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, May 9, 1961, at 9:00 a.m.

PRESENT: Mr. Hayes, Vice Chairman, presiding
Mr. Allen
Mr. Balderston
Mr. Irons
Mr. King
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Swan
Mr. Wayne

Messrs. Ellis, Fulton, Johns, and Deming, Alternate Members of the Federal Open Market Committee

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

Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Coldwell, Einzig, Garvy, Mitchell, and Noyes, Associate Economists

Mr. Molony, Assistant to the Board of Governors
Mr. Sammons, Adviser, Division of International Finance, Board of Governors
Mr. Holland, Adviser, Division of Research and Statistics, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors
Mr. Yager, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Petersen, Special Assistant, Office of the Secretary, Board of Governors

Mr. Hickman, Senior Vice President, Federal Reserve Bank of Cleveland

Messrs. Eastburn, Jones, and Tow, Vice Presidents of the Federal Reserve Banks of Philadelphia, St. Louis, and Kansas City, respectively
Messrs. Black and Litterer, Assistant Vice Presidents of the Federal Reserve Banks of Richmond and Minneapolis, respectively
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta

Upon motion duly made and seconded, Mr. Coldwell was elected as an Associate Economist of the Federal Open Market Committee to serve until the election of a successor at the first meeting of the Committee after February 28, 1962, with the understanding that in the event of the discontinuance of his official connection with the Federal Reserve Bank of Dallas he would cease to have any official connection with the Federal Open Market Committee.

Upon motion duly made and seconded, the action of the Federal Open Market Committee on April 28, 1961, in approving the recommendation of the Manager of the System Account that the Account subscribe for $1,700 million of the new Treasury 3 per cent certificates maturing May 15, 1962, and $700 million of the new Treasury 3-1/4 per cent notes maturing May 15, 1963, and that the remaining $295 million of the total Account holdings of $2,695 million Treasury securities maturing May 15, 1961, be run off was ratified, approved, and confirmed.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period April 18 through May 3, 1961, and a supplemental report covering the period May 4 through May 8, 1961. Copies of both reports have been placed in the files of the Committee.

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

Open market operations since the last meeting of the Committee have been more difficult than in preceding periods, as diverse influences in bank reserves and interest rates produced a number of dilemmas for the Management of the System Account, requiring more than usually complicated efforts to meet System objectives. In the first part of the period the money market became excessively easy as a result of an unexpected bulge in float which aggravated already strong downward pressures on short-term rates. Some sales of short-term issues were made on Monday, April 24, in an effort to mop up the excesses and to temper the drop in short rates, but very large sales would have been required to influence the rate strongly and to meet the demand for bills. This demand was illustrated by the bids for $677 million bills and $172 million certificates received on a "go-around" conducted on that day. Massive sales seemed unwise in the face of a sharp decline in reserve availability projected for the next statement week. Despite moderate System sales, the 91-day bill rate dropped to 2.18 bid in the auction that day, the lowest level since December 1960. Fortunately, some dealers showed resistance to this lower level, and market rates subsequently rose to around 2.30 per cent.

In the middle of the same week, we learned that the Deutsche Bundesbank was planning to make a debt repayment of $487 million to the Treasury in dollars on Friday, April 28, which would require the sale of about that amount of Treasury bills for German account. This was a windfall of a sort inasmuch as we were able to take the bills into the System Account and thereby avoid the necessity for substantial System purchases of securities in the market. The Treasury was credited with the proceeds and then redeposited the proceeds in the "C" banks, thereby increasing the reserve balance. These redeposits had the effect of concentrating available reserves in the money centers, and creating excessively easy money conditions despite a somewhat lower level of free reserves than had recently prevailed. The easy money conditions added to downward pressures on short rate which again reached 2.18 per cent for 91-day bills on Wednesday, May 3. Once again massive sales of short issues seemed inadvisable for the same reasons as before. Yesterday Treasury bill rates backed up a bit, with average issuing rates of 2.23 and 2.42 per cent established for 3- and 6-month bills in yesterday's auction.

Part of the problem with short rates has arisen from repeated press comments, from various sources, to the effect that since the balance of payments has improved, the System is satisfied to see short rates go lower. We have tried to deal with these situations by selling short issues a bit more aggressively as a signal to the market that we are still concerned with short rates. But since these sales have been running contrary to our desire to supply reserves, we have tried to offset them by purchases of longer issues which have not always been available in sufficient size to meet our need. Our purchases over a period have, of course, absorbed a large portion of what might be termed the floating supply of longer issues.

Considerable publicity has been given to statements by Secretary of the Treasury Dillon and the majority of the Joint Economic Committee with respect to longer-term rates. Such statements, together with continued System and Treasury buying, seem to be encouraging a more confident market attitude toward longer-term securities. There has been evidence of increasing willingness to commit longer-term funds, especially in corporate and municipal securities. Retail buying of Governments has been modest, but even this small demand, given a shrinking supply, has had the effect of pushing up prices sharply on several occasions. In each instance new selling has emerged at the higher prices, and moderate System and Treasury purchases have been sufficient to hold these levels. It is quite conceivable, however, that if the incentive for switching out of Governments into corporates and municipals continues, we may be faced at some time with considerable selling pressure on longer Governments. Signs of this are lacking so far, and in the meantime the flow of funds into the corporate and municipal issues continues at a fair pace.

The successful completion of the Treasury's cash refunding operation seems to have further encouraged a firm tone in the Government securities market. The terms were considered very attractive, and despite the fact that the new issues were only one- and two-year maturities, there was more than the usual speculation on the part of brokerage houses which entered very large subscriptions. The overallotment by the Treasury of $500 million on both issues combined seems to have been taken in stride by the market and, of course, the additional cash will reduce the Treasury's need for new borrowings in the near future. The latest projections indicate that they will need to come to the market about June 22 for roughly $1.5 billion new money.

> At the last meeting of the Committee, Mr. Rouse asked whether the provisions contained in the special authorization to acquire intermediate and longer-term issues could also be included in the regular directive given to the Federal Reserve Bank of New York. He has decided not to recommend this in view of the feeling in the Committee that the arrangement under which we have been operating was satisfactory to everyone.

At the request of Mr. Hayes, Mr. Sherman reviewed the terms of the special authorization, stating that advice of the authorization, when first sent to the New York Bank in February, was worded in terms of the minutes of the meeting of the Committee held on February 7, 1961. Thus, the authorization was for the Bank, within the terms and limitations of the policy directive, to acquire intermediate and/ or longer-term U. S. Government securities having maturities up to 10 years, or to change the holdings of such securities, by an amount not to exceed $500 million between that date and the next meeting of the Committee.[1/] Mr. Sherman went on to say that he, Mr. Young, and Mr. Rouse had discussed the words "acquire" and "change", and it was agreed that they meant to purchase, sell, or exchange and, in addition, to swap. The meaning was considered to be as broad as the opening sentence of the policy directive, which covers purchases, sales, and exchanges. In addition, the words were considered to cover swap transactions.

Mr. Hayes asked whether the Committee agreed that it would be just as well to leave the matter as it stood, and no different

1/ The maturity limitation was removed by the Committee at its meeting on March 28, 1961.

view was expressed. Accordingly, it was understood that no change in procedure would be made.

Mr. Mills referred to the statement by Mr. Holmes and said that he would like to raise a question to straighten out his own thinking. In the past three-week period, market conditions had afforded an opportunity to engage in purchases in the longer-term sectors of the market for the System Account, and those purchases apparently had focused on specific securities with the intent of holding the prices of those securities at some predetermined level set by the judgment of the Management of the Account. His question was whether, with the acute knowledge of market participants as to what was going on in the market, engagements of that sort might not be regarded as an approach to, if not an actual, pegging operation.

Mr. Holmes replied that it was the practice to make purchases from dealers approaching the Desk with offers, to which prices were attached. The Desk then compared the prices quoted by the dealers with the composite, or rough average, of market prices. In other words, the purchase rates were related to the composite of the market rather than to any predetermined price.

Mr. Mills then inquired whether, if the Desk concentrated its purchases in certain securities, it was not acting to influence the price, and hence the interest yield, of those specific securities.

Mr. Holmes said that the selection of securities for purchase was based on the securities that were offered, and how the price of those securities related to the prices of those securities in the market. No specific issues were chosen in advance. Instead, the Desk took what was available in the market.

In reply to a question from Mr. Mills concerning whether, as the market became accustomed to System operations in longer-term securities, the Desk sensed that offerings would tend to be in the maturity ranges regarded by the market as acceptable to the Account, Mr. Holmes replied that there had been a substantial increase in offerings of longer-term securities by dealers. However, the Desk was still getting offerings of shorter-term securities as well.

Mr. Mills then said he had the impression that the Account was skating on rather thin ice in some of these operations.

Mr. Hayes remarked that it was not quite clear to him how the Desk could operate more effectively. As Mr. Holmes had indicated, the Desk received offerings throughout a wide range of maturities and prices, and it took those securities that were favorably priced in relation to the composite of market quotations, regardless of maturity. It was not the practice of the Desk to decide in advance what issues it would take.

Mr. Mills commented that the Committee was experimenting, and now had gotten behind it some area of experience. In reviewing the experimentation, he sensed that the Desk was perhaps participating in the market more aggressively than was called for by the state of the market or Committee objectives.

