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, January 24, 1961, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Balderston
Mr. Bopp
Mr. Bryan
Mr. Fulton
Mr. King
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak

Messrs. Treiber, Leach, Allen, Irons, and Mangels, Alternate Members of the Federal Open Market Committee

Messrs. Erickson, Johns, and Deming, Presidents of the Federal Reserve Banks of Boston, St. Louis, and Minneapolis, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Brandt, Eastburn, Hostetler, Marget, Noyes, and Tow, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Koch, Adviser, Division of Research and Statistics, Board of Governors
Messrs. Garfield and Williams, Associate Advisers, Division of Research and Statistics, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors
Mr. Yager, Economist, Division of Research and Statistics, Board of Governors
Mr. Petersen, Special Assistant, Office of the Secretary, Board of Governors

Mr. Wayne, First Vice President, Federal Reserve Bank of Richmond
Messrs. Ellis, Mitchell, Parsons, Coldwell, and Einzig, Vice Presidents of the Federal Reserve Banks of Boston, Chicago, Minneapolis, Dallas, and San Francisco, respectively
Mr. Garvy, Adviser, Federal Reserve Bank of New York
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Grossman, Economist, Federal Reserve Bank of St. Louis

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on December 13, 1960, were approved unanimously.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period January 10 through January 23, 1961. A copy has been placed in the files of the Committee.

Supplementing the written report, Mr. Rouse commented as follows:

I should like to point out that because of the short interval since the last meeting of the Committee, we have not prepared the usual detailed report covering this period. The regular weekly report which was mailed to you on Friday covers most of the period in detail and the summary report just placed in your hands covers the highlights of the full period, and the last three days in some detail. We expect to follow this same procedure for the two-week period through the next meeting.

Since the last meeting, the money market has been generally easy, although the bulge in float over the past week end has created an abnormally easy situation for this statement week. The level of reserves seems to have been reasonably satisfactory, being above the averages for December.

Treasury bill rates remained in the same general range as in previous periods, although downward pressures developed at times, particularly in recent days. The dealer market is becoming aware of a resistance point around 2.20 per cent for 91-day bills and until yesterday there had not been sufficient buying, bank or otherwise, to push through that rate. The strongest downward pressure developed yesterday before the auction when last week's bills reached 2.18 per cent bid. The bidding in the auction, which centered around 2.23 per cent, was aggressive in that the rate was 1/8 per cent lower than a week ago. At the close last night, last week's bills were quoted 2.16 - 2.13. In view of this pressure, reflecting as it did the very large amount of excess reserves accumulated over the week end, the System Account sold $75.5 million of Treasury bills and other short-term issues, as well as $33.5 million of Treasury bills to foreign accounts. Other System action during the two-week period was confined to making moderate amounts of repurchase agreements which subsequently matured, and selling Treasury bills to foreign accounts. The Treasury's action in increasing the amounts offered in its weekly bill auctions by $100 million last week and by $200 million this week was also helpful in keeping the lid on the Treasury bill market. The Committee will recall that some weeks ago Mr. Thomas remarked that if free reserves were to be maintained at $500-600 million, a decline in bill rates below 2 per cent was inevitable. I think we all agreed with this statement, barring variations in supply-demand factors, psychological influences, and operations in other short-term securities. We have been fortunate in these respects. However, based on our projections the System Account will have to enter the market as a buyer before the next meeting of this Committee, putting additional pressure on the market and almost assuring a decline in rates such as Mr. Thomas mentioned. We can try to avoid such a decline by buying other than three-month Treasury bills, but it may turn out that the choice will have to be between a bill rate below 2 per cent or lower levels of free reserves.

The reduction in the discount rate at the Deutsche Bundesbank from 4 per cent to 3-1/2 per cent is encouraging as an indication of further support to the United States balance-of-payments position. Apparently as one result, the British Treasury bill was reduced to about 4.09 per cent before the week end, so that the spread in favor of those bills, with exchange risk covered, remains around 1 per cent despite the decline in U. S. Treasury bills. The long-term market for Government securities showed a mild spurt in reaction to the German move, but this market continues to be sluggish and cautious, in view of the same factors that have affected it for some time, i.e., expectations for a business pickup in the near future, uncertainties over the international situation, and uncertainties as to the policies to be pursued by the new Adminstration.

The next Treasury financing operation will be the refunding of the February 15 maturity of $6.9 billion 4-7/8 per cent certificates, of which the System owns about $3.6 billion. The initial question is whether the Treasury should refund through the normal exchange operation or adopt a cash refunding plan such as was last used in July 1960. One of the main objectives of the cash refunding technique is to enable the Treasury to curb speculative excesses in connection with refundings. There seems to be no need for protective measures of this kind at the present time, and it was evident last July that there were some serious objections to the cash refunding technique on the ground that it did not give regular holders of the short-term debt a fair opportunity to roll over through an exchange. However, there is something to be said for using the cash method occasionally just to keep the market alert to this possibility and to keep the "rights" value out of short-term rates. At the moment, the maturing February issue is traded without any significant premium for "rights" value, indicating that the market is waiting to see what the Treasury will do. Although the market is not buoyant, the Treasury should not encounter undue difficulty with this refunding.

In response to a question, Mr. Rouse said that dealer awards in yesterday's Treasury bill auction were about normal. Dealer positions continued to be very high, however. In this connection, he called attention to certain charts, attached to the report on open market operations distributed before this meeting, which related to dealer positions and money market rates.

Thereupon, upon motion duly made and seconded, the open market transactions during the period January 10, 1961, through January 23, 1961, were approved, ratified, and confirmed.

