

## **Implementation of the Policies of the Federal Open Market Committee\***

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Before turning to a description of the process by which the policies established by the Federal Open Market Committee are translated into action by the management of the System Open Market Account at the Federal Reserve Bank of New York, it might be of interest to the Joint Economic Committee to hear about one or two of the special developments in the Government securities market since my last testimony before your Committee in August 1959. First of all, I am pleased to report that the program for regular statistical reporting by the Government securities dealers that arose out of the Treasury-Federal Reserve study of the Government securities market, and which was encouraged by your Committee, has become a reality, with publication of the first data at the end of March. The collection and dissemination of these statistics is now working quite smoothly. Many of the dealers, despite some initial doubts, are finding that the statistics are useful to them. The general public interest in these statistics is illustrated by the fact that we have had requests from about 1,400 individuals and organizations to be put on the regular mailing list to receive them. I am also pleased to report that there has been an addition of one firm to the number of Government securities dealers with which the Desk does business. This brings the total number of such dealers to 18, and there are good prospects that we may see two more organizations develop into full-fledged Government securities dealers in the near future. As I indicated to you in 1959, we welcome additions to the list of primary dealers; we hope that there will be more in the future.

I should also like to compliment your Committee on the excellent study prepared under the direction of its staff and written by Professors Meltzer and von der Linde of Carnegie Institute of Technology. This study was a significant contribution to public knowledge of the Government securities market.

Much of what I have to say regarding the implementation of the policies of the Federal Open Market Committee is probably already familiar to you, since a great deal has

already been written and said on this subject. In his appearance before the Joint Economic Committee in December 1956, Mr. Hayes, President of the Federal Reserve Bank of New York, described in some detail how the Federal Open Market Committee reaches its policy decisions and how these decisions are implemented by the Federal Reserve Bank of New York; and my own statement at that time also commented on the role of the Manager of the Account in this respect. In addition, there is the booklet prepared by Robert Roosa, entitled *Federal Reserve Operations in the Money and Government Securities Markets*, which has been widely circulated among the public. This booklet was prepared by Mr. Roosa while he was associated with the management of the Account as assistant vice president in the Securities Department of the New York Bank. We believe it important that the interested public know as much as may properly be disclosed of how the System operates in the money and Government securities markets. Despite the fact that there is much that is already known, I thought it might be of some interest to the Committee to review briefly my personal experience as an individual in the front line of System operations that are designed to carry out System policies.

Open market policy is determined by the Federal Open Market Committee, which meets regularly at approximately three-week intervals in Washington. These determinations are based on a broad and careful analysis of all aspects of the current state of business, credit conditions, international developments, and related matters. The Federal Reserve Bank of New York has been designated by the Committee as the institution in the System that conducts actual operations, on behalf of all twelve Federal Reserve Banks, to put the Federal Open Market Committee's policy into operation.

As Manager of the System Open Market Account, it is my responsibility to supervise the execution of all open market transactions carried on in accordance with the Committee's policy decisions. In view of my position as Manager of the System Account, I attend the meetings of the Open Market Committee. At each of these meetings, I make a report of System operations and stand prepared

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to answer any questions that any member of the Committee may care to raise on the manner in which the Committee's directions have been carried out. My attendance at the meetings gives me an opportunity to hear at first hand what the Federal Open Market Committee has in mind as to policy for the succeeding period as developed in the meeting. As you know from the record of policy actions contained in the *Annual Report* of the Board of Governors, the Federal Open Market Committee at each meeting issues a directive to the Federal Reserve Bank of New York setting forth the Committee's policy in broad terms. In addition, the Committee arrives at a consensus during the course of each meeting, which tends to specify in somewhat more concrete terms, but still in a relatively general way, a series of guidelines for the Manager of the Account. It is my duty as Manager of the Account to make sure that the intentions of the Federal Open Market Committee as to the management of the Account during the period between meetings of the Federal Open Market Committee are clear to me. My presence at those meetings affords me an opportunity of raising any questions that I may have at that time. In addition to the directive and the consensus laid down by the Committee, I have the benefit of hearing all the detailed statements by the several members of the Committee and by the other Presidents of the Reserve Banks who are not currently serving on the Committee. The views expressed in these statements serve as an important supplement to the more formal statement of the directive and the consensus, and furnish a number of additional guideposts for day-to-day operations.

A great deal remains to be said about the process by which day-to-day decisions to buy or sell Government securities are made on the basis of the Committee's policy intentions, and about the process by which the day-to-day activity of the Account is reviewed by the Committee on a current basis.