In reply, Mr. Hayes said it was his observation that in view of the difficulty of finding a sufficient quantity of longer-term maturities to have the desired effect on reserves, the Desk sometimes had had to take a fairly good portion of what was offered to it.

Mr. Holmes confirmed this observation, stating that on some days when the Account Management was particularly anxious to supply reserves the Desk had to take a substantial proportion of what was offered.

Mr. Hayes then commented that it was necessary to look at the matter within the context of the dilemma the Committee had discussed frequently. Many times, in order to keep the reserve position consistent with what the Committee had indicated that it wanted, the Desk had to find some way to inject reserves. When short rates were under pressure, there was a greater inducement to be relatively liberal in making purchases in the intermediate and longer ranges.

Mr. Mills said that much would seem to depend on the reasons for pressure on the short rate. In the recent period it appeared that the pressure had been the result of a superfluous supply of reserves not counteracted by market actions. This situation apparently had resulted from unforeseen increases in float. In any event, it seemed to him that accidentally, rather than by design, the supply of reserves in the market during two of the statement weeks had been a far cry from what was envisaged at the April 18 Committee meeting.

Mr. Hayes remarked that there had been greater ease than intended.

Mr. Holmes added that float was much higher than expected in the first week of the period. In the second week the Treasury, by depositing the German payment in money market banks, had made their positions far easier than would otherwise have been the case. Over the last week end the money market firmed up, and the present reserve position was a more normal one.

Mr. Robertson noted that by accident the results of the past three weeks were about in line with the position indicated by the minority at the April 18 meeting of the Committee.

Mr. Hayes remarked that, as indicated, this was not intentional. In response to the earlier comment by Mr. Mills, he added that there was a difficult problem in reconciling the extreme ease in the money centers with over-all reserve positions. In the circumstances, the Account Manager had some hesitancy about running over-all free reserves down too low in relation to the levels of previous weeks. As it was, free reserves outside the money centers did run substantially lower than they had been. Such circumstances always require a difficult judgment, and Mr. Hayes' feeling was that the judgment made by the Manager was a reasonable one.

Thereupon, upon motion duly made and seconded, the open market transactions during the period April 18 through May 8, 1961, were approved, ratified, and confirmed.

Mr. Noyes made the following statement with regard to economic developments:

This morning I should like to review for you quickly some of the most significant data that have become available in recent weeks, and then take a few moments to relate these recent developments to a projection prepared by the staff here early last winter; and also to Professor Samuelson's task force report to the President-elect, released January 6.

Perhaps the most striking economic statistic on current developments is one yet to be announced--our own index of industrial production. We still do not have all the information, but it appears that March will be revised up from 102 to 103, and April will be up two points from that to 105.

But this is not an isolated fact. Not only is the April index of department store sales now estimated at 150--but March has been revised upward to 146--more than wiping out the decline from February to March suggested by the preliminary data. Total retail trade was first reported up 1 per cent from February to March, and later revised to show a 3 per cent increase. Sales of domestically produced autos were at a 5.2 million annual rate in April--about the same as March, which was up sharply from the depressed mid-winter level. Dealer stocks are down further--now well below a year ago and close to the same level that prevailed at this time in 1959. Used car stocks are also down sharply from a year ago, and even below the 1959 level.

Among other selected developments, consumer credit moved up again in March, after two months decline. New orders received by durable goods manufacturers picked up in both February and March, and with sales improved, the backlog of unfilled orders began to increase again. Business inventories were liquidated further in March, especially at the retail level. The latest McGraw-Hill survey of plant and equipment expenditure plans for 1961 indicated a 1 per cent decline from 1960, an improvement over both the Commerce-S.E.C. survey earlier in the year and their own survey last fall.

While consumer and wholesale prices have generally been stable, sensitive commodities have moved up--regaining 2 percentage points of the 7 per cent decline that occurred from January 1960 to February 1961.

In addition to these developments, the schedules for steel and auto production in May virtually assure some further increase in the production index this month--perhaps enough to wipe out half of the decline since last year. For the current quarter, all the available evidence points to a substantial rise in GNP.

It is hard to characterize these developments as representative of a weak or anemic recovery--yet we observe two facts: first, seasonally adjusted unemployment, at 6.8 per cent of the labor force in April, remained at about the mid-winter high; and second, yields on medium- and long-term Government bonds declined further in recent weeks to the lowest levels since 1958.

The apparent inconsistency between these facts and the vigorous recovery in the economy generally leads me back to the projections I mentioned at the outset of my remarks.

In what he referred to as his "optimistic" model, Professor Samuelson estimated that unemployment would "not shrink much or any below present levels in 1961." The November figure of 6.8 per cent was the latest available at the time the report was written. This estimate of unemployment was based on the assumption that GNP would "decline for at most one or two quarters," and that it would rise to a little less than $520 billion by the end of the year, yielding an average for the year as a whole "of from $510 to $515 billion." Our own so-called Model A projection, which we described as one of moderate recovery, was very similar to Professor Samuelson's. We had GNP declining to around $500 billion in the first quarter, rising moderately in the second, and then going on up to a little better than $520 billion in the fourth. On the basis of these assumptions we calculated that unemployment might rise well above 7 per cent in the second quarter, and that it would remain close to 7 per cent in the fourth.

I have reviewed this background to make clear that either in terms of Professor Samuelson's estimates or our own, a 6.8 per cent unemployment rate in April is completely consistent with a very substantial improvement in economic activity generally.

Similarly, with regard to recent interest rate developments, the estimates of financial flows we made on the basis of the aforementioned assumptions as to economic activity implied declining long-term rates in the first half of 1961. You will recall that Mr. Thomas discussed these projections in his report to the Committee in March. At that time he observed that "with respect to interest rates, there is a popular view that any economic recovery will bring about a rise in both long-term and short-term rates. This view is based, in part, on expectations as to credit demands and, in part, on beliefs as to shifts in monetary policies. This may not be a necessary conclusion. Although pressure for further declines in short-term rates might come to an end, it is not certain that a marked rise in interest rates will accompany the earlier stages of recovery." Later in the same report he pointed out that even assuming the early recovery envisaged in our model, private credit demands in 1961 would be the lowest in five years. It must be remembered that, while a reduced rate of inventory liquidation will probably contribute to the increase in GNP from the first quarter to the second, net inventory liquidation will almost certainly continue in April, with consequent repayment of bank borrowing. Furthermore, the substantial volume of financing in the capital market has been used, to some extent, to repay bank loans. Thus, it seems clear that neither the recent course of interest rates nor the very moderate rate of bank loan expansion in recent weeks reflects on the strength of the recovery that is under way.

Both the level of unemployment and interest rate movements which have accompanied the recovery thus far are those that we should, and in fact did, anticipate. The recovery is proceeding more rapidly than was generally anticipated, and at least as fast as the most optimistic forecasts.

The problem this poses for monetary policy is almost too obvious to mention. In the very early stages of an upturn, the burden of proof falls on those who would not continue the prevailing degree of ease. But we are now rapidly approaching the point, if we have not already reached it, at which the generally recognized principles of countercyclical monetary policy would call for a lessening of ease--and perhaps even a somewhat restrictive policy. This is not to say that a policy of ease should not be continued, or even that special efforts should not be made to promote further ease in longer-term credit markets. My point is only that in the conditions now prevailing, and which seem likely to continue to prevail, a responsible monetary authority should have specific and unequivocal reasons for maintaining a policy of active ease. Uncertainty as to the economic outlook is no longer a sustainable basis for such a policy. It is true that uncertainty is still with us, as it always is, but it is an inconstant ally, and it has shifted sides.

In response to a question from Mr. Deming regarding estimated gross national product in the second quarter, Mr. Noyes indicated that there were a lot of question marks. Probably for the quarter as a whole the best guess was that there would be no net inventory liquidation or accumulation. Also, there was the question whether the United States would lose anything from the first quarter to the second in terms of net exports. As a guess, an upward movement of GNP of from $5 to $7 billion, annual rate, might be possible, but as he had indicated this was dependent largely on how the inventory and net export figures came out.

In reply to a comment by Mr. Deming that he would not classify such an increase as a strong rise, Mr. Noyes said that it would require a rather strong movement toward the end of the quarter to realize the figure he had mentioned. Inventory liquidation was still going on fairly substantially in April. It would be necessary to look within the quarter to see the true strength of the recovery.

Mr. Thomas commented that GNP of $505 billion, annual rate, was the highest quarterly rate on record, having been attained in the second quarter of 1960.

Mr. Thomas presented the following statement on the credit situation:

> Information becoming available during the past month has indicated some progress toward certain of the goals of credit policy. Business recovery appears well launched,

growth in the money supply is continuing, and intermediate- and long-term interest rates have shown marked declines, except in the case of the corporate market, where there has been an unusually large volume of new financing.

At the same time, short-term interest rates have also declined and funds continue to flow abroad, although at a much reduced rate compared with late 1960. The private money supply increase has been only moderate, and seemed to stem from an exceptionally large decrease in Treasury deposits rather than from any notable expansion of total bank credit. Business loans, in fact, showed a considerable decline in April. Reserves were available to banks in somewhat larger volume during April than during March, despite a sizable reduction in the System portfolio. Reserve availability declined last week, however, and, perhaps reflecting this change, yields on Government securities turned up yesterday.