The economic review at this meeting consisted of a visual-auditory presentation, in which Messrs. Noyes, Marget, Williams, Garfield, Koch, and Young participated.1/ The presentation, which highlighted developments of the year 1960, contained sections on the balance of payments, changing demands for goods and services, the effects of changing private and governmental demands on industrial activity and prices, and financial developments. The concluding portion of the presentation was as follows:

> The aim of this morning's presentation has been simply to review the principal facts relating to economic developments in 1960. We have not tried to fit these facts into any theory of business cycles or of growth; nor have we attempted to assess the prospective impact of fiscal, monetary, or other Government policies on economic developments. In concluding the presentation, we shall not attempt an advance review of 1961 or any analysis of alternative policies with regard to the problems which the country now faces. Nevertheless, still holding to the spirit of the presentation, we can make a few observations which may be of some help in thinking about the implications of the present situation for the future.
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> The situation at the beginning of 1961, it is evident, is quite different from that at the beginning of 1960, different enough to make it clear that changes during 1961 will differ widely from those of 1960. In particular, the $15 billion shift from rapid inventory accumulation at the beginning of 1960 to liquidation at the end of the year will not be repeated. While liquidation may be faster for a time than the estimated $4 billion rate of the fourth quarter, any further downward pressure from this source will be relatively small. At some point, moreover, inventory liquidation will stop and if past experience is any guide this point should come sometime in the not too distant future. On the other hand, net exports are now at a sharply advanced rate and may turn down sometime in 1961. It will be important that no accentuation of the existing balance-of-payments problem result from this development. To avoid such a result will call for determined efforts to restore full confidence in the dollar.
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> The course of final domestic demands suggested by recent developments varies from continuing increases for State and local governments similar to those in 1960 to declines, at least early in the year, for plant and equipment. The actual balance of all changes in domestic final demands of government,

1/ Messrs. Garfield and Williams withdrew from the meeting at the conclusion of the economic presentation.

business, and consumers will largely determine how soon the decline in activity will end, how soon thereafter recovery will begin, and how far the recovery will go.

It will be recalled that in 1958 recovery began immediately after the decline ended whereas in 1954 the end of the decline was followed by about six months of little change.

One feature of developments in 1954 was a continuing decline in defense outlays to a new level lower than that prevailing before the end of the Korean War in mid-1953.

Basic questions concerning the underlying strength of demands in relation to available resources have been raised by several developments. A year ago, even though inventories were being accumulated at a near-record rate, unemployment did not fall to as low a level as in 1957 or 1953; the lowest rate was just below 5 per cent as compared with less than 4 per cent in 1957 and less than 2-3/4 per cent in 1953.

Again, the downturn started sooner this time, and it started before inventories had reached as high a level in relation to sales as in 1957.

In the housing field, vacancies have been rising--although the latest report shows no further increase--and observers are wondering whether present demand conditions will facilitate a recovery in housing starts as in 1958-59 and 1954-55.

Similarly, with plant capacity greater in relation to demand than earlier in the postwar period, can plant and equipment outlays be expected to stop declining soon and advance to higher levels than in the past? The answers to such questions are not simple; recent capital outlays, for example, have been much more for modernization than for plant expansion and the level of outlays for improving techniques of production and developing new products has reached a new high.

Study of any one of these problems reveals many interrelationships and many connections with the past, some with the past at least back to the war period. The present U. S. balance-of-payments problem, for example, is a sequel to a set of balance-of-payments problems successfully resolved by our trading partners abroad, partly through the new American policies embodied in the Marshall Plan and partly by a decade and a half of rebuilding and stabilization undertaken by the war-torn countries themselves. The present easier supply situation, with substantially reduced expectations of inflation in this country, has also come about over a long period. Recognizing that many uncertainties must be dissolved as the future takes its shape, the staff presentation today has focused on the facts of the present and the recent past in order to throw some light on possible developments over the year ahead.

It was understood that a copy of the text of the economic review and the accompanying charts would be placed in the files of the Committee and that copies would be sent to the members of the Committee and the Reserve Bank Presidents not currently serving on the Committee.

Mr. Hayes then presented the following statement of his views on the business outlook and credit policy:

> Such additional business statistics as have become available in the last two weeks point to a continuing decline in activity, with no evidence that the bottom has yet been reached. Of particular concern is the further rise in seasonally adjusted unemployment to nearly 7 per cent in December, and the seasonal peak in joblessness in absolute terms still lies ahead. December developments included not only widely diffused declines in employment and industrial production but also further weakening in personal income and retail sales, besides a sharp drop in new housing starts which may have been partly attributable to unusually bad weather.
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> Among the few brighter spots now discernible are the continued strong export surplus, indications of greater availability of mortgage money, which might have a favorable effect on housing trends, slight signs of improvement in steel production and orders, and the fact that business confidence is apparently holding reasonably high. There seems to be no evidence that the business decline has been feeding on itself to an alarming extent, with the principal downward pressure still apparently coming from inventory cutbacks.
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> As for credit developments, there is increasing evidence that monetary ease is making a contribution to cushioning the business decline and facilitating--though not sparking--a new advance. Commercial bank credit rose by a record amount in December, reflecting strength in both loans and investments; and the total rise in bank credit for the full year, attributable mainly to heavy acquisition of Government securities by banks during the second half, was far higher than in most recent years, although far below the 1958 gain. Bank liquidity improved

considerably in December and for the full year--in New York as well as outside of New York. While loan-deposit ratios are still relatively high by historical standards, they have improved somewhat. The improvement may be greater than the index indicates, for included in the loans are increased holdings of relatively liquid dealer loans.

Total and nonborrowed reserves showed gratifying gains from the early 1960 lows through the end of the year. In contrast with the sluggish recovery of the money supply proper, total nonbank liquid assets have risen at the annual rate of 3-1/2 per cent since the May trough--a rate almost equal to the average annual increase of the last decade.

Despite the highly favorable foreign trade situation, the balance-of-payments deficit and the outflow of gold have continued at disturbingly high levels. While the London gold price dropped sharply after the issuance of the Presidential order prohibiting United States citizens from holding gold abroad, it is clear that there is still a good deal of nervousness about the dollar in European financial markets. Thus, we cannot indulge in any relaxation of our intense concern over this sensitive area.