First of all, it should be remembered that the Committee's decisions do not take place in a vacuum, but are made against the background of recent experience in the money and credit markets. I should like to emphasize this ever-present element of continuity. Quite often policy can be summarized in terms of creating somewhat more or somewhat less pressure in the money market and on member bank reserve positions, or in terms of maintaining about the same conditions that prevailed in an earlier period. In moving from a policy decision to day-to-day operations, the first question for determination is the effect of the natural influences in the market on bank reserves and on the degree of tightness or ease in the money markets. It may be, for example, that in the period immediately ahead, float, or a return flow of currency from

circulation, or an inflow of gold, may be reasonably counted on to supply reserves to the market. If the Committee has decided upon a policy of ease, this natural flow of funds through the market may do a great part of the Manager's job for him. If, on the other hand, the Committee is pursuing a policy of restraint, an increase in bank reserves through such natural factors will require offsetting operations and thus will tend to make the Manager's problem more complicated.

In order to keep abreast of the very latest developments in all the factors affecting member bank reserve positions and the money market, the Federal Reserve has developed an elaborate system for collecting information, designed to feed into the Manager's hands all the latest data pertaining to bank reserve positions and the various factors that may be affecting these positions. On each morning, for example, we have on hand a complete nation-wide picture of the reserve positions of member banks as of the close of business the night before, including full information on the distribution of reserves as between the money market banks, reserve city banks, and country banks. In addition to up-to-the-minute information on past developments, we have a number of specialists who forecast changes in factors affecting bank reserves for the period immediately ahead. These estimates are revised each day for the next succeeding three- or four-week period.

But it is clear that cold statistics do not provide sufficient basis for the conduct of day-to-day operations. We also rely heavily on the specialists who work on our Trading Desk, which serves as the listening post of the Federal Reserve System on the nation's money and securities markets. Located as we are in the heart of the country's financial center, and with direct communication with the Government securities dealers and the money market banks, we have a unique opportunity to follow developments in the market as they are occurring.

Part of our job is to disseminate this information on current developments throughout the System, and to the Treasury for which we execute transactions as fiscal agent of the United States. But in addition, hour-by-hour developments, particularly those in the Federal funds market, in the Government securities market, in the progress of Government securities dealers in finding the financing required to carry their portfolios of Government securities, provide the Manager of the Account with information which gives him an informed judgment of the degree of ease or tightness in the market—sometimes referred to as the "feel" of the market. The Federal funds rate tells us something about the availability of excess reserves in the banking system, with a rising rate indicative of somewhat greater pressure and a falling rate indicative of

declining pressure on bank reserve positions. Similarly, if Government securities dealers—who scour the country each day in search of funds from banks, corporations, and State and municipal bodies—are having an easy time finding funds to finance their portfolios at relatively low rates, we know that there is a ready availability of short-term funds throughout the country. Movements in Treasury bill rates, too, may at times be indicative of nonbank liquidity as well as bank liquidity, and may be an important part of the information we use in reaching decisions on operations. Current trends in the capital markets are also taken into consideration in viewing the mix of pertinent factors.

The Manager of the Account is also directly concerned with activity by foreign central banks, monetary authorities, and international institutions in our money market. Developments in our balance of payments and in the international position of the dollar are, of course, taken into consideration by the Federal Open Market Committee in its policy deliberations. But as Vice President in charge of the Securities Department of the New York Bank, I have a direct and immediate technical interest in these operations, since foreign central banks hold and invest so large a part of their dollar reserves through the Federal Reserve Bank of New York. Transactions for foreign accounts affect member bank reserves and thus must be taken into account when operations for System Account are being considered. The gold outflow in 1960, for example, was one of the major factors affecting member bank reserves with which we had to deal. The fact that the Federal Reserve Bank of New York has close institutional relationships with foreign central banks and performs so large a percentage of transactions for their account in the money market enables us to have first-hand information concerning the timing and the potential market impact of these transactions. At times the coordination of these foreign operations in the Government securities market with Federal Reserve open market operations can become a particularly important undertaking. Transactions for foreign accounts in the market on occasion may make the job of the Manager of the System Account somewhat easier; on other occasions, they may complicate it. At times, for example, it is possible for us to avoid an undesirable market impact of foreign account transactions by arranging transactions among these accounts or directly with the System Open Market Account. In any event, the fact that we have knowledge of such foreign transactions permits us to integrate them with System operations.

To sum up, then, we start from a policy decision of the Committee as to the degree of pressure or ease desired, and on the basis of our knowledge of the present

and prospective influences on bank reserves as a result of the operation of natural factors, together with the information that is fed to us on a current basis by the money and securities markets themselves, a decision whether to supply reserves to the market or absorb reserves through open market operations is arrived at. This is a decision that has to be reached each day in the light of all of the factors that I have mentioned before. Our estimates and forecasts of bank reserve positions are subject to wide fluctuations as a result of any number of factors that can only be imperfectly predicted, and I might add that a decision not to undertake open market operations is as difficult as a decision to buy or sell. I should emphasize here that, while the management of the System Open Market Account is in constant touch with the market, the Account does not necessarily operate in the market every minute, every hour, or even every day or week.