Yields in the Government securities market declined fairly steadily from April until the end of last week. They more than retraced the upward adjustments in rates that occurred during the last half of March and early part of April and were associated with the heavy concentration of financings in that period and the spreading feeling that the recession had touched bottom. Long- and medium-term yields have declined to the lowest levels since 1958, and the three-month bill rate has been close to the low end of the relatively narrow range maintained since last summer.

Basic supply and demand factors contributing to this yield decline in the longer-term area of the market, and also in the medium-term area, were the slackened pace of Treasury and State and local financings, and the successful absorption of an unusually large amount of flotations in the corporate securities market. Recurrent purchases of securities maturing in over five years for System and Treasury accounts may also have been a factor in lowering yields on such issues. Yields on corporate bonds have risen, however, and the spread between yields on high-grade corporate issues and those on long-term Governments is close to the widest of recent years.

The bill market drew strength from the investment of corporate accumulations of tax funds and the proceeds of securities issues by corporations and various State and local authorities. Reductions in Treasury cash balances may also have supplied some funds to the market. Bank reserve positions eased as the month progressed, and, with the Federal funds rate low, some flow of bank funds to the bill market took place. Dealers built up very large positions in bills in the first half of April, but though they subsequently reduced them they still ended the period with a higher level of holdings than in March. Dealer positions in other short-term issues increased during April. Psychological or expectational factors may have had some influence in the trend of bill rates, including a less exuberant tone in the stock market and press reports speculating about official moves to keep down interest rates.

To absorb some of the reserves provided by market factors and to resist the decline in short-term rates, the System made gross sales of $1.3 billion of bills and other short-term securities (due in 1 year or less) between April 5 and May 5. Purchases of nearly $500 million of bills from the German authorities partially offset these operations, but substantial sales of short-term securities were also made on behalf of the Treasury as part of the maturity lengthening operations being undertaken for its investment accounts. In the same period System Account purchases of longer-term issues exceeded $300 million and other purchases in that area were made for the Treasury.

Within the banking system, credit expansion continued during April and early May, though at only a moderate pace. Total loans and investments of city banks increased somewhat less in the five weeks ending May 3 than in most other recent years. A similar trend was shown by other banks in the four weeks ending April 26. Holdings of Government securities increased by $1 billion at city banks in the 5-week period, reflecting Treasury financing, in part, which often occurs in April of each year, with an increase of over $1.5 billion in issues maturing in less than one year held by city banks. Commercial banks participated importantly in the advance refunding in late March, and thereby shifted holdings from the 1-5 year to the over 5-year category.

Holdings of State, local, and agency securities by city banks were about unchanged over the period, with new purchases more or less offset by the usual seasonal redemptions of municipal tax anticipation notes. Total loans, meanwhile, rose much less than usual in recent weeks. The most striking loan developments during April were a drop in business loans and an increase in loans on securities.

Business loans at city banks dipped in April about as much as in the comparable period in the recession years of 1954 and 1958. A moderate recovery is indicated by preliminary data in the week of May 3, but not sufficient to offset the previous decline. Net repayments were recorded during April from industries with seasonal inflows of funds in this period, from those continuing to reduce inventories, and from firms which may be drawing funds for bank debt retirement from refinancings in other markets, particularly utilities and related lines. One exception was the petroleum and chemical sector, which borrowed more during April than in most other recent years, including a substantial volume of term credit.

Loans for purchasing and carrying securities have risen more substantially than any other form of private credit at leading banks in recent weeks. Most of this advance has been in credit to brokers and dealers. Loans to Government securities dealers mounted in step with the build-up of dealer positions in short-term securities from the reduced March level. Loans to other brokers and dealers have also increased, as did other loans on securities--this increase was most marked in the week in which the A.T.&T. rights expired, but with further increases continuing to be reported in succeeding weeks.

Deposit expansion proceeded in substantial volume at commercial banks during April. The bulk of the increase centered in time accounts, which moved up a billion and a quarter dollars in April, a much larger rise than in most other recent periods. The increase continued at city banks in the week of May 3 (nearly $200 million). A substantial proportion of this net increase was accounted for by the rise in negotiable time certificates of deposit, as interest rates on such instruments appeared increasingly attractive with the decline in bill rates. This increase included the deposit of some of the proceeds of recent corporate security issues.

The money supply, seasonally adjusted, is estimated to have risen moderately in the second half of April to $142.3 billion, or $300 million above the second half of March. For April as a whole the private money supply averaged $800 million larger than in February, an annual rate of increase of 3-1/2 per cent. The April average is about $2 billion, or 1-1/2 per cent, larger than a year ago, when economic activity was somewhat higher than this year. A decline in the Treasury cash balance to unusually low levels during April undoubtedly helped to sustain the expansion of privately-owned demand deposits.

Recent deposit expansion has carried required reserves substantially above earlier projections. By the beginning of May required reserves averaged $300 million higher than the estimated needs which had been projected from February, after allowing for the lower level of U. S. Government deposits. A substantial portion of this expansion occurred in the second half of April, when market factors in excess of offsetting System operations gave rise to free reserves averaging around $650 million. Reserve absorption by market factors since that time lowered free reserves to about $450 million last week and probably to around $350 million for the current statement week, after allowing for System purchases of nearly $100 million yesterday. Reserves supplied by market factors late next week and during the following week will be largely offset by the scheduled net redemption of $295 million of System holdings of May 15 maturities.

Further purchases for System Account will be needed this week and substantial purchases will be necessary in the last week of May and the first week in June to bring total reserves to the projected level of needs. Intervening sales of securities in the middle of each of these months may be required in order to offset temporary reserve inflows from other sources. On the average, over $500 million of additions to System holdings from the present levels will be required to provide the reserves called for by projections through July and August.

Any less than the supply of reserves indicated would surely be inadequate to foster economic recovery. Yet, if recovery is going ahead, it is highly unlikely that supplying the amount indicated or perhaps somewhat more would have the effect of reducing interest rates to any appreciable extent from present levels. At the same time, unless economic expansion proceeds very rapidly, it is possible that no substantial rise in interest rates would need to occur for some time.

Mr. Sammons presented the following statement on the international situation:

What might be termed the "basic" elements in the balance of payments--that is, those elements other than the higher-than-normal outflows of short-term capital, both recorded and unrecorded--have continued to show in the first quarter of this year a partly cyclical movement toward an increasing positive balance for the United States. The balance on current transactions, Government aid, and private long-term capital apparently exceeded an annual rate of $1-1/2 billion, seasonally adjusted. The gold outflow has virtually ceased during the past 2-1/2 months. But private short-term capital outflows, although somewhat reduced, continued high in the first quarter, so that there was still an over-all deficit (as conventionally measured) at an annual rate of about $1 billion. The greater part of the $3 billion reduction in this deficit between the fourth quarter of 1960 and the first quarter of 1961 was due to changes in the basic items--including some changes that may be temporary in the outflow of funds for Government aid and private long-term capital.

The continued outflow of short-term capital occurred despite a reduction in the difference between short-term rates in the United States and in most other important money markets--or in those cases where foreign interest rates are lower than in the United States, a widening of the negative difference. In March and April, there was also a large outflow of funds to Continental centers from London--where interest rates across the board have remained relatively high. Evidently, speculative factors, including the opportunity for capital gains accompanying reductions in German long-term interest rates and the belief that additional exchange rate adjustments might yet occur--were playing a larger role than pure short-term interest rate differentials in stimulating shifts of short-term funds.

The short-term rates that now seem to be having the most substantial influence on capital movements are bank lending rates. The relatively low level of these rates in the United States has induced borrowers in Continental Europe as well as in other areas to seek accommodation in New York rather than in other centers, and thus has contributed to outflows of short-term capital from this country in the form of bank credit.

The recent further reduction in the German discount and Treasury bill rates is important, according to this analysis, not so much because of its immediate probable effects on the inflow of short-term capital into Germany, but because of its possible impact on the basic German balance of payments through an expansion of German demand for consumption and investment.

There remains the question of exchange rate expectations. The United States authorities can directly influence the decisions of foreign monetary authorities regarding the form in which they hold reserves mainly through the recently much-discussed international cooperation of central banks. Apart from that, United States monetary policy can affect international flows of volatile capital in one obvious but vital way; it must continue to eliminate any suspicion that a change--planned or unplanned--in the international value of the dollar might even remotely be thought possible. This objective--which of course coincides with the basic objective of the Federal Reserve to avoid inflation--is, in my opinion, and at least for the present, the most significant restraint which international pressures impose on the freedom of action of the United States monetary authorities.

In summary, recent movements of volatile capital have been influenced mainly by (a) exchange rate speculation; (b) differences in bank lending rates; and (c) opportunities for capital gain, especially in German fixed interest securities--and have not been much influenced by traditional interest-rate arbitrage operations in money market instruments.

If this analysis is correct, its implications for monetary policy are fairly evident. The problem of the rate on short-term money market paper, while not negligible, is not crucial. A further decline in United States long-term rates would seem to be unlikely as business activity rises here, but in any event would not be a favorable factor for the balance of payments if it did occur. Also, a decline in bank lending rates here would probably tend to stimulate further capital outflow in the form of bank credit to foreigners.