In the current setting, and for the next two weeks, it would appear that the System would have little choice but to pursue the present policy of "keeping steady in the boat." Bearing in mind the weak business picture, which calls for monetary ease, but also the balance-of-payments problem--and the important need to give the new Administration at least a breathing space to clarify its position and program on this and other major economic issues, I believe our open market policy should continue to aim at providing the banking system with ample reserves but not flooding it with reserves to the extent that short-term rates would be pushed lower. In fact I would think it of overriding importance, with respect to immediate policy objectives, that short-term market rates, and especially the three-month bill rate, be maintained at or above the general level prevailing in the last couple of weeks. I think it is very important also to hold the line on the discount rate, especially as the German central bank has just demonstrated its desire to cooperate by cutting its own bank rate in an effort to narrow the rate differential. During my recent trip to Basle, many of the central bankers expressed the fervent hope that this country would not undermine this spirit of cooperation in the delicate payment situation by allowing our own rates to drop at the same time.

I see no need to change the Committee's directive at this time.

While the immediate policy problem for the next two weeks does not seem too difficult, I hope that the Committee will be giving careful attention to some of the broader questions--long term in their implications, but highly relevant to the United States economy in 1961--concerning the role of the central bank in influencing the entire interest rate structure--besides the availability of bank reserves--in carrying out its broad responsibilities in promoting the sound growth of the economy. Certainly, in an economy striving to realize its potential in fuller measure, a good deal of attention must be given to the cost and availability of long-term funds. At the same time it seems quite possible that in the future we may be faced more frequently with a situation in which business fluctuations in this country are out of phase with those in the principal countries abroad, and in which interest rate differentials and attendant short-term capital flows are a problem. All of this suggests that the Federal Reserve System should demonstrate a willingness to be highly flexible in the development and application of its techniques for influencing credit flows and liquidity. There is always a risk that Treasury debt management may be assigned the role of stepping into a breach that the System has failed to fill, with consequences that might aggravate future problems of the System and the Treasury.

Decisions by the new Administration in the area of fiscal policy will, of course, have an important bearing on our own problems and policies. While the Government's approach in this area seems commendably cautious, there is always a possibility that new fiscal measures could create an excessively large deficit, with consequent difficulties in the monetary sphere. I am sure we shall all follow with interest the proposals for greater flexibility of fiscal policy through variable tax rates, with the attendant possibility of a greater measure of coordination between fiscal and monetary policies.

This is a time when readiness for experimentation seems to be "in the air." I would hope that the System, without abandoning any of its basic principles or objectives, could demonstrate that its policies and practices have not become frozen but can be adapted to meet changing needs.

Mr. Johns said that there appeared to be no significant differences between the state of business and economic activity in the Eighth District and in the country as a whole. Because of the diversification of business in the area, the District usually tended to be not quite as sensitive to fluctuations and changes in economic activity as the nation generally. However, at least in the metropolitan and other highly industrialized areas, this did not seem to be the case at the present time. In those parts of the District where agriculture is the predominant influence, people appeared to be feeling rather good, except, of course, for the automobile dealers. Last year's crops were good, and it was far too early to make any kind of guess about this year's crops. On the other hand, even in the smaller communities where industrial plants were located, there was a good deal of concern about slack conditions and unemployment, which was reflected in retail activities and otherwise. In St. Louis, where automobile assemblies had become more important in recent years, the unemployment situation was bad and deteriorating. In addition to the cutbacks more or less prominently publicized as inventory adjustments, there had been some temporary lay-offs, such as in Chrysler and Ford plants, for a week at a time now and then. In the Louisville area, activities at the General Electric appliance park were still contracting. No signs of pickup in residential construction were discernible in the metropolitan areas. Mortgage money seemed to be somewhat more available, but as yet there had been little change in rates. At a meeting of the Louisville Branch directors last week, the opinion was expressed that no substantial pickup in residential construction in that area was reasonably to be expected. Banking developments in the District resembled national developments so closely as hardly to warrant any detailed comment.

With regard to the two-week period ahead, Mr. Johns said that, all things considered, he continued to hold the view he had expressed two weeks ago, namely, that the policy directive, which called for encouraging some further expansion of bank credit, was correct. In this connection, he wished to emphasize, as he had done at the January 10 meeting, that he was advocating moderate expansion and not great aggressiveness. It was his view that the reserve projections supplied in a memorandum from the staff dated January 23, 1961, might appropriately be used as a guide. The projections as to total reserves needed were based on the maintenance of excess reserves of $700 million, and he felt that there should be some modest increment in total reserves. For this purpose, he would suggest as a reasonable target the figure of $50 million mentioned by Mr. Bryan at the January 10 meeting.

Mr. Bryan said that there were almost no new figures to report from the Sixth District. As far as he could judge, however, nothing significantly different was happening in the District than in the nation. As to the national picture, it was his conviction that although the deterioration of the economic situation was not at all drastic, nevertheless it was continuing and in all likelihood the situation would get a bit worse before it got better. In such circumstances, he felt that a moderate contracyclical policy was appropriate. As Mr. Johns had said, emphasis should be on the word "moderate"; the situation did not seem to call for dramatic actions. He was quite pleased with what had happened, vis-a-vis the reserve and other figures, since the January 10 meeting.

Mr. Bryan noted that in the staff memorandum of January 23, previously referred to by Mr. Johns, question had been raised as to whether expansion of the money supply at an annual rate greater than the 2 per cent rate that had occurred roughly over the past six months might not be appropriate. His answer would be that in a situation where the System was following a contracyclical monetary policy, a somewhat greater rate of expansion would be appropriate, and that the System should furnish the reserves necessary to permit such further expansion, either through bank loans or investments. In this connection, the memorandum also raised a question as to whether, in view of the new vault cash situation, the $500 million figure that previously had seemed to be the minimum practicable figure for excess reserves continued to provide an adequate benchmark. His inclination would be to think that the amount may have increased somewhat, but he did not know by how much; perhaps it would be only a few tens of millions of dollars.

