancial business had remained moderate and dealer loans had declined. Business loan demand during the past month had been lower than in other recent years. On the other hand, loans to consumers and finance companies and bank purchases of mortgages and non-Federal securities had risen in recent weeks.

Mr. Scanlon pointed out that while business prospects had strengthened, many businessmen had doubts regarding prospects for the second half of the year, particularly because of expected declines in the output of steel and autos. These doubts were strong enough that he would be hesitant to recommend any material change in System operations at this time. In view of these factors and the forthcoming Treasury refunding, he believed that no basic change was indicated for monetary policy. He would not change the directive, and obviously he would not change the discount rate.

Mr. Deming reported that inventories of livestock and grain were quite high in the Ninth District. It appeared that marketings would be heavy this year. Therefore, despite price weaknesses he rather anticipated that cash farm income in the first half of this year might be from

5 to 10 per cent higher than in the first half of 1962. The Reserve Bank's latest survey, taken in April, showed a considerable rise in business sentiment since February, when the previous survey was taken. A much higher percentage of respondents thought that improvement was probable or certain. On the other hand, the pattern of optimism was not appreciably different from that reported last July and in the early part of the fall. In general, it might be said that the prevailing attitude at present was one of tempered optimism.

On a seasonally adjusted basis, bank credit expansion continued in the District in March. The pace of increase was not quite as strong as in February, but it was a bit stronger than a year ago. At city banks there was no particular strength in the demand for business loans, with credit expansion taking the form of increased investments. Deposit behavior was about normal for this time of year. City banks were in a reasonably easy reserve position as long as they could get money through the Federal funds market. At country banks, on the other hand, the loan growth for the first quarter of the year was the largest on record. This reflected not only loans to farmers but small business and real estate loans. The growth seemed to have tapered off a bit in March, being about normal for that month, but the deposit decline was smaller than in previous years.

Turning to policy, Mr. Deming said that without prejudice to the possibility of probing toward lesser ease at some future time, he would not want to see any change in policy for the next three weeks. The Treasury financing schedule, the overhang of undistributed bonds from the recent auction, and market uncertainties all argued that no change in policy would represent the best course. He saw no particular reason to change the policy directive, except possibly in one technical respect, and he would not favor changing the discount rate at this time.

Mr. Swan reported that on a seasonally adjusted basis the rate of unemployment in the Pacific Coast States declined in March, but the drop was less than for the nation. For the third successive month defense-related industries laid off workers, and some further decline in aircraft employment in California and Washington was anticipated for April, and possibly for May. Department store sales set a new record in the District in March, but in early April the year-to-year comparisons for the District lagged behind those for the nation as a whole. Late snow and rain had improved both pasture conditions and the outlook for the water supply this summer.

In the three weeks ended April 3, demand and time deposits at District weekly reporting banks both increased. The picture of credit expansion was somewhat similar to that reported nationally, being primarily in investments, and major District banks continued to be net sellers of Federal funds into mid-April. The demand for municipal securities apparently continued to be strong. The State of California recently marketed two bond issues at the most favorable terms for any large issue since 1958.

Mr. Swan expressed himself as gratified by the improvement indicated in the national business situation. He believed, however, that any move toward less ease at this juncture would be premature. Of the statistics presented the drop in the rate of unemployment was perhaps the most dramatic change, but the decline was only to about the 1962 average. It certainly did not seem conclusive as yet that a rapid and continuing expansion of domestic economic activity was inevitable, and in his opinion the increased pace of expansion noted thus far should certainly not be discouraged. Also, despite the existing problems from the international standpoint, he saw no impelling reason in the balance of payments position for immediate action.

In summary, Mr. Swan said, it seemed preferable for the System to save its ammunition until either the international or the domestic situation, or both, called for stronger action than would be justified at this time. Further, the problems of the Treasury, including its imminent financing program, supported a position of no change in monetary policy.

Mr. Swan concluded by saying that he would not recommend a change in the discount rate at this time and that he would leave the policy directive unchanged.

Mr. Irons reported that conditions in the Eleventh District were reasonably good. During the past month there had been a slight strengthening of several of the major indicators of economic activity. Industrial production was up a bit according to the basic index and as reflected in the use of electric power. Construction conditions were very strong, with activity during the past month having risen to a record high for that month. Construction of office buildings and apartments was going on apace in the major cities. Nonagricultural employment had increased slightly, but unemployment had also increased slightly on an unadjusted basis. The agricultural outlook was quite good despite a lack of rainfall, and department store sales were up after adjustment for the date of Easter. Petroleum was off a bit in terms of production, refining, and drilling.