One other international fact is relevant now. This is the widespread resumption of growth in demand in Europe, following a lull last year. Though output growth will be limited by capacity problems arising out of labor-market tightness, sizable advances are possible this year through rising productivity and through utilization of slack that existed in some countries at the end of last year--especially in Britain. The United States will continue to get benefits from this renewed growth of demand abroad, but to maximize those benefits and to make them lasting calls for holding price advances in this country to a minimum.

In response to a question from Mr. Ellis, Mr. Sammons said that he did not feel that the short-term open market rates had been as critical a factor in recent weeks as earlier. Instead, the outflow of short-term funds from the United States might be attributable more to the relatively low level of bank lending rates in the United States.

Mr. Allen said he gathered from Mr. Sammons' statement that foreign concerns were finding bank lending rates in the United States attractive, and Mr. Sammons replied that German concerns, particularly, were said to be borrowing in New York. The rates were lower than in Germany, and the procedure provided a hedge against a further revaluation of the mark.

Mr. Hayes expressed the opinion that the exchange protection feature was a more important factor than the interest rate. Many loans were being made to German exporters who bill in dollars and expect to receive dollars.

Mr. Hayes then asked whether, even though the actual flow of funds due to interest rate differentials might not have bulked large recently, it was not felt that the 90-day bill rate might have a psychological influence abroad.

Mr. Sammons replied that he thought this was quite possible. The impression foreigners got of United States monetary policy based on short-term rates might be rather important.

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

> While it now seems clear that business is on the upgrade again, there remain a number of major uncertainties as to the business outlook. One is, of course, the question whether the expansion will be slow or rapid. There is no real basis for a solid judgment on this, although considerable initial thrust

could result from a changeover from inventory liquidation to accumulation. Another major uncertainty concerns the probable course of prices and whether inflation will again become an important threat within the coming year or so. An important factor will be the extent to which businessmen try to restore weakened profit margins by raising prices, as against a policy of seeking to solve the same problem by maximizing volume at currently prevailing, or in some cases perhaps even lower price levels. It seems to me probable that the strength of consumer demand may be affected importantly by price developments, as the Chairman suggested in his Boca Raton speech. And of course decisions in this area will be affected by the intensity of further cost pressures, reflecting in part the type of wage settlements to be made this year in major industries, especially the automobile industry.

As already suggested, the changing inventory situation may well be a major factor in business expansion in the coming months. We can also find encouragement in recent data on business spending on plant and equipment; manufacturers' orders; housing starts; and personal income and retail sales, among other items. Whether the recovery is slow or rapid, the problem of getting back to a reasonably full level of employment seems very difficult. We have made some very rough calculations indicating that 3.3 million jobs might have to be found over the coming year to reduce unemployment to, say, 4 per cent of the labor force. The dollar increase in GNP needed to reach this goal would appear to be very substantially greater than the GNP gain actually achieved during the first year after the trough of any of the previous postwar recessions.

As for bank credit, the statistics for all commercial banks in March and for the weekly reporting banks in the first four weeks of April generally point to a weaker performance, in relation to comparable periods of recent years, than had been observed in February; and this is particularly true of loans. However, there are a number of special factors in partial explanation of this, so that the bank credit showing does not necessarily cast doubt on the probable strength of the recovery. It is heartening to note some improvement in bank liquidity ratios in April, both in and outside of New York--as well as good gains in total nonbank liquidity in March, the latest month for which data are available.

In view of widely expressed fears that larger Federal spending programs might, after some interval, lead to deficits approaching the $13 billion recorded in 1958-59, it may be well to point out that that unusually high total reflected several major special factors which are unlikely to recur soon. It is hard at present to find any spending areas likely to lead to a runaway deficit; and on the other hand, a business expansion faster than is now anticipated could cut quite sharply the deficits of uncertain but rather moderate size now in prospect for the next year or two.

With respect to policy, the basic considerations dictating a policy of monetary ease remain unchanged. In view of the fact that banks are still much less liquid than at the outset of earlier post-war recoveries, and with an abundance of unused resources in the economy (both labor and plant capacity), we can well afford to maintain the existing policy for some time to come, deferring our traditional posture of "leaning against the wind" at least until later in the expansion phase of the cycle.

Although we are hearing a good many comments on the "excessively timid" approach of the Federal Reserve System to the task of encouraging lower long-term interest rates, it is quite evident that there have been strong market factors at work in the direction of higher rates--including growing and widespread business optimism, an increasing volume of new corporate bonds and mortgage financing, and the Treasury's advance refunding of last month. Under these conditions we have probably done well merely to counter these tendencies and contribute to an atmosphere of reasonable stability or even mild buoyancy in bond prices, and it would be worth while to see what we can continue to accomplish along these lines.

In the short-term rate area our policy has been criticized too for not permitting an adequate rate decline. As a matter of fact I think it would be a grave mistake to permit short-term rates to decline materially from present levels. There is a very dangerous tendency to look upon our balance-of-payments difficulties as a thing of the past, whereas I am convinced that we have only begun to cope with our hard-core balance-of-payments problem, faced as we are with the possibility of less favorable circumstances in the future for our trade balance, and with the virtual certainty of a heavier, rather than a lighter, foreign aid burden. Our basic competitive position in the world is still strong but could easily be jeopardized by unsound wage and price policies. The automobile wage settlement, for example, will be watched keenly abroad as well as here. Also, dollar holdings of some major central banks are currently at a level which could prove embarrassingly high if we fail to do all we can to preserve confidence in the dollar. Our balance of payments did not show any improving trend during the first quarter, despite the large improvement in that quarter as a whole over the showing of last fall; and the prospective favorable balance for April will probably be due entirely to the nonrecurring German debt repayment. Last week the Bundesbank, in cutting its discount rate to 3 per cent, demonstrated again its willingness to make a deliberate contribution to help restore international equilibrium, even though such an endeavor might be hard to reconcile with purely domestic considerations. It seems to me the very least we can do is to meet our foreign friends halfway by doing what we can to avoid a further decline in our own short-term rates. This means, among other things, maintaining firmly our 3 per cent discount rate, as an anchor for our short-rate structure.

As for open market operations, I believe that any purchases called for over the weeks to come should be concentrated in the intermediate and long sectors, while heavy sales in the short end may be necessary to prevent a further decline in short-term rates. Much of the recent downward pressure on these rates is due to reinvestment purchases by issuers of long-term securities who are apparently trying to beat an upturn in long rates. At some point the pressure will be relieved as these funds gradually move out of the short-term market into the spending stream, but meanwhile the downward pressure on short-term rates constitutes a serious problem which may make it necessary to let free reserves decline somewhat from recent levels. Such a decline would not compromise domestic policy objectives. The money market has been exceptionally easy recently, and there has been a gratifying loosening in the flow of longer-term capital funds at somewhat lower rates. Under these conditions a rigid free reserve target is probably even less warranted than usual, and I can see no objection to free reserves in the $200-$400 million range provided other signs point to a continuing atmosphere of ease.

The directive, having just been amended, should, I think, be reaffirmed in its present form.

Mr. Hayes added the comment that his view on short-term rates was based to a large extent on conversations and contacts with foreign central bankers and other foreign parties. In talking with Chairman Martin on the telephone recently, he was interested to learn that the Chairman also had received the same general impression. The Chairman had volunteered the opinion that it was quite important that the System not let the short-term rate weaken appreciably, even if that meant, perhaps, a lower level of free reserves.

Mr. Ellis reported that New England business conditions, in general, showed signs of gradual recovery from an unsatisfactory level. Unemployment was, of course, always pointed out as an unfavorable factor, but there were other elements of an unsatisfactory nature. As an illustration, Mr. Ellis described the situation in respect to the marketing of Maine potatoes. As to unemployment, the March level of 7.9 per cent compared with slightly lower figures for the United States, and there appeared to be less than seasonal strength in the factory segment. Construction activity strengthened in March. The strength was largely in the residential component, and multi-unit awards were up substantially. However, the total was still down 4 per cent compared with a 6 per cent gain for the country as a whole. Figures on new orders showed some strengthening in April, consumer spending was holding up well, and bank debits were strong in 22 cities.

Deposits of District banks had risen during the past eight weeks, Mr. Ellis said, while business loans declined a little more than seasonally. About 10 per cent of the savings banks reduced their mortgage rates 1/4 of a percentage point or more from February to March. Banks had been increasing their holdings of bills and increasingly were net sellers of Federal funds. Borrowing from the Reserve Bank was at a five-year low.

Turning to the credit conditions generally, Mr. Ellis referred first to the high level of corporate issues, which obviously had accounted for some of the decline in business loans. He also noted that banks had had their liquidity restored somewhat; the average loan-deposit ratio was down about two percentage points from a year ago although still at a relatively high level. The money markets appeared to be flush with reserves, as indicated by the low Federal funds rate. As suggested by the views he had expressed at the April 18 meeting, money market conditions in the past few weeks had been just about as he would like at this stage of the business cycle. It would be necessary to supply some reserves intermittently during the next four weeks, and he would judge that the proper way was to continue in about the same manner as during the past several weeks. To supply needed reserves, he would suggest purchasing maturities of over one year. At this stage he would not seek to expand purchases of longer maturities for the purpose of affecting long-term interest rates.