In summary, Mr. Bryan said, his inclination was to agree with Mr. Johns that a modest increment to the projection of total reserves needed should be provided. Whether an increment of $50 million would be modest or not, he did not know, but he was inclined to settle for that figure as a reasonable target.

Mr. Bopp reported that Third District conditions continued relatively unchanged during the past two weeks. In other words, they continued to be about as unsatisfactory as he had reported at the January 10 meeting. One mildly heartening factor was that steel mill operations in the District were at a little better rate than that for the country as a whole. Even so, however, the level certainly was not high. Department store sales continued to be fairly good, and the unemployment situation, although bad, did not seem to be getting worse.

From the point of view of the domestic economy alone, Mr. Bopp said, it would appear appropriate to provide whatever monetary ease was possible. However, in view of the balance-of-payments situation, it seemed that there was little room to do much more than had already been done. He would not favor changing the directive or the discount rate at this time, and in his opinion open market operations should be conducted with a view to maintaining about the present degree of ease in the market.

Mr. Fulton said that the picture in the Fourth District was one of continued doldrums, even more so than in December. The factor that had contributed a further downward push seemed to be the abrupt falling off of automobiles sales. In some other sectors of activity, however, it seemed as though the downward drift might be leveling off.

Proceeding to a more detailed review of District developments, Mr. Fulton reported that there had been a seasonally adjusted increase of 3.5 per cent in unemployment in the most recent month, but that department store sales for this year, to date, were 12 per cent above the same period a year ago. Another possible "straw in the wind" was that a large plant supplying twist drills to the manufacturing industry claimed that the decline in its orders had halted over the past couple of months. Steel mill operations had increased slightly from the very low rate of December, but the industry was still in the doldrums. However, in primary metals, fabricated metals, and machine production, excluding transportation equipment, it looked as though the bottom may have been reached. Also, although there had been no upturn as yet, manufacturers of appliances appeared to feel the same way. Price-cutting was reported to be getting severe, however, and not much hope was seen for an improvement of profits. Construction, except for residential, had been holding up quite well, largely in the public sector. On the other hand, automobile companies had been cutting back their production schedules. They at first indicated they were going to produce about 450,000 units in January, but this was cut back to 434,000, and for February it was anticipated that only about 430,000 units would be produced. Inventories of over one million cars were proving to be rather unwieldly. Surprisingly, there did not seem to have been any substantial cutback in plans for plant and equipment expenditures, even in the steel industry. As an illustration of the type of expenditures contemplated, one smaller company had arranged for a credit to improve its mill facilities in a manner that would enable it, without any increase in the price of steel, to work profitably at a 50 per cent operating rate. The new facilities would also enable the company to eliminate about 2,400 men from the work force, which indicated why the District might be getting into a chronic condition of underemployment.

Turning to interest rates, Mr. Fulton told of having been informed that insurance companies in the District and elsewhere had been experiencing a considerable build-up of funds. At some point this situation should exert a downward pressure on yields. In other words, although one could not say how soon that might occur, the ingredients were there for a downward push on longer-term rates without any activity on the part of the System in sectors of the market other than those in which it had been operating.

Mr. Fulton suggested a possible change in the policy directive, noting that the last previous change, in October 1960, merely added a reference to international developments, and that the other part of clause (b) had not been changed substantially for a considerably longer period. A change such as he had in mind would not require a further change in policy at this time, but he felt that it would serve to recognize better the present posture of monetary policy. Specifically, his suggestion would be to eliminate the words "sustainable growth in economic activity" in clause (b) and substitute "economic recovery." He would not favor changing the discount rate at this time.

Mr. King said the suggestion that the System remain steady in the boat seemed to him to be a good one. This was a time, he felt, to ponder any possible contribution that the System could make toward maintaining confidence in the stability of the dollar. Not only people in this country, but people abroad with a vital interest in the strength of the dollar, would be watching every action of the Federal Reserve with great interest, and this led him to think that it might be possible to obtain a lot of mileage out of relatively modest actions. Most people, he thought, did not believe that the ills of any economy, certainly the American economy, could be corrected by printing more money, and any move, even though small, that the System could make on the other side should be beneficial from the standpoint of maintaining confidence in the dollar. He would not suggest doing anything radical or extreme. However, if the matter were approached from the standpoint of a choice between lower free reserves or a lower bill rate, he would accept lower free reserves, even if they dropped to the vicinity of $400-500 million. He would hope that a relatively easy atmosphere could be maintained in the credit market without having the bill rate go lower, and his own preference would be to see the bill rate move up somewhat if that was at all possible. In the circumstances, he would be willing to conduct further operations in short-term securities, other than bills, in the 15-month maturity area if that would offer any possibilities. In substance, if the System moved even slightly in the direction indicated, he felt that perhpas it could get a lot of mileage out of its actions in terms of confidence in the dollar; and with the economy in a state of stagnation, he believed that serious consideration should be given to trying to get whatever mileage was possible.

Mr. King went on to say that he realized the System was trying to walk a narrow path, but that he wondered whether the path had been as narrow as it should be. He noted that some who had formerly criticized System policy as being too tight were now criticizing it as being too easy, which led him to wonder whether the System might not have swung a little too far on the side of ease. Although he had a built-in bias against high interest rates, per se, in the present circumstances he was inclined to feel that any strengthening of rates probably would do more to promote confidence than if the System continued to play along the lines that it had been following.

Mr. Shepardson commented that some of the figures that had been reported, including those on unemployment, did not look too encouraging. On the other hand, he wondered whether present attitudes might not reflect seasonal influences to a considerable extent. Thinking back over the past several years, it seemed to him that every year about this time, with the exception of last year, there had been considerable concern expressed. Accordingly, he thought it would be a mistake at this point to attempt to push further toward ease. The manner in which savings were continuing to build up indicated that it was not a lack of money but a lack of values or a lack of confidence that was causing people to restrict their spending. The money was there, apparently, if the people wanted to use their savings. He did not think that anything would be accomplished by moving toward further ease, and that instead such a move would have an adverse effect on confidence in the dollar. Reflecting his concern about maintaining confidence, he hoped that there might be some little recovery in the bill rate. His preference would be to maintain about the degree of ease that had prevailed generally over the past period, and to let time and seasonal factors work a little. Aside from the usual seasonal factors to be considered, this year there were also the uncertainties associated with the change of Adminstrations, and the new Administration had not yet had time to indicate what policies it would elect to follow from among the many that had been suggested by various task forces. In summary, he would remain steady in the boat, and he would hope that, if possible, there might be some little improvement in the bill rate.