District banks seemed adequately liquid, and there was no substantial borrowing from the Reserve Bank by either city or country banks. Except for two large banks that were persistent buyers of Federal funds, most of the banks dealing in such funds had been on the selling side. There were no reports of need for additional reserves. Loans had increased during the past three weeks, along with time and savings deposits, but investments declined--counter to the national pattern--and demand deposits declined seasonally.

There seemed to be no particular problem areas so far as attitudes in the District were concerned. On a random basis, businessmen seemed quite encouraged. They were worried about the usual number of things and would like to see better profit margins, but the results, when added up, looked quite good.

Mr. Irons noted that the improvement in the broad sweep of national economic activity was encouraging. This was, of course, what the System had been hoping to see for a long time. In his opinion it would not be appropriate to make any change in policy at this stage, for he doubted whether the degree of improvement in domestic activity that had been noticed thus far was sufficient to warrant the conclusion that a different monetary policy was in order. The same line of thinking appealed to him from the standpoint of the international situation, and the fact that the Treasury would be in the market also argued for maintenance of the status quo. All in all, he would suggest continuing the policy that had been followed for the past three weeks. The Desk had done a good job of implementation, and he hoped the same conditions could prevail for another three weeks, including a continuation of the same degree of market firmness.

In conclusion, Mr. Irons said he would not change the policy directive or the discount rate. He added that in his opinion this was not a time when fine shadings and gradations of policy would serve a useful purpose.

Mr. Ellis reported that the New England economy reflected some improvement in most of the economic indicators except employment and unemployment. In March unemployment ran some 10 per cent above a year ago, and initial claims for unemployment compensation were about 5 per cent higher. The manufacturing index rose slightly in February after seasonal adjustment, and construction awards and building permits showed improvement, along with personal income, consumer spending, new orders, and capital outlays. Business loans had increased more than seasonally since January, with reporting banks showing increases well distributed according to broad categories.

Mr. Ellis then reviewed a recent report indicating that savings banks in at least one part of the District were encountering difficulty in putting to work a record volume of deposits. Competition for mortgages apparently had led to some lowering of quality standards, along with rate reductions. He also referred to financial difficulties besetting potato growers in Arostook County, Maine, due to higher costs and lower prices.

Mr. Ellis expressed the view that in retrospect Federal Reserve policy had been properly stimulative and should be entitled to some credit for making a contribution to the current strengthening of the economy. He found it interesting to review the financial trends that had prevailed since the modest shift in monetary policy last December. Since then, total reserves appeared to have expanded at an annual rate at about 3.5 per cent. The reduction of reserves available for growth to about the 3 per cent guideline seemed to fall within the pattern of what the Committee should have been trying to achieve.

Mr. Ellis suggested that the first paragraph of the policy directive might be changed to reflect the recent improvement in economic conditions. He also suggested that the range of policy making open to the Committee seemed somewhat broader than in recent months. At least this would be the case once the imminent Treasury financing was out of the picture. For some time, he noted, the Committee had been walking a narrow path, between concern about short-term capital outflows and stimulation of the domestic economy. Now, however, there was more of a choice of paths to follow. The Committee could move down the middle or undertake some probing in one direction or another.

Mr. Ellis foresaw that a continuation of the current degree of monetary ease would lead to a more rapid expansion of credit as the current economic improvement continued. It also appeared, according to reports from lenders, that the present degree of ease was leading to a slight weakening of credit standards. His inclination would be to probe toward less ease, and determine pragmatically the effect on the domestic economy, after the imminent Treasury financing was out of the way. Such a course of action would involve aiming for a slightly lower level of free reserves, perhaps around $250 million, with short-term rates edging toward 3 per cent, few days when the Federal funds rate was below 3 per cent, and moderately higher member bank borrowing. Only after such exploratory probing and judgment as to the effect would he consider increasing the discount rate.

As to the next three weeks, Mr. Ellis said he would consider it appropriate to modify the first paragraph of the policy directive so as to reflect the fact that some strengthening in the domestic economy was being seen. He would not, however, change monetary policy in any significant degree due to the need for an even keel in view of the Treasury financing.

Mr. Balderston expressed the view the impending Treasury financing, together with the aftermath of the Treasury bond auction, indicated a need to maintain steady money market conditions until the next meeting of the Committee. After that time, however, he believed the Committee should come to grips more vigorously with the problem of how best to minimize disturbing influences that were lurking beneath the surface.