Bill rates below 2-1/4 per cent had been experienced recently, Mr. Ellis pointed out, without visible impact on the outward movement of short-term capital. The small differential on covered movements of short-term capital suggested that, although the threat of an accelerated outflow of funds was still present, this was not an overriding factor. On the other hand, he would not like to have the System press its luck too far; probably the System should not accept a penetration of the short-term rate below 2 per cent. An adequate stimulation of investment flows apparently was being obtained at present rates, which led him to accept the present pattern as a general goal for the next four weeks. From that point of view, and in recognition of the points raised by Mr. Noyes, he would be willing to retreat from the position expressed by the minority on April 18 to the position expressed by the majority of the Committee. He would not recommend a change in the discount rate at this time, and he would not favor a change in the directive until economic recovery had been more firmly established. To summarize, he would supply needed reserves by purchasing maturities over one year, and if necessary he would sell bills and buy longer-term securities. Also, he would favor renewing the special authorization covering operations for the Account in longer-term securities.

Mr. Irons said that Eleventh District conditions were similar, generally speaking, to those reported nationally. There were an increasing number of signs of strength; while many of them were not very substantial in amount, the number had grown. The situation with respect to both employment and unemployment had improved moderately. Improvement also was noted in construction, with further increases indicated in that area of activity. Although department store sales had not been rising sharply, they were quite strong, and the agricultural situation seemed generally favorable. The prevailing attitude of businessmen and bankers appeared to be one of confidence. He sensed, however, that there might be a trace of awareness of the Government deficit; people were beginning to think a little more about that, and possibly the anticipated rise in Government spending, and were beginning to wonder whether this would mean sooner or later a resumption of inflation. While this was not in the forefront of their thinking, it was tucked away in the back of their minds.

Mr. Irons said that the District banking situation was easy. Deposits were up substantially from year-ago levels, with just over half of the increase represented by time deposits. During the past three weeks loans, investments, and deposits were down slightly, and borrowing from the Reserve Bank was minimal. Federal funds transactions were at a lower level on both the buying and selling sides.

Mr. Irons commented that, although the reasons may have been plausible, during the past period ease became a little more active than he would have liked. He appreciated the various market factors that had prevailed. However, judging from the level of rates and other developments that took place, reserves were very readily available, and Federal funds were trading at low rates. In his opinion there should certainly be no further easing; possibly there should even be some lessening of ease, although not necessarily any deliberate move in that direction. He would be influenced by the level of rates as reflecting the state of the market more than by any free reserve figure, but he was inclined to believe that the System might be getting to the point where maintenance of some given amount of free reserves would be itself expansive and contributory to a more active ease than the statistic alone would indicate. Essentially, however, he would not be too much concerned about where the level of free reserves was set as long as excessive ease was avoided. In his view the bill rate should be in the area of 2-3/8 to 2-1/2 per cent, at least not lower than at present, the rate on Federal funds should move to at least the range of 2-1/4 to 2-1/2 per cent, and other short-term rates should be at relative levels. Such a situation would still signify a policy of ease. He would not advocate a tightening policy at this stage in view of the extent of unutilized facilities and manpower. The economy was not producing, in general, at anything near capacity, and the System therefore could afford to be a little easier, or less restrictive, than it otherwise would be until these unused resources were brought into play. At the same time, however, he questioned the degree of ease that had existed in the past period.

Mr. Irons said that he would not change the directive at this time, and he felt strongly that there should be no change in the discount rate. For a free reserve figure he would say somewhere around $400 million, but he would discount the value of any such figure. Rather, he would urge that the Desk give consideration to the feel of the market and to the rate structure, and not inject funds in an effort to bring about a statistical figure that would not mean much if attained.

Mr. Swan commented that on the basis of the more complete March data now available, evidences of recovery in the Twelfth District were still quite moderate. A slight seasonally adjusted increase in employment was more than offset by a gain in the labor force, with the result that unemployment rose a little from February. However, if, as appeared to be the case, recovery in the District had not yet been as vigorous as in other parts of the nation, he would not be too surprised because heavy industries, including steel and autos, are not relatively as important in the District. To illustrate, steel production in April rose more rapidly than in the nation, but that rise did not have as much impact on the District picture, in which aircraft and lumber are considerably more important. As to lumber, including Douglas fir, after the upturn in new orders in late February and early March, orders in the first three weeks of April dropped below the March level. A more substantial pickup in housing was needed to sustain any appreciable increase in demand for lumber. As to aircraft, it appeared that the abatement of layoffs that occurred in March might prove to be somewhat temporary. Southern California firms were now predicting further layoffs in the next three months.

Mr. Swan noted that a small gain occurred in commercial and industrial loans at District weekly reporting banks in the three weeks ended April 26, in contrast to the national decline in that category. By and large, however, additional funds that had become available to the larger banks in that period were invested in bills. State and local governments had also been heavy buyers of bills, using the proceeds of the April property tax payments. Savings and other time deposits continued to rise quite substantially at weekly reporting banks.

Mr. Swan said that the policy of the past three weeks seemed to him quite appropriate. Apparently the fluctuation in the bill rate from 2.30 to as low as 2.18, along with free reserves of well over $600 million in two of the three weeks, had not exerted adverse effects from the international standpoint. If it so developed, he would not object to the bill rate declining to somewhat below the present levels. In the prevailing circumstances, he saw no particular basis at the moment for a change in policy, as reflected by the results of the past three weeks. Apparently, there was increasing evidence of recovery nationally, yet the oversupply of manpower and plant capacity was still quite impressive, and he saw no indication as yet of the bottlenecks that tend to give rise to inflationary pressures. Therefore, he would continue a program of supplying reserves moderately in excess of seasonal needs to contribute to the expansion of bank credit and the money supply referred to in the policy directive, even though the bill rate remained at present levels or on occasion dropped below those levels toward 2 per cent. He agreed with the view that the free reserve figure had become less and less useful, and he would not care to specify any particular level as a target. However, he hoped that it would not be necessary to have any very abrupt or substantial change from recent levels. He would not favor changing the discount rate or the directive at this time.

Mr. Deming said that there had been no particularly significant developments in the Ninth District. Manufacturing employment had been gaining and retail sales looked quite good. Total personal income in March was 6.8 per cent above March 1960, while cash farm income for the first quarter was about 12 per cent above 1960. Thus, the District appeared to be moving along in just about the same manner as the country.

Mr. Deming agreed with the view that there was no longer any uncertainty about the fact of an upturn, at least as to direction. He did not see the upturn as strong, however. Gross national product of $507 billion in the second quarter might be a new peak, but it would not be a very impressive peak, being only about one-half a percentage point above the previous one. Continuation of the second quarter rate of gain throughout the rest of this year would produce a gross national product of about $520 billion in the fourth quarter, a figure that also was not very impressive, representing a gain from the previous peak and from the fourth quarter of 1960 of only about 3-1/2 per cent. This development certainly would not push very hard against the nation's capacity or against the high level of unemployment.

It had been suggested, Mr. Deming brought out, that classical monetary policy might call for some movement toward restraint, or at least abandonment of ease, at this stage of the cycle. He was not at all sure that this was correct, however, given the excess capacity prevailing in the economy, the relatively high loan-deposit ratios still evident (despite some recent improvement in them), and the relatively low money supply--GNP ratios, which were about where they were in the 1920's. It seemed to him that these factors argued for continuation of present policy, which he would call "adequate" rather than "active" ease. On the one hand, the excess capacity factor would argue for continued "adequate" ease; on the other hand, the relatively low liquidity factor would argue that there was little danger in continuing such a policy, for control could be exercised fairly quickly if a shift to more restraint seemed indicated in the future.

Thus, Mr. Deming continued, without attempting to press funds on the banking system, he would advocate keeping the reserve supply ample so as to permit credit expansion without any build-up of pressure, at least until a significant cutback of excess capacity of plant, materials, and manpower could be foreseen fairly clearly. In essence, this policy called for keeping a loose rein on reserves--not letting the horse run completely free but not snubbing him either. What this meant in terms of free reserves, particularly when the Committee was still concerned about short-term rates, Mr. Deming could not say. He would hope that free reserves could be kept in the neighborhood of $500 million, but he would temper this goal as necessary to keep short rates from falling. He would continue the discount rate at 3 per cent, both as an anchor to short rates and as a symbol that the System was not easing further. He saw no reason to change the directive.

Mr. Allen reported that business appeared to be moving slowly upward in most metal-using lines, with some indication that the uptrend might accelerate. An important factor was the completion of voluntary inventory reduction in the durable goods manufacturing industries. Although these inventories declined by $400 million in March, much more than in earlier months, there was evidence that some of the reduction was not planned but resulted from larger shipments than expected. Unemployment compensation claims and data on new hires indicated a modest improvement in the job market in most areas of the Seventh District, and reports from State employment offices suggested that this trend would continue in the next several weeks.

The steel industry was increasing production as orders began to "snowball," to quote Iron Age. At the end of April the steel production index was 100 for the country, 102 for Chicago, and 113 for Detroit. Auto industry orders were beginning to put some strain on cold rolled sheets.

Automobile sales in April were 466,300, or 3 per cent above March, but 17 per cent below April of last year. May sales, aided by sales contests, were forecasted at 520,000, and June sales at 535,000. If those forecasts were realized, total second quarter sales will be 1,515,000, or 13 per cent below a year ago. Indications were that new model change-overs would begin on July 15 and that the last shutdowns would be in the third week of August. That, along with the expectation that styling and engineering changes would be minor, should mean full tilt production by mid-September. Inventories of new cars, 913,000 on April 30, or 100,000 units below last year, were expected to remain around 900,000 until July when they would begin to drop seasonally. About 475,000 current models were expected to be left in stock on September 1, whereas last year there were 798,000.