Mr. Robertson commented that everyone around the table was equally concerned about maintaining confidence in the stability of the dollar. However, some felt that primary importance should be attached to the domestic economy, while others thought that primary importance should be attached to the international picture. His own views had been well expressed by the statements of Messrs. Johns and Bryan, taken in combination. He believed that the best use of monetary policy at this particular time, in the light of the state of economic activity, which certainly showed no signs of moving upward, would be to provide a moderately greater degree of ease, even if the bill rate should fall lower than 2 per cent. The rate of 2 per cent had been mentioned as kind of a floor for the purpose of determining the appropriate volume of reserves. However, he would not be too concerned if the bill rate moved down; he doubted that the bill rate was the proper guideline for the establishment of monetary policy. Consequently, he would move in the direction he had indicated.

Mr. Robertson said that he saw no need for a change in the directive, because he felt that it contained ample latitude for the kind of policy currently being followed or for the policy that would be followed if his views were accepted. He would not object to eliminating the word "sustainable" from clause (b), but the taking out of that one word might create difficulties of understanding more than it would accomplish anything.

With reference to the comments that had been made to the effect that the System should keep itself in a posture of flexibility, Mr. Robertson said he thought everyone around the table would agree that the System should be flexible. This was a time of change, and the System should show that it could gear its actions to the needs of the day. This did not mean, however, that the System should jump in panicky fashion from one position to another merely to avoid the charge of being doctrinaire. Instead, flexibility should be based on views and principles that had been thought out well. This was more important than avoiding any charges of being doctrinaire.

Mr. Mills said that, as he interpreted the economic review presented to the Committee today, it placed primary emphasis on the balance-of-payments problem of the United States. This caused him to refer to the point of view that he expressed to the Committee some six weeks ago; namely, that it is not possible or practicable for the Open Market Committee to attempt to conduct a monetary and credit policy that will attempt to foster monetary expansion and growth in the economy at the same time that action is necessary to protect the integrity of the dollar in international markets. Evidence since that meeting had reinforced his views. He believed that the ease that had been injected into the position of the commercial banks through supplying reserves had given visible proof that an abundance of reserves at a time of receding business activity does not serve to promote economic growth or expansion, or even the expansion of credit except as additions are made to commercial bank protfolios of United States Government securities. Under present circumstances, that seemed to him a rather weak reed upon which to lean, particularly if at the expense of producing a climate damaging to the essential efforts that should be made to preserve international respect in the integrity of the dollar. As he viewed the shape of economic developments, they suggested depression rather than recession. Such being the case, it followed that the injection of reserves was not going to turn the economy immediately toward expansion. Along that line, he recalled that one of the charts used in today's presentation, which showed positive free reserves and negative free reserves over a period of years, indicated that after each of the periods when there was a sustained appearance of positive free reserves there was a succeeding period of unwise expansion of bank credit and an involvement of the Federal Reserve System in the difficulty of restraining inflationary pressures. He noted that fact only in the light of experience and because of the possibility that the tone of the discussion today and at previous meetings suggested a temptation to repeat what might be the same fatal error. He had great sympathy for Mr. King's observations about international confidence in the dollar, and he saw a necessity to move drastically to preserve respect for the dollar. Admittedly, there were grave risks in doing so, involving the possibility of spreading the depressive influences in this country to abroad. However, since the dollar is the linchpin in the scheme of international currencies, in his judgment protection of the dollar was vital. Personally, he believed that the System had allowed the time for action to drift, and that when any action was taken it would lack the effects that should be expected from it. This would inevitably leave the System in a position of having to depend on Providence rather than on conscious monetary action designed to deal with the balance-of-payments problem.

Mr. Leach said that no significant change in the general condition of Fifth District business during the past two weeks could be discerned from the information available. Recent increases in insured unemployment were somewhat more than seasonal. January clearance sales appeared to be sustaining or improving the relatively good level of business, seasonally adjusted, that most stores had in December. District automobile dealers, however, generally reported disappointing sales for the past few weeks. Since the last meeting of the Committee, a distinct ease had continued to characterize District banking as weekly reporting member banks continued to increase their liquid investments without borrowing.

With respect to policy, Mr. Leach said he thought this was clearly no time to rock the boat. To him, national and international considerations, which were fully discussed at the meeting two weeks ago, called for a continuation of the same degree of ease that had been the objective for several weeks. It might be too much, he said, to hope that short-term interest rates would continue at existing levels.

However, he thought the Manager of the Account should be careful to do what he could, within the terms of the Committee's instructions, to avoid any appreciable reduction in the ninety-day bill rate. By this, he meant buying other short-term Governments when this was practicable and not resolving doubts on the side of ease. He doubted that a few more reserves would materially improve the economy, and he believed a sizeable reduction in the ninety-day bill rate could prove harmful. This did not mean that he would subordinate System policy to the bill rate. What he was advocating was continuation of the same degree of ease, while keeping an eye on the bill rate, avoiding exessive ease, and buying short-term securities other than bills when practicable. Thus, it might be hoped that the bill rate would not go down, at least very much.