I think it is obvious that a considerable amount of judgment is required as to the nature, the timing, and the exact amount of any given open market operation. The very nature of open market operations means that they must be approximate and directional in nature, rather than precise, and it is only by a constant review of the impact of our operations on the money market and on bank reserve positions that we can answer the question of how much we should do and when we should do it.

Although the Federal Open Market Committee meets periodically, open market operations must be conducted on a day-to-day basis. While the Open Market Committee lays down a number of guidelines for the Manager of the Account, the nature and complexity of our financial structure precludes the Committee from setting forth a precise schedule of purchases and sales of Government securities that the Manager should follow on each day. This should not be taken to indicate, however, that the Manager operates solely on his own initiative between meetings of the Committee, and hence has an opportunity to determine policy on his own account. I shall not attempt to go into the many advantages that stem from the regional character of the Federal Reserve System. The fact that we do have a regional system, however, and the fact that the Board of Governors is located in Washington while operations are, of necessity, conducted in New York, does require a highly developed system of communications within the System to insure that each member of the Board of Governors and each President of a Federal Reserve Bank is kept fully informed of the Manager's operation of the System Account on a day-to-day basis.

To start with, each morning there is a conference call at 11 o'clock, at which time the Account Management

talks by telephone with a representative of the Board of Governors and one of the Presidents of a Reserve Bank who is currently serving on the Committee. Quite often, Mr. Hayes, the Vice Chairman of the Committee, and his alternate on the Committee, Mr. Treiber, the First Vice President of the New York Bank, sit in with my associates and myself on this call, and one or more of the Governors of the Board may sit in at the Washington end. After a summary of conditions in the money and capital markets as they have developed during the first hour of trading in the morning, a summary of the reports received from dealers as to the volume of trading in Government securities and their positions at the close of business on the preceding day, a review of the country-wide reserve positions, with special attention to the reserve position of the New York and Chicago money market banks, a review of developments expected for the day in the Treasury balance and other information that may appear pertinent, the Account Management outlines the approach it proposes to take with respect to operations during that day. (This review of our intentions is, of course, based on our assessment of conditions as they exist at 11 o'clock or thereabouts, and is subject to change should there be a significant change in the market atmosphere.) The other participants in the call may choose to comment on the course of action outlined by the Manager and may review any other developments that appear to them to be pertinent in this respect. A rather detailed summary of this call is prepared at the Board of Governors and placed before each member of the Board within a short time after the completion of the call. The same information is transmitted by telegram to the Presidents of all the other Reserve Banks, so that within a very short time the entire System has been alerted to the morning's developments and to the course of action that the Manager deems appropriate to implement the policy laid down by the Committee. This rapid dissemination of this information permits each member of the Committee to assess the desirability of the action contemplated by the Manager, and to make comments and suggestions if he believes it desirable to do so.

I might add that, while the final responsibility for determining day-to-day operations rests with me, I rely heavily upon the staff work of specialists, traders, statisticians, economists, and others who devote so much of their time to the conduct of our System operations. I am, of course, able to discuss at any time problems that may arise with the Vice Chairman of the Committee or his alternate on the Committee, and if there are particularly troublesome problems, I may consult directly with Chairman Martin or request a telephone conference of the full

Open Market Committee.

In addition to this daily call, a written report is submitted daily to the Board of Governors and to interested officers of other Reserve Banks, and at the end of each statement week, a full written report of Account operations as well as developments in bank reserve positions, the money, Government securities, and capital markets is submitted by me to the members of the Open Market Committee and to the other Presidents. Similar reports are prepared to cover developments between meetings of the Open Market Committee, including a report which covers developments and Account operations up to the close of business on the Monday night preceding a meeting. Thus, when the Committee convenes on a Tuesday morning, it has a full written record of all the activity conducted for the Account, as well as a description of the background against which these operations were conducted.

And this is not all. During the course of the day, we submit hourly reports to the Board of Governors on prices and interest rates on Government securities, and indicate, on an hourly basis, the operations that have been undertaken by the Account Management. In addition, a summary of the day's developments is also transmitted by telephone to a member of the staff of the Board of Governors by the Trading Desk after the close of the market at 3:30 p.m., and a summary of this information is prepared for distribution to members of the Board.

In addition to these informational activities, the System has devised, as part of its Emergency Planning Procedures, a program whereby certain officers and staff members of the other Reserve Banks and of the Board of Governors spend two to three weeks with us at the Trading Desk in New York. While this program was devised mainly to provide some measure of continuity in System operations in case of a national emergency, it has served to provide key people in the System with a broad understanding of the scope of, and the problems involved in, day-to-day open market operations.

All in all, while this program of information and training takes great time and effort, we feel that it is absolutely essential and that it has been quite effective in keeping the entire System up-to-date on operations undertaken on behalf of the Open Market Committee. The completeness of the information provided, and its current nature, permits each member of the Committee to be fully informed of the operations undertaken, and provides each member of the Committee an opportunity for continuous review of, and comment concerning, the manner in which the Manager is carrying out the instructions he received at the meeting of the full Committee.