A field survey of lenders, builders, and real estate brokers in the Chicago and Milwaukee areas provided confirmation of reports that the housing market remained weak at the beginning of the 1961 season, although builders were somewhat more optimistic over prospects for the season than they were a few weeks ago. The supply of mortgage funds was comparatively easy, with FHA 5-1/2's available at par and 20 to 25 year 80 per cent conventionals at 5-3/4 to 6 per cent. Lenders showed no enthusiasm for the 40-year, no downpayment FHA's.

In the agricultural areas of the District, interest in the feed grain program was unexpectedly high, Mr. Allen said. Reports from the Corn Belt indicated that the total sign-up might well run over 50 per cent, with much higher proportions in the cash grain areas. This degree of participation should mean rising corn prices next spring and summer, in the absence of substantial CCC sales.

Despite increasing evidence that the economy was now moving upward, bank credit had been slow to expand. For the months of March and April, reporting banks in the Seventh District showed a decline of $307 million in loans and investments, of which $143 million was a decline in loans. The continued inventory reduction, some of it not planned, was undoubtedly a factor. The Chicago money market banks had shown a basic surplus position for the past several weeks, with both deposit gains and loan declines contributing.

Under the circumstances, Mr. Allen said, the banks seemed to be sufficiently well supplied with reserves to support a substantial increase in loans as and when the demand showed up, and he favored carrying on the current degree of ease until the next meeting. In the light of current quotations on Treasury bills and Federal funds, he would not like to see the degree of ease augmented, and he did not feel that the recovery had proceeded to the point where the Committee could seriously consider a tightening move. He would not suggest changing the directive or the discount rate. If there was a time in the current cycle to lower the discount rate further, he felt that it had passed.

Mr. Clay commented that the latest information on developments in the national economy was encouraging in giving evidence that the recovery phase of the business cycle was under way. It must be recognized, however, that these developments constituted only the beginning of the substantial economic expansion that would be required in order to obtain a satisfactory level of resource utilization. For its part, monetary policy would need to be conducted with a view to facilitating economic recovery and expansion by making the requisite funds available to the banking system and by encouraging favorable conditions in the credit and security markets. At the present time, this called for a continuation of the policy of monetary ease.

In carrying out open market operations, Mr. Clay said, appropriate recognition would have to be given to the international flow-of-funds problem so far as the impact on the Treasury bill rate was concerned. On the other hand, it also was important for domestic monetary policy that the bill rate not be maintained any higher than necessary. Just what that international level might be was difficult to assess accurately, but the range of the past two or three weeks did not appear unduly low.

Continuing, Mr. Clay remarked that developments in intermediate and longer Treasury yields since the last meeting of the Federal Open Market Committee had been particularly noteworthy. While it frequently was not easy to explain just what factor brought about a particular market development. and in this instance there probably were several factors, the downward adjustment did occur in the context of Federal Reserve operations in these maturity sectors that were modest in size. It appeared that market expectations with respect to Treasury and Federal Reserve intentions played a key role in the downward adjustment in these longer-term yields. It was to be hoped that those expectations would not be destroyed by either open market operations or open mouth operations on the part of the Federal Reserve, for a further reduction in long-term rates would be desirable as a means of stimulating recovery and expansion.

Mr. Clay suggested, rather, that further operations be carried out in those sectors as a part of the program of making the necessary additions to reserves of the banking system and in connection with offsetting operations that might be required for maintaining the Treasury bill rate within an appropriate range. Moreover, he suggested that these probing operations be concentrated more heavily in longer maturities than heretofore to obtain more effect on longer-term yields.

In conclusion, Mr. Clay indicated that he would not recommend a change in the directive or in the discount rate at this time.

Mr. Wayne reported indications that recovery in the Fifth District had continued into its third month. Virtually all principal manufacturing industries were holding their own or advancing, and there were widespread reports of rising orders in the past three weeks, suggesting that further expansion was likely. Textile industry spokesmen had been somewhat heartened by announcement of the Administration's seven-point plan for assisting the industry, which suggested that the industry's plight was at least understood in some quarters. Stocks of raw cotton were being built up with borrowed funds in anticipation of increased support prices this fall.

Continuing, Mr. Wayne said a check indicated that leading banks that had been active in Federal funds in recent weeks had, with the greater ease that developed, switched from net sellers to net buyers in order to profit from the differential between rates on very short-term investments and rates on Federal funds. It was also reported that a main reason for the marked shortening of portfolios was the expectation that interest rates would increase later this year. It was expected that loan demand would be fairly strong in the third and fourth quarters, and in several areas there appeared to be some expectation that increasing Government spending would lead to a renewal of inflationary pressures, probably by early next year.

Turning to the national picture, Mr. Wayne commented that recovery seemed to be proceeding with encouraging vigor. He saw nothing to be gained from any additional ease, but he also believed that it would be premature to begin tightening in view of existing overcapacity and unemployment. Like Mr. Deming, he would favor adequate ease as contrasted with active ease. In view of the strengthening recovery, he felt that the Committee must begin to think in terms of moving cautiously and gradually toward a neutral reserve position, but not at this early date. In his opinion it would not be advisable to lower the range of free reserves that had prevailed prior to the past few weeks. Recently the situation had unfortunately been too easy, and he would suggest a range somewhere around $400-$500 million, with any doubts resolved on the side of the lower level. In any event, maintaining a fixed free reserve figure may result in constantly increasing the volume of reserves, which could go beyond the Committee's intent and lead to a too rapid contraction of reserves at some later date. He would not favor a change in the directive or in the discount rate at this time.

Mr. Mills commented that the record of movements in the supply of reserves during the past three weeks showed up the kind of pitfalls that can upset the conduct of monetary policy in the present sort of economic climate. Against a background of a superfluity of reserves a wide gap had opened up between interest yields on Treasury bills and open market paper and the discount rate of the Federal Reserve Banks. This condition had again raised the potential problem that the attractiveness of higher interest rates abroad would promote a new outflow of funds. Of most seriousness, however, was the fact that excessive market ease had seemingly created expectations of rising prices for U. S. Government securities that had come within an ace of fomenting a speculative movement that would have been akin to the 1958 experience if it had taken hold on the market. In the light of these circumstances it was his opinion that for the next several weeks technical, rather than economic considerations, must have first call on the conduct of System credit policy until more appropriate reserve conditions have been restored.

Mr. Mills said he must confess that he did not, at least as yet, have the degree of confidence in the vigor and lasting quality of the recovery that others appeared to have. In line with his preceding comments, he therefore had different reasons for believing that a lower level in the supply of reserves than had been the case recently would be helpful. However, he felt that it would be dangerous to draw back too fast and thereby allow the market to be whipsawed by bewildering fluctuations in the supply of reserves. It was his impression that free reserves at around $350 million in the present statement week could be harmful and that it would be preferable to draw back cautiously and gradually from a $500 million to a $400 million level. He saw no reason to change the discount rate or to consider a revision of the directive at this time.

Mr. Robertson indicated that he agreed substantially with the views expressed by Mr. Swan. He would only add that in his opinion the degree of ease achieved inadvertently during the past three weeks, with perhaps a slight bit of backsliding during the most recent week, was very salutary. Such a degree of ease did bring about an increase in the money supply and in bank liquidity, of which more was needed. The downward pressure on rates was, he felt, attributable more to an open-mouth policy on the part of some outside the System than to actions of the Committee or the degree of ease in the market. He was a bit concerned, however, about the indications that some of this ease was resulting in an increase in loans on securities, which led him to the thought that consideration should be given to the question of margin requirements. This did not mean that he thought an increase necessarily was needed, but consideration should be given to the problem in the near future.

For the next four weeks, Mr. Robertson said, he thought it desirable to avoid backsliding, and to maintain approximately the same degree of ease that had been achieved during the past three-week period. He would suggest a target for free reserves in the neighborhood of $600 million, simply because he had the feeling that there would be a tendency to backslide into the $200-$300-$400 million range, and he would be happier if the level of free reserves was held higher. He agreed with all of those who had spoken against a change in the discount rate, for the time had long passed by when the System could move. He felt that the directive should not be changed.

Mr. Robertson then stated that he would like to add a footnote to the presentation by Mr. Bryan at the April 18 meeting with regard to the use of total reserves as a guide to open market operations. Accordingly, he read the following memorandum:

> During the past year and a half, there has been a good bit of exposition at our meetings concerning the trend of total reserves as a guide to the operation of the System Open Market Account. We are indebted to Mr. Bryan, and also to Mr. Johns, for their formally calling to our attention this added perspective concerning our operations. At the same time, it seems to me we must be careful not to go too

far in using this type of guide as a substitute for the other strategic and tactical considerations to which this Committee is also called upon to give attention.

As I cast my mind back over our operations of recent years, I find numerous occasions which illustrate this point. The first half of last year, when business was cresting, provides one such example. During that span, total reserves if one attempts to allow for seasonal movements, evidenced a downward trend. This implied a shrinking base for commercial bank demand deposits which we could all agree in retrospect merited consideration in determining the appropriate course for monetary policy. This total reserve trend, however, was not in itself a sufficient measure of what our policy was or should have been. In fact, our operations were importantly improving bank liquidity during that period by providing sufficient reserves to enable banks to retire their net indebtedness to the Federal Reserve. Reserve injections used for debt retirement produced no net growth in the aggregate reserve base, but did serve to ease restraints upon bank managements and thus to enhance bank credit availability.