Mr. Leedy said there had been no developments in the Tenth District since the January 10 meeting that seemed to require a report. It appeared to him that the System had two fundamental responsibilities, neither of which it could escape. First, the System had a responsibility to make whatever contribution it could toward the recovery of the domestic economy. Second, it should not contribute to further deterioration of the problem with respect to the balance of payments. Although it was difficult to reconcile these two things, it seemed to him each of them was part of the System's total responsibility. The optimism that appeared to prevail at this particular time in the markets, and on the part of analysts, as to an early reversal of the present trend was an element in the System's favor. This kind of psychology tended to give the System a little more elbow room than might otherwise be the case. As he saw it, a further easing of the reserve position of the banks would contribute nothing at all. Therefore, for the period ahead, he would suggest that the System simply avoid tightening the reserve position of the banks materially. If some additional reserves were required, those operations should be undertaken in the part of the longer-term area in which the Committee's operating policies permitted operations to be conducted. He would be concerned about any further deterioration of the bill rate. As long as the bill rate remained substantially in its present area and as long as the Federal funds rate remained moderately below the discount rate--and certainly it had been far below in the past few days--a nominal sliding down of free reserves would not disturb him. In summary, for the period until the next meeting he would prefer to sit quite steady in the boat and follow policies such as he had outlined.

Mr. Allen reported that automobile manufacturers had privately revised their sales estimates for 1961 down to 5,500,000 cars, including 400,000 imports. Accordingly, with inventories again over 1,000,000 production schedules were being further reduced, and January output was now estimated at 430,000 units, the lowest January since 1952. February and March were currently figured at 450,000 and 550,000, which would make a total of 1,430,000 for the first quarter--29 per cent below a year ago. However, with the high inventories, and even assuming that the industry would be content to continue with them right up until the expiration of labor contracts on August 31, sales would dictate production schedules. And, as he had said, sales predictions were not encouraging.

Mr. Allen went on to say that unemployment compensation claims in the Seventh District had been heavy in recent weeks. The automotive cutbacks had been largely responsible, but there was evidence that production of most types of industrial machinery and equipment also was being reduced. However, in the midst of a generally gloomy picture there were a few signs of improvement in order trends. Producers of steel strapping, farm and construction machinery, and appliances indicated that orders had improved in recent weeks, as did die shops, but these reports were too fragmentary to signify a general rise in activity. District department stores were having a good January, with sales nicely above a year ago, and in the past four weeks Sears Roebuck sales, seasonally adjusted, were the highest since the record level of last April.

District banks reported further weakening, apparently more than seasonal, in the demand for bank credit. Total loans of reporting banks declined $275 million, and business loans $50 million, in the first two weeks of January. There did not seem to be any reserve pressures. The Chicago central reserve city banks were currently showing a basic deficit position of around $50 million, but that was more than accounted for by one dealer bank. Other money market banks had been consistent sellers of Federal funds in sizeable amounts. Although their positions had eased, the banks had shown no inclination to buy intermediate Governments, although they continued to increase their portfolios of municipal bonds. In the week ended January 18, reporting Chicago banks purchased $70 million of Treasury bills but sold a larger amount of one- to five-year Government issues.

After summarizing certain observations that were made at the meeting of the directors of the Detroit Branch last week, Mr. Allen said he agreed with the expressions that had been heard this morning about the importance of confidence in money and financial matters, at this time particularly. His own view as to the best course to follow in the interest of maintaining confidence was to sit steady in the boat, as some had expressed it. Therefore, he would not change the directive, the discount rate, or the degree of ease at this time.

Mr. Deming said that relative to a year ago Ninth District economic indicators pointed to better gains than did those for the nation. The December-to-December change in District debits was plus 1-1/2 per cent in contrast to minus 1 per cent for the nation; Minnesota personal income was up 4.8 per cent against a 3.2 per cent gain nationally.

In large part, the District's favorable picture reflected a good farm year, with net farm cash income estimated at 10 per cent higher than in 1959.

The stronger District gains in 1960, however, were partly illusory, for they were measured from a relatively weak 1959 base. It probably was more accurate to say that in 1960 the Ninth District merely came back on the same track on which the nation was running in both 1959 and 1960, and that the immediate future prospects for the District were not significantly better or worse than those for the nation.

District banking had shown substantial improvements in liquidity in recent weeks, reflecting both diminished loan demand and rising deposit totals. Relative to earlier years, however, the liquidity measures did not look so favorable.

Mr. Deming commented that in the past two months he had visited a number of countries in Asia and Europe, and had talked with a number of people. He then reported briefly on some of his findings, as follows:

> 1. The question of the value of the dollar is of no particular consequence in Asia, although the question of our balance of payments is of considerable consequence because the Asians fear that it may lead to some diminution in aid. There has been some feeling of uncertainty about the value of the dollar in Hong Kong, and perhaps some in Bangkok and Bombay, but it does not at present seem to be very serious.
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> 2. There is considerable concern about our balance of payments and about the value of the dollar in Europe, although that concern has lessened recently. The Europeans, however, are watching very closely to see what is done in

this country, and the concern could grow quite rapidly if they interpreted statements or policies in the United States as indicating too much of an easy money approach to our domestic difficulties.

3. The interest rate differentials between the United States and other countries have led to very substantial movements of funds, and these movements have been intensified by the concerns noted above, which have made other currencies and gold relatively more attractive.

4. In summary, I would say that there is a rather delicately balanced confidence in the dollar which is the product of (a) the record of the dollar as a hard and a reserve currency, plus the presence of a still huge gold reserve, plus the recognition that we do not need to devalue, and (b) the psychological or emotional feeling that perhaps the above points are not completely conclusive. That delicate balance could be lost rather quickly.

Mr. Deming noted that it had been said that the System was facing a policy dilemma because of the balance of payments and the course of the domestic economy. He does not see it quite that way, however. The domestic economy certainly was not buoyant, but neither was it waterlogged. The System had put a fair amount of liquidity into the banking system, and the banks did not seem to be suffering from lack of funds to make loans or invest in securities. On the other hand, the System was faced by a rather shaky confidence in the value of the dollar. As he saw it, the policy choice, while perhaps not crystal clear, was reasonably well indicated. Policy should be influenced more by the international monetary climate than by the domestic economy.

Thus, Mr. Deming said, he was more concerned at present about interest rates than about measures of reserves or the money supply; more concerned about the effects of too easy a policy than too tight a policy.

