1961 Advanced Management Conference of the Metropolitan Life Insurance Company, 1:30 p.m., Monday, July 24, 1961, Nassau Inn, Princeton, New Jersey.

MONEY, BANKING AND MONETARY POLICY AS THEY AFFECT THE ECONOMY

I. NATIONAL GOALS OF OUR ECONOMIC SYSTEM.

A. Section 2 of Employment Act of 1946:

> ". . . Federal Government shall use all practicable means . . . in a manner calculated to foster and promote free competitive enterprise and the general welfare . . . to promote maximum employment, production, and purchasing power."

B. Money as the instrument of economic freedom.

1. Freedom to earn, spend, save, invest.

2. Spending decisions guide production.

   (a) Profit and loss economy. Edsel → Rambler.

3. Earning and spending decisions.

   (a) As individual consumers, household, businesses (proprietorships).

   (b) In voluntary collectives -- corporations.

   (c) In public capacity -- Government.

C. Full use of resources.

1. Private and public demand.

   Output at maximum employment and stable price level.

2. No automatic.

   Fiscal policy. Debt Management.

   Automatic effects.

   Policy.

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II. THE ROLE OF MONETARY POLICY.

A. Adjust flexibly to economic developments.

1. When demand is excessive, make money harder to get and more expensive.

2. Vice versa.

B. Efficiency in use of money mitigates effects.

C. Experience shows it works.

Affects capital values and whole economy.

Wide variety of borrowers/lenders free to choose.

Treasury bills
Transfer to c/d.

THE ROLE OF FINANCIAL INTERMEDIARIES

1. They cannot create money.

2. If they acquire long debt for short debt, the remainder of the economy is more liquid but they are less liquid!

3. Flow of expenditures may be influenced.

   Velocity may rise; but can't excape monetary authorities.

4. The economy requires less money than otherwise; but quantity can be regulated.

5. True also if, e.g., corporations invest demand deposits in Treasury Bills.

6. Also their actions are affected by conditions in money and capital markets.

   e.g. -- Finance companies.

   Pressure by banks to repay in tight money periods forces into capital markets at higher rates. Reinforces higher rates.

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III. TOOLS OF MONETARY POLICY.

A. Deposits as money: work through the banking system.

1. Commercial banks --

   Seek loans and investments when they have more to lend.

2. Vice versa.

3. Reserve position as measure of banks' position.

   Supply, availability + cost.

B. Reserve requirements.

C. Open Market Operations.

D. Discounting.

1. Rate.

2. Administration.

IV. GUIDES TO CURRENT OPERATIONS.

A. Lags.

1. Between an event and knowledge

2. Between knowledge and decision.

3. Between decision and effects.

B. Methods of determining current policy.

1. Past relationships.

   (a) Population forecasts.

   (b) Harvard A.B.C. curves: Speculation, business, banking.

   (c) Leading indicators.

2. Current behavior.

   Inertia -- weather forecast.

   Miss every change!

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3. Expressions of current opinion.

4. Expressions of current intentions.

5. No rabbits in the hat.

6. Judgment.

V. <u>OPERATIONAL PROCEDURES</u>.

A. Organization for policy-making.

1. Relations to the Government.

2. Central vs. decentralized.

(a) A Federal System.
(b) A National Policy.

B. Reaching a decision.

1. Federal Reserve Banks.

(a) Boards of Directors.

2. Board of Governors.

3. Federal Open Market Committee meets every three weeks.

(a) N.Y. Memo on operations.

Economic memorandum:
Staff review of economic developmemts --
Credit developments.

12 Presidents and 7 Governors report.

Discussion of past three weeks.

(b) Decision as to whether to --

(1) Continue as is.
(2) Tighten -- and how much.
(3) Ease -- and how much.

(c) Changes are usually moderate.

(1) A little more -- a little less.

(2) <u>Resolve doubts</u> on one side or the other.

(d) The directive.

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C. Execution of policy.

1. Manager of the account and daily telephone calls and wire reports.

(a) Projections of non-controllable factors.

Float -- uncollected cash items.
Deferred availability cash items.

(b) Inevitable errors in projections.

(c) How correct for errors --

Conduct of an operation.

(1) Bring average in line?
(2) What happens on subsequent days?

(d) Regular way transactions.