Moreover, substantial bank deposit creation was in fact taking place during the first half of 1960, but the net deposit increase was being transferred by deposit owners into time accounts. With the smaller reserve requirement on time accounts, this pattern of deposit expansion could be accomplished with a smaller reserve base. In effect, this decrease in public preference for money relative to near money enabled banks to economize on their reserve balances. Finally, the lessened public demand for money was also evidenced by declining market interest rates, reflecting substantial demands for Governments and other interest-bearing instruments in the financial markets. Taken together, the above developments could be construed as indications of some shift of public preference between money and other liquid assets; in brief, the demand for money was flagging.

Our responsibilities in such circumstances are not to keep the supply of money up to the level that would have been needed if no demand decrease had occurred, but to keep reserves sufficiently abundant as money demand decreases to produce a spreading availability of money and credit at declining interest rates, in the interest of stimulating recovery. The extent and duration of such easing must depend upon the dimensions of the recession and the amount of recovery necessary to return to as full use of resources as can be sustained without generating inflationary price pressures.

Policy determinations as to the degree of monetary ease or tightness must also be conditioned by the relative contribution of other elements of Federal economic policy toward the objective of stable economic growth. For example, from mid-1958 to early 1959 the Treasury was running a very large deficit, aggravating rather than dampening the ebullient atmosphere which characterized much of the period. In this circumstance, monetary policy was compelled to assume a larger share of the burden of restraining excessive demands than most of us would regard as desirable ordinarily. In the light of its responsibilities, the System had no other choice at that time. In the process, however, this kind of policy on our part held the total of member bank reserves below its postwar trend line, and led to virtually no growth in the reserve base for one and one-half years. Some of the consequences of that period of overreliance upon monetary policy may still be with us, requiring some further adjustments in order to bring the total liquidity available to the economy back more in line with public desires.

The comments I have made up to this point are qualifications of the type which I believe we must keep in mind in including total reserve measures among the various tactical guides for our open market opeations. Such reservations would apply a fortiori, however, to any tendency to use an historical trend line of total reserves as a strategic objective of policy. I am wary of speaking of anything as fixed as a 3 per cent--or 2 per cent, or 4 per cent--annual growth trend in the economy's need for money. The popular appetite for monetary assets changes over time. During World War II with few spending alternatives available, additions to deposit holdings were very large. Much of the postwar period has been colored by a gradual reduction from wartime peaks in the proportion of income held in monetary form, often with unfortunate inflationary consequences. I do not like to project this kind of monetary readjustment indefinitely, yet aiming our operations at the postwar trend line of total reserve growth seems to me to do so. I think we must be alert to shifting public demands for demand and time deposits, as well as for nonbank near monies, and we must be prepared to moderate our policies accordingly.

More broadly, let me point out that the long-run trend line of reserve growth does not allow for the wide variations which have occurred in the performance of the economy itself. The postwar era has been characterized by recurrent price inflations. Thus, from the point of view of preserving the value of the dollar, the 3 per cent postwar annual growth trend in the reserve base was too much. Now, in contrast, with nearly 7 per cent of our labor force unemployed and with prices slack, I believe that a good deal more than a 3 per cent annual growth trend in our reserve base would be salutary for a time in order to stimulate, in so far as monetary policy can, an early and orderly advance in levels of economic activity.

I think the import of what I am saying is that our job cannot be made easy. A steady growth trend in the reserve base is not a new target toward which we can aim as a substitute for other measures. The trend of total and nonborrowed reserves is rather an additional perspective--and an important one--to be examined in combination with other longer-run and shorter-run factors. If we find the current total of reserves departing far from its recent trend, we must take pains to assure ourselves that there are either (a) changes in the public's appetite for money relative to other assets, or (b) inflationary or deflationary factors outside the money supply, which justify some adjustment in, or departure from, the previous path of monetary growth. This, I am sure, can prove a helpful discipline, as it already has given indication of doing in the recent past. But, when such justifications appear, as I believe they do in our present state of underutilization of resources, we should not hesitate to employ monetary policy in flexible and compensatory fashion, in order to promote our long-run objective of stable economic growth.

Mr. Shepardson said it seemed to him the situation at the present time was one that obviously would give concern to some people. Yet it was one that he considered wholesome. Mr. Robertson had just mentioned in his statement the recurring inflationary pressures of the postwar period. It is easy, Mr. Shepardson noted, to develop a habit, or line of reasoning, in that connection, and it takes a long time to change. However, the System's concern must be with the promotion of sustainable growth. In horticulture, sustainable growth is dependent on the root system, which is not visible, except by deep probing, as much as the foliage. One can get quick growth and show a lot of leaves, but in the face of adversity that kind of growth withers fast.

At the present time the possibly slow, but nevertheless persistent, economic readjustment seemed comparable to the development of the root system. For example, available reports on plans for investment in plant and equipment indicated that a larger proportion was to be spent on modernizing present facilities than on construction of new facilities, and in his opinion this was all to the good. The modernization would tend to improve the country's competitive position, which was one of the underlying needs, both for domestic growth and in relation to the balance-of-payments problem. Also, there were now some indications of a little more concern on the part of labor about its role in relation to the growth problem; those reports likewise were encouraging, even though not too much had been accomplished as yet. Further, it was encouraging to note that more thought and attention was being given to increasing the mobility of labor through retraining, and to broader training for the growing labor force that was due to appear. These developments were noteworthy because growth inevitably involves change. It would involve change in the requirements for labor and an increasing flexibility and mobility of labor. Such things move slowly, but they are as essential to sustainable economic growth as the root system development is to a thriving plant. For this reason, he was not interested in a mushroom growth that might wither in the heat of the July sun. Instead, he would prefer to give the root system time to develop before getting too much of the plant above ground, for that was the way to bring the crop through the harvest. True, it was disturbing to look at some of the existing unemployment, but it must be recognized that some diseases cannot be cured overnight, particularly when they are deep-seated.

Mr. Shepardson expressed the view that the System should not be in a position at this time of imposing restraint, and that it should be prepared to provide reserves as the need might develop. At the same time, he continued to feel that it would be inadvisable to try to flood the garden too fast. Therefore, he would not care to see a continuation of the degree of ease that had developed inadvertently in the weeks just past. In his opinion Mr. Mills had made a good point about trying to avoid wide swings; to drop down too fast from the level of free reserves that had occurred through inadvertence might be disconcerting to the economy. He did think, however, that it would be desirable to trend back to a free reserve level below $500 million, for he would not want to see monetary ease become a drug on the market. In summary, he would provide needed reserves freely but try to avoid the excessive ease that had occurred recently. The Committee must continue to be concerned about the short-term rate situation, and he would subscribe to goals such as Mr. Irons had outlined with regard to the bill rate and the Federal funds rate. He saw no reason to change either the directive or the discount rate at this point.

Mr. King recalled that at the April 18 meeting he had suggested an exact free reserve target figure of $575 million. At present, he said, he would again suggest the area of $550-$575 million. The relatively small decline in the bill rate apparently had not alarmed anyone unduly, and he would not object if the bill rate receded to around the 2.05 level. This did not mean that he would propose any overt action to try to push the rate to that point. However, if pressures should develop that would tend to move the bill rate in that direction, he would not object. Also, he felt that a further drop in the bill rate might afford an opportunity to begin withdrawing from operations in the longer end of the market, at least to the extent that such operations were being engaged in at the present time. To summarize, he would not object if the bill rate stayed in its present range or declined a few more points. His suggested target for free reserves would be around $575 million, and he would hope that the Desk could hit that figure fairly closely, even though he appreciated the problems inherent in the operation of the Account. He would not favor a change in the discount rate at this time.

Mr. Fulton reported that despite some further gains in steel output and construction the program of recovery in the Fourth District was running into a few snags, particularly in the area of retail sales. This was evidenced by persistent unemployment, increasing softness in department store sales, and lack of sustained demand for bank credit. However, the views of District industrial economists seemed to have changed somewhat. Earlier, they had expected a continuing slow economic improvement, but now there was at least a minority feeling that the recovery would not be as gradual as formerly was contemplated.

The unemployment situation was not good, Mr. Fulton said. The figures had shown a slightly less than seasonal improvement. With regard to the retraining of labor, Mr. Fulton commented on a situation in the Cleveland area where the response to an offer of that kind had been disappointing.

In the steel industry there had been a marked pickup, percentage-wise, and orders in April were the best since a year ago. While shipments were still prompt, they were probably not going to stay that way; some backlog seemed likely to begin to build up, particularly in sheets. It was felt that customers' inventories had been liquidated below reasonable operating levels and that the orders being received might include some provision for inventory accumulation as well as for current use. The industry was looking for improvement in the third quarter and for a good fourth quarter. However, the picture was not bright for the companies because of increased costs. Labor rates were due to go up this fall under the terms of the existing labor agreement, and the present contract would expire in July 1962. Everything that the companies had to buy had gone up in cost, whereas the price of steel had not increased.