Ideally, he would like to see short rates up and long rates down, to see ready availability of funds at somewhat higher rates than now prevailed, and to see the rate on time deposits lifted. However, since he did not see how these ideals could be attained very easily, he would settle for about the current availability of funds and the hope of some rise in short-term rates, or at the least no decline in them. To him, this meant continuation of present policy, with no change in the discount rate, no change in the directive, and emphasis on rate maintenance as a guide to open market policy.

Mr. Mangels said that scattered and incomplete data for December and January that had become available since the January 10 meeting did not indicate much change in general business conditions in the Twelfth District. Department store sales since the first of the year had held about even with a year ago. There had been some price reductions in copper, and some curtailment of output. In lumber, plywood prices had dropped from $68 per thousand to $60 per thousand, which was equal to the postwar low reached last summer. This price was somewhat below the cost of production at some of the smaller mills. However, steel production had improved a little to the highest level since last July, and the mills expected a continued increase in demand. Twelfth District mills, of course, do not produce much steel for the automobile industry. Unemployment claims in the District as a whole increased in December, but there was a drop in unemployment in California and particularly in Washington, where the rate fell from 6.8 per cent in November to 6.0 per cent in December. Compared with December 1959, unemployment in the District was about 49 per cent higher. District banks showed a loan decline of about $100 million in the two weeks ended January 11; holdings of Government securities were down about $80 million, and demand deposits dropped a little less than $50 million. Time deposits increased rather substantially ($60 million), reflecting mostly deposits by States and political subdivisions. Savings deposits declined $18 million, substantially less than the $250 million decline that occurred during the comparable period of 1960. The small San Francisco bank computing interest on a daily accrual basis showed an increase of 14 per cent in savings deposits in the first 10 days of the year, and a Los Angeles bank following the same procedure also showed a substantial increase. There had been no borrowings from the Reserve Bank since the first of the year. District reporting banks had excess funds and reported that they expected to sell five or six times the amount of Federal funds that they would buy this week. District banks were still using excess funds in the Federal funds market rather than investing those funds in Government securities.

As to policy, Mr. Mangels commented that the System was still facing the dilemma presented by the domestic situation on the one hand and the international situation on the other. It was generally recognized, he noted, that monetary policy alone could not resolve either problem. Recently, a college professor was quoted as having said that when facing the horns of a dilemma, one possibility is to grab both horns and try to throw the animal to the ground. Another possibility is to analyze the situation, determine whether it is better to grab one horn or the other, and proceed on that basis. On entering this meeting, Mr. Mangels said, he had fairly well concluded that if the System grabbed the domestic horn and did everything that monetary policy could do, within recognized limitations and with the hope, of course, that debt management and fiscal policy would do their part, a recovery in business activity could be stimulated. If that occurred, the improvement would generate increased demands for credit, which in turn would firm up interest rates and thus help the international situation. This line of thinking would suggest continuing a policy of ease, with free reserves in the area of $600-700 million, not too far, that is, from what had prevailed. As to the bill rate, Mr. Mangels referred to a paper of recent date in which the author suggested that a policy designed to keep the bill rate from falling when the domestic economy was on the verge of stagnation would be self-defeating; that such a policy would only hamper economic recovery and growth; and that this would induce an outflow of long-term capital. Mr. Mangels went on to say that he realized that the views he had held placed him in the minority at this meeting and that, as he listened to the discussion today, he felt that he might have been a little wrong in his judgment.

As far as the directive was concerned, Mr. Mangels said that he thought language along the lines suggested by Mr. Fulton perhaps would be suitable to the present situation. As to the discount rate, he still felt that it should not be reduced, but he wished the System were in a position where a reduction could be made. Some of the San Francisco directors felt that it would be a good thing to reduce the rate, but in all the circumstances he would not recommend such action at this time.

Mr. Irons said that Eleventh District developments during the past couple of weeks were not significantly different from those he had reported previously. In general, they followed the national trend rather closely, and he did not feel that they had particular significance from the standpoint of the determination of monetary policy. He would say, however, that the banking situation was one of genuine ease. Borrowings from the Federal Reserve Bank were negligible, and sales of Federal funds had been substantially in excess of purchases. The loan decline in the first few weeks of the current year was moderate, possibly less than seasonal, and the banks had added to their holdings of Government securities. Total deposits had been moving upward, a slight decline in demand deposits being more than offset by the increase in time deposits.

As to policy, Mr. Irons said it seemed to him that there had been a very easy credit position over the past three weeks, and possibly before that. Free reserves had been quite high and Federal funds had been almost constantly on the bargain counter, so it seemed that there was almost a surfeit of reserves. He concurred in the view that this was a situation where there should be no overt or drastic action, and he did not believe that any change in the directive was necessary at the moment. However, he felt that the policy of the past few weeks, or few months, had led the System gradually into a position of more aggressive ease than was warranted or justified, and he would like to see some of that ease recaptured. The Treasury bill rate had been tending to hold in the lower part of a range that the Committee had talked about earlier, but he would prefer to see it move in the upper levels of that range. In other words, he would be glad to see that rate show a slight upward tendency. He would not want to reduce the discount rate to bring it in line with other short-term rates; instead, he would like to see other market rates brought up into better relationship with the discount rate. This, he thought, could be done through open market operations without taking overt or drastic action. The objective that he had in mind was that the Federal funds rate would firm up within the range of 2.5 to 3 per cent, rather than 1 to 2 per cent, with the bill rate moving into the 2.5 per cent area rather than softening below 2.20 per cent. In his opinion, if more attention could be given to rate aspects as a guide and less to maintaining $600 to $700 million of free reserves, that would be a much better policy for the situation with which the System was now confronted. In summary, he would not want to change the discount rate; instead he would like to see the bill rate move into better relationship with the discount rate. Accordingly, he would absorb some of the ease that the System had put into the market.

Mr. Erickson reported that statistics on department store sales, automobile sales, and construction in the First District were still slightly better than the national figures. However, the situation with respect to production and employment continued to be discouraging. In the first two weeks of 1961, District banks reported an expansion of commercial and industrial loans, compared with a reduction a year ago. The gain was 7 per cent.