(e) Cash transactions.

(f) Repurchase agreements.

D. Ultimate authority in a united Board of Governors.

RECENT POLICY

Last overt move to greater restraint --

September 11, 1959 -- Rate: $3\frac{1}{2}$ to 4%.

Despite steel strike.
Inflationary psychology.

1960 Boom assured because of strike.

However, no additional restraint on availability.

Net borrowed reserves in 400-500 will range until end of year.

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(1960 ANNUAL REPORT OF BOARD OF GOVERNORS)

DIGEST OF PRINCIPAL FEDERAL RESERVE POLICY ACTIONS, 1960

Period	Action	Purpose of action
January-March	Reduced System holdings of U.S. Government securities by about $1.6 billion. Member bank borrowings at the Federal Reserve Banks dropped from an average of $900 million in December to $635 million in March.	To offset the seasonal inflow of reserve funds, mainly from the post-holiday return of currency from circulation, while permitting some reduction in borrowed reserves.
Late March-July	Increased System holdings of Government securities by nearly $1.4 billion. Member bank borrowings at Reserve Banks declined to an average of less than $400 million in July.	To promote further reduction in the net borrowed reserve positions of member banks and, beginning in May, to provide reserves needed for moderate bank credit and monetary expansion.
June	Reduced discount rates from 4 to 3½ per cent at all Reserve Banks.	To reduce the cost of borrowed reserves for member banks and to bring the discount rate closer to market interest rates.
July	Reduced margin requirements on loans for purchasing or carrying listed securities from 90 to 70 per cent of market value of securities.	To lower margin requirements from the high level in effect since October 1958 in recognition of decline in volume of stock market credit outstanding and lessened danger of excessive speculative activity in the market.
August	Authorized member banks to count about $500 million of their vault cash as required reserves, effective for country banks August 25 and for central reserve and reserve city banks September 1. Reduced reserve requirements against net demand deposits at central reserve city banks from 18 to 17½ per cent, effective September 1, thereby releasing about $125 million of reserves.	To provide mainly for seasonal needs for reserve funds, and to implement 1959 legislation directed in part toward equalization of reserve requirements of central reserve and reserve city banks.
August-September	Reduced discount rates from 3½ to 3 per cent at all Reserve Banks.	To reduce further the cost of borrowing from the Reserve Banks and reduce the differential between the discount rate and market rates of interest.
August-November	Bought or sold at different times varying amounts of Government securities with a net increase in System holdings of about $1[illegible] billion, including securities held under repurchase agreement and issues with short maturities other than Treasury bills. Member bank borrowing declined further to average below $150 million in October and November.	To encourage bank credit and monetary expansion by meeting changing reserve needs and offsetting the impact of a large gold outflow without exerting undue downward pressure on short-term Treasury bill rates that might stimulate further outflow of funds.

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(Digest of Principal Federal Reserve Policy Actions, 1960)

Period	Action	Purpose of Action
Late November-December	Authorized member banks to count all their vault cash in meeting their reserve requirements and increased reserve requirements against net demand deposits for country banks from 11 to 12 per cent. The net effect of these two actions, effective November 24, was to make available about $1,050 million of reserves. Reduced reserve requirements against net demand deposits at central reserve city banks from 17½ to 16½ per cent, effective December 1, thereby releasing about $250 million of reserves. Sold U.S. Government securities except for seasonal purchases in last week of December. Member bank borrowings at the Reserve Banks averaged less than $90 million in December.	To provide, on a liberal basis, for seasonal reserve needs, to complete implementation of legislation directed in part toward equalization of reserve requirements of central reserve and reserve city banks, and to offset the effect of continued gold outflow, while avoiding direct impact on short-term rates that might stimulate further outflow of funds.

RESERVE SYSTEM BOND PURCHASES

"N Y At the direction of the Chairman of the Open Market Committee of the Federal Reserve System the Manager of the System Open Market Account announced:

"The System Open Market Account is purchasing in the Open Market U. S. Government notes and bonds of varying maturities, some of which will exceed five years.

"Price quotations and offerings are being requested of all primary dealers in U. S. Government securities. Determination as to which offerings to purchase is being governed by the prices that appear most advantageous; i.e., the lowest prices, net amounts of all transactions for system account will be shown as usual in the condition statements issued every Thursday.