Internationally, the dollar was on the floor in most of the European markets, and the current foreign exchange figures were not reassuring. It appeared that not too much progress had been made in achieving a basic equilibrium in the U. S. international payments position even though the first quarter figures might appear somewhat better than those for the first quarter of 1962. The most recent flash report on the balance of payments carried the disturbing possibility that the deterioration indicated thereby might be more than merely ephemeral.

Domestically, it seemed to Mr. Balderston that the quality of lending was lower. Stock market loans were on the rise again, especially in the area of unlisted securities. While he was told that insurance companies had not gone below the 5-1/2 per cent rate on mortgages, he was also told that they were taking on mortgages of definitely lower quality and were engaging in direct deals with companies they would not have looked at a couple of years ago. In short, he saw more and more resemblances to 1928. Preoccupation with unusued resources, human and otherwise, might be setting the stage for substantial difficulties. Three weeks from today he felt that he might be inclined to favor a shift in the course of monetary policy toward less ease.

Chairman Martin commented that the discussion at this meeting had seemed to recognize as overriding factors the problem being faced by the Treasury and the condition of the money market. Seldom had he seen a time when the market situation was as much dominated by long-range changes. In the March advance refunding a large volume of securities had changed hands, and that operation had not yet been fully digested. Additionally, there were the difficulties encountered in the long-term bond auction and the fact that an uncertain market atmosphere existed, reflecting conditions that had been discussed around the table today. The Committee should not do anything, in his opinion, to upset market forces in either direction. Although he was sympathetic to the points raised by Mr. Treiber from the standpoint of the balance of payments situation, it would be disturbing to the money market for the System to interfere in any way at the present time. Instead, the Committee should be concentrating on maintaining the same degree of ease. To use Mr. Koch's expression, "steady in the boat" ought to be the policy for the next three weeks, at which time another look could be taken at the situation. In this connection, the Chairman cautioned against committing one's self to a policy position at some time in the future. A lot of things could change in the interim.

The Chairman foresaw difficulties for the Treasury in the present situation. Although the Treasury had not talked with him about the matter, it was almost certain to have a difficult period ahead, with a refunding coming up so shortly after the long-term bond auction. In his view the System should not complicate the situation in either direction. Steady in the boat was the policy that ought to be pursued.

Continuing, Chairman Martin expressed agreement with those who felt that the balance of payments picture looked more cloudy. He did not pretend to know how long it might take for a storm to develop. Nevertheless, vigorous domestic business activity could create further difficulties from the standpoint of the balance of payments and intensify the problem. One should not overemphasize what monetary policy could do in that regard, nor should one underestimate.

Chairman Martin then proposed that the current economic policy directive be renewed in its present form, adding that he doubted whether it was necessary even to make technical changes. This would imply no change in current policy and no change in the discount rate. He inquired whether there were those who would want to be recorded as dissenting.

Mr. Mills stated that he wished to be recorded as dissenting, in line with the views he had expressed earlier during the meeting.

Mr. Treiber also indicated that he would like to be recorded as dissenting. In explanation of his position, he said that the degree of liquidity now existing in the economy and the improvement in the domestic economic situation made it possible, in his opinion, to give greater attention to the balance of payments problem, which he considered a very serious one. He recognized that probing toward less ease in a period of Treasury financing presented a delicate problem, and there might be developments in the market of such nature that the probing could not take place. However, from the point of view of policy formulation, he felt the Committee should be moving in that direction.

Chairman Martin commented that if he were the Account Manager, he would not want to be given that degree of discretion in view of the problems being faced at this juncture. This, of course, was a matter of judgment.

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 for the System Open Market Account in accordance with the following current economic policy directive:

It is the Committee's current policy to accommodate moderate growth in bank credit, while aiming at money market conditions that would minimize capital outflows internationally. This policy takes into account the continuing adverse United States balance of payments position and the increases in bank credit, money supply, and the reserve base in recent months, but at the same time recognizes the limited progress of the domestic economy, the continuing underutilization of resources, and the absence of general inflationary pressures.

To implement this policy in a period of a Treasury bond financing, System open market operations during the next three weeks shall be conducted with a view to maintaining about the same degree of firmness in the money market that has prevailed in recent weeks, while accommodating moderate reserve expansion.

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

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, May 7, 1963.

The meeting then adjourned.

Ralph A. Young

Secretary