Mr. Erickson said he saw no reason to change the directive or the discount rate. In view of the balance-of-payments problem, he thought the System should concentrate more, in operations of the Desk, on trying to have a Treasury bill rate somewhere within the present range than on trying to attain any certain free reserve figure. If it was necessary to put reserves into the market, he would not hesitate to conduct transactions in short-term securities other than bills.

Mr. Szymczak indicated that he would not recommend any change in policy. In his opinion, the policy that the System had been pursuing was about the best that could be devised, because of the two horns of the dilemma. It must be recognized that the interest rate structure has a relationship to the balance-of-payments situation. To repeat, he felt that what the System had been doing up to this time was about as right as it could have been under the circumstances. The picture might become more clear after the President's State of the Union Message had been delivered next week and some idea could be obtained as to the thinking of the new Administration. Also, the situation might be clearer after the Committee had heard from the Ad Hoc Subcommittee on its study of operating techniques and after the terms of the Treasury's February refunding had been announced. In any event, however, the balance-of-payments situation was at the heart of the problem, not only here but abroad.

Mr. Balderston said that Messrs. Mills, Deming, and Irons and others who spoke in similar vein had expressed his own concern at the moment. It was his feeling that the System, for the time being, had supplied as much in the way of reserves as the economy was willing to use. Consequently, at the moment he would pay more attention to short-term rates than to further ease. In essence, his suggestion would be the same as he had made two weeks ago, and the same as Mr. Irons had made today. He would supply such ease as the System supplied less aggressively, with the hope that the Treasury bill rate might rise somewhat. The Federal funds rate had been substantially below the discount rate, he noted, and that rate was worth watching as an indicator of the degree of ease in the market. He would not favor changing the directive or the discount rate.

Chairman Martin commented, with reference to the expression used by Mr. Mangels, that he did not think there was any real dilemma about the choice of horns: it was necessary to grab both of them. Continuing, he said he had come to the belief that there was every indication that money was on the side of being too easy rather than the reverse. Also, from a personal survey he had made, he could not escape the belief that some of this money was going into the stock market. While mortgage rates might not be down as drastically as some would like, the fact remained that money was available to the public. After commenting on a recent conversation with an insurance company executive which pointed up the extent of the availability of funds, the Chairman noted that reports from abroad, such as that of Mr. Deming, confirmed the emphasis that was being placed on the balance-of-payments situation. These reports all indicated that there was a delicate balance of confidence in the dollar. Thus, there was a problem in respect to rates that was different than heretofore. In the circumstances, he would certainly go along with those who had expressed the view that the Treasury bill rate was a matter of real importance at the present time. To sit by while the bill rate slipped to, say, 1.5 per cent would in his opinion be irresponsible. Likewise, in his opinion a reduction of the discount rate now would be an act of irresponsibility. The discount rate should be brought in line at some point, but this was not the time.

After expressing the view that in the present circumstances no overt actions were called for, Chairman Martin said that the burden of proof now rested on those who thought that money was tight, not on those who thought it was too easy. As he saw it, there was plenty of money every place in the economy. While rates might not be what one thought they should be, nevertheless the money was there. In time, the rates would make an adjustment.

The Chairman repeated that in his view serious consideration should be given to the bill rate; the problem should be thought through. Question had been raised whether the Committee should go into longer-term securities or, if not, how the situation should be handled, but in any event one could not just simply say that the System would supply reserves. The problem was a little different than that.

Under normal circumstances, Chairman Martin commented, he thought that the Committee's operating procedures had been clear. Generally speaking, he felt that they were the right operating procedures. However, he did not think that these were normal circumstances. One must be concerned about the short-term rate, about reserves, and about the arbitrage that occurs in the market.

The Chairman said that he hoped the Desk would use its best judgment at this time. Further, if it appeared as though the bill rate was going through 2 per cent, he thought that perhaps the Committee should have telephone meetings. The situation was too serious just to sit by and let things develop in that way. In one sense, he suggested, this was a disorderly market situation. It was not a disorderly market in the sense in which that term was used in the Committee's operating policies, but there were nevertheless some of the elements of a disorderly market situation because of world interest rates and the world pull on funds. While that pull might be temporary, the problem was serious and the System should not let the situation get away from it.

Chairman Martin suggested that the next meeting of the Federal Open Market Committee be held on Tuesday, February 7, and, there being no indication of dissent, it was understood that the next meeting would be held on that date. It was also understood that the date of the next succeeding meeting would depend on developments.

The Chairman then said that it was the clear consensus that there should be no change in the directive and no change in the degree of ease in the market. He did not believe there was much that could be added to what would appear in the minutes to help guide the Manager of the Account; that is, there was not much he could add to the comments that each individual had made.

Chairman Martin inquired whether there were additional comments, and Mr. Hayes said he assumed that the Chairman meant to include in the consensus the distinct concern about the level of the short-term rate that most of those at this meeting had expressed.

Chairman Martin replied that that was what he had been trying to express in his comments on the bill rate. He believed that most of those around the table had expressed that concern.

Mr. Bopp commented that, although he had not expressed himself on the point earlier, he would go along with the expressions of concern regarding the bill rate.

Chairman Martin then indicated that, in the absence of further comments, the directive would be approved on that general basis, and no further comments were heard.

Thereupon, upon motion duly made and seconded, it was voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the Committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the Account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million.

At the suggestion of the Chairman, Mr. Hayes summarized the nature of views that had been expressed to him and Mr. Coombs during their trip to Europe earlier this month to attend a regular monthly meeting of the Bank for International Settlements, following which Mr. Deming commented on observations he had heard during his recent assignment in the Far East and in the course of his return trip through Europe. Mr. Hayes commented that it had been brought home to him repeatedly that trips abroad by System representatives, to the extent that they could reasonably be arranged, were most helpful from the standpoint of all concerned.

The meeting then adjourned.

Ralph A. Young

Secretary