"During recent years transactions for the system account, except in correction of disorderly markets, have been made in short-term U. S. Government securities. Authority for transactions in securities of larger maturity has been granted by the Open Market Committee of the Federal Reserve System in the light of conditions that have developed in the domestic economy and in the U. S. Balance of payments with other countries."

(WIRE SERVICE - 2:50 p.m.)

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System moved toward ease or less restraint --

Before the economy over-all turned down because --

1. Inflationary psychosis subsided - dormant at least.

2. Competitive buyers markets - unused manpower
   unused plant and equipment.

Could have credit for real growth without inflation.

VI. PROPORTION AND PERSPECTIVE ON OUR INTERNATIONAL POSITION.

A. Improve our competitive position at home and abroad.

1. Regain our leadership in innovations -- new products.

   Home market -- compact car.
   Foreign market -- what they want.

2. Quality of product.

3. Competitive prices.

   Control of costs.

B. Avoid inflation at home.

C. Maintain confidence in the dollar.

D. Influence foreign behavior.

1. We generously and successfully helped the west to reconstruct.

2. Rising international liquidity.

   (a) Reduce barriers against U. S. imports.
   (b) Aid in development -- especially Germany.

3. Review our government expenditures abroad.

E. The business cycle and the balance of payments.

Convertible currencies.
Interest rates.
Gold movements.

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CRITICISM

FOR NOT MOVING FAST OR FAR ENOUGH:

Letter dated July 24, 1960 from C. Lowell Harriss, Professor of Economics of Columbia University:

Dear Friend:

In glancing through the FEDERAL RESERVE BULLETIN last night, I noted that you are on the FOMC. This note may be a presumption, but I send it with the best of intentions.

With many people, I suppose, I have been sharing disquiet about the business picture. The immediate outlook may be tinged by gloom from the stock market. Yet business ought to be expanding more, I feel. And last night when I looked at the figures of the money stock over recent months and years -- I do not ordinarily keep up with matters of this nature -- the very slow rate of growth seemed to be not consistent with what I should consider best for the economy. Perhaps if the "Fed" gave a bit more encouragement to money growth, the economy would be better. And I say this recognizing my long record as one who thinks we should pay quite a price to prevent inflation.

Please be assured of my very best personal wishes.

FOR MOVING TOO FAST:

BARRONS's, August 22, 1960:

Against this sober setting the recent moves by the Federal Reserve begin to look less like a calculated risk, as they complacently have been described, than a wild gamble with the nation's solvency. For whatever else it may achieve, easy credit invariably works to postpone or prevent the adjustments in prices and costs without which no country for long can remain competitive. Thus it tends to perpetuate the very conditions which inexorably lead to debasement of the currency. By easing credit the Fed has appeased its critics and, perhaps, helped stave off an impending recession. However, it has done so only at mounting peril to the dollar and the long-range national interest.

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THE SHORT-RUN:

Hiatus from difference in cycles.

Convertible currencies -- interest rates -- and gold movements.

IF WE HAD:

Inflationary psychology --

Rising prices.
Deteriorating trade position.
Full use of resources.

Large fiscal deficit.

Low gold reserves.

Then, to compound with easy money would, indeed, be hazardous.

But surely with the reverse, the dangers from easier credit are less than those from tight credit.

Cycle in Europe and United States.

Proportion and perspective on our International position.

Flight from the dollar to gold simply have not had.

Balance of payments position.

Our trade position --

Great improvement since second quarter of 1959.

Auto imports -- except V.W. & Renault exports

At $4 billion annual rate, mostly exports!

Our businessmen have been adjusting --
Still a problem.

WHAT CAN BE DONE ABOUT OUR UNFAVORABLE BALANCE OF PAYMENTS?

1. Influence behavior of foreigners.

We helped them - generously - reconstruct -- and successfully!

(a) Rising international liquidity.

∴ Reduce barriers vs. U. S. Imports.

Aid in development -- especially Germany!
The lesson of Germany.

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(b) Review our expenditures abroad.

Families of servicemen.

(c) Avoid inflation at home.

(d) Improve competitive position at home/abroad.

QUALIFICATIONS OF CENTRAL BANKER.

Open mind -- but not draughty!

Tough skin.

Know when to stop!

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