Turning to a bright spot in the District picture, Mr. Fulton said one good-sized foundry that in the past had been quite a bellwether reported that about a month ago orders began to come in strongly for immediate delivery. It was felt that the companies with which that foundry dealt, and they represented a wide segment of manufacturing industries, had run out of inventory, that their orders also may have picked up somewhat, and they were ordering both for current production and for inventory. It was also felt, however, that inventory levels were likely to be considerably smaller than heretofore, which meant that loans by banks to carry inventories would be less than they had been in the past. Of course, if boom conditions should develop and delivery times lengthened, there might be a reversion to the previous inventory practices. In this industry, also, it was indicated that prices were too low, that the cost of everything, including labor, was increasing, and that price rises seemed inevitable.

Turning to policy, Mr. Fulton said that he would not favor changing the discount rate or the directive. He would suggest free reserves in the area of $500 million and hoped that the level would not remain as high as it had been recently. A disturbing factor was the appearance of some evidence of speculation in Government securities, particularly longer maturities, possibly reflecting to some extent the recommendation of the Joint Economic Committee that the Federal Reserve put more money into the financial system in order to reduce the long-term interest rate. He felt it would be desirable if the Federal Reserve could in some way assure the investing public that its actions were always taken within the context of monetary policy, and were not dictated by views expressed outside the System.

Mr. Bopp reported that business in the Third District clearly was improving. Though total unemployment still was high, unemployment claims were dropping. Department store sales were rising, although sales to date in 1961 had not yet reached the levels of 1960, and production was increasing, with recent increases concentrated in durable goods industries. Construction contract awards in the District dropped in the first quarter of 1961, but compared more favorably with national construction awards than they had for over a year. There was still no evidence, however, of any vigorous upturn in demands being made on banks in the District. Stability in bank credit and a slowly increasing deposit level had been in evidence since February. Reserve positions were still easy.

Mr. Bopp commented that policy considerations were somewhat unusual at this time. Usually the decision rested between (a) no change and (b) movement in one direction. Today, however, consideration was being given in various quarters to (a) no change, (b) less ease, or (c) more ease. Any case for less ease would have to rest largely on the strength of the business recovery. Although the recovery so far looked good and even suggested that the business revival could turn out to be more vigorous than many thought it would be, it was nevertheless still only beginning. And while it was probably true that there was a natural tendency for the System to overstay both booms and recessions, action toward less ease right now would seem premature. This was quite apart from the question as to whether there was a "different" economy now from the one that prevailed in the 1954 and 1958 recoveries.

The case for more ease would seem to rest largely on the argument that the System would like to have had more ease earlier, but only now that the gold flow had ceased was this possible; true, it was rather late in the cycle, but better late than never. This course assumed the calculated risk that lower short-term rates would not trigger a resumption of the capital outflows which were so troublesome earlier. It was still far from clear that the balance of payments was strong enough to stand this test. If the gains to be achieved domestically were very great, this risk might be worth taking anyway, but there was evidence that the present degree of ease was accomplishing its purpose of restoring bank liquidity and stimulating a demand for capital in corporate and municipal markets. A substantial move toward more ease would inevitably call for a reduction in the discount rate, and this could have the adverse psychological reactions (a) that the monetary authorities lacked confidence in the strength of the business recovery and (b) that it represented a yielding to pressures from outside the System.

On balance, Mr. Bopp said, the wisest course seemed to be no change. Therefore, he recommended continuation of the present directive, the present degree of ease, and the existing discount rate.

Mr. Bryan noted that during the discussion today several persons had referred to the liquidity of the banking system as being less than at the beginning of previous recoveries. The assumption seemed to be that this was an unfavorable factor. In this connection, however, he brought out that the inflation associated with previous recoveries may have arisen out of excessive liquidity in the banking system. Thus, the System might be in a more fortunate position now by virtue of the fact that the banking system was somewhat less liquid.

Mr. Bryan also commented that a number of persons seemed to think that, although the country was experiencing a good recovery, there was a terrific problem due to the underutilization of resources. While he shared with everyone a desire to see resources fully utilized, a considerable part of the underutilization could not be remedied by monetary policy. Some part of it reflected the misapplication of capital induced by inflation. Further, some part of the unemployment problem was attributable to deliberate Governmental policy outside the field of fiscal and monetary affairs. To many people, unemployment had become a profession. Monetary policy alone could not bring about a full utilization of resources, particularly in the face of other policies and in the face of a preceding inflation of many years that had robbed the American people and had contributed to the misallocation of a lot of capital.

The most dramatic development in the Sixth District, Mr. Bryan said, had been the increase in the workweek and in manufacturing payrolls. For the most part, however, things had been going along about the same as in the nation generally.

With regard to policy, Mr. Bryan said he could not quarrel too much with the reserve situation in the past three weeks. However, he felt the Committee would make a grave mistake if it did not watch reserve developments closely because an inflationary course could result. Required reserves had gone up somewhat more than seasonally, as had total reserves, and the money supply appeared to be behaving about as it should. In substance, he thought that reserves were ample at present and that the Committee should begin to think ahead to the time when it might want to let free reserves trend downward.

Mr. Johns said that if he had been present at the April 18 meeting he might well have joined in the minority position. Like Mr. Ellis, however, he was disposed to retreat from that position.

The policy directive, Mr. Johns observed, continued to call for encouraging expansion of bank credit and the money supply. He considered this appropriate. However, he thought it was impossible for one who must make recommendations about policy to avoid making some judgment as to the appropriate rate of expansion of bank credit and the money supply. From the latter half of November 1960 to the latter half of April 1961, it appeared that the money supply, as defined for the purposes of the Board's semi-monthly series, had grown at an annual rate of 4.1 per cent. If the definition were expanded to include time deposits, the rate of growth over the same period was at an annual rate of 9 per cent. Further, the only comparable rate of growth in total deposits plus currency during the past ten-year period was from February to June 1958. The question he raised was whether the Committee would want the present rate to continue or whether some other rate would be more appropriate. Considering pertinent factors such as (1) the upturn of the economy, which probably would result in some modification of the public desire for liquidity, (2) fiscal policy, including the change from a cash surplus of substantial amount in the second and third quarters last year, and (3) current debt management policy, which was increasing the supply of short-term securities in the hands of the public as contrasted with a decline in the latter half of 1960, it occurred to him that it would be inappropriate to bring about or encourage an increase in the money supply at a greater rate than in the past five months. It might even be possible that the rate of the past five months was too great and something less should be the objective. Having said that, he recognized quite well the difficulty which confronts the System in trying to control the rate of growth with any degree of precision.

Inasmuch as, along with others, he had been talking considerably in recent months about total reserves, Mr. Johns said he would like to observe that whereas the staff calculations assumed excess reserves of $700 million in the banking system, actually there had been in the most recent past excess reserves of about $500 million. He suggested that it might be possible to obtain an appropriate rate of growth of the money supply and bank credit without a further increase in total reserves, seasonally adjusted, if close attention was paid to the use that the banking system was making of excess reserves. There was, of course, the possibility of falling into the error to which Mr. Thomas called attention several months ago when he pointed out that the maintenance of a free reserve target, with continual replenishment as banks used reserves, could result in what the Committee might not think was an appropriate rate of growth of bank credit and the money supply. Therefore, he would be disposed for the short run, that is, until the next meeting and perhaps until the succeeding meeting, to observe the use that the banks were making of excess reserves. A rate of growth of the money supply might result that seemed appropriate. On the other hand, if the rate of growth was less than desired, it would be necessary to supply some further reserves.

Mr. Johns said he assumed that if the recovery continued the tendency would be for interest rates to move upward. In his opinion, a policy designed to prevent that from occurring would be more expansionary than justified. He would think that if and as the recovery proceeded to the System's satisfaction, some upward tendency in rates should not be resisted. If the time was not actually here, it might not be too far off when the System ought to consider whether it should any longer be concerned with the pattern of interest rates. As he had said, if the recovery progressed rates would probably move up. Even without a special operation, it seemed likely that short-term rates might be high enough relative to longer-term rates to discourage a flow of short-term funds from the country. If purchases for the Account were concentrated in longer maturities in an attempt to hold long rates down, short-term rates might tend to go up all the faster, perhaps faster than would be liked. The time might be near in this cycle, it seemed to him, when the System should no longer attempt to keep the short-term rate up relative to longer-term rates, or vice versa. There might be considerations outside the field of monetary and credit policy that would make it inadvisable to abandon operations in the longer-term area precipitantly, and he would not advise that. Despite such operations, however, it seemed likely that if business expanded the creation of an appropriate amount of bank credit and money was not likely to be accompanied by a downward adjustment in long-term rates.

In conclusion, Mr. Johns said that he would not change the directive or the discount rate at this time. He shared the view that it was not too early to begin to think about margin requirements.

Mr. Johns then withdrew from the meeting.

Mr. Balderston expressed the view that the fundamental domestic problem for the longer run remained that of providing sufficient job opportunities to take care of the rising need for them. This, he supposed, called for a greater flow of capital funds into investment. Therefore, the signs, even if temporary, of some renewed activity in the capital markets gave him encouragement. In this connection, he observed that those who criticized the Federal Reserve for its so-called experimentation in the longer-term sector of the market seemed to confuse interest rates with the results that were sought. If funds flowed increasingly into investment, that was the desired result.

Looking at the longer run, Mr. Balderston said, he was concerned that the ratio of the money supply to gross national product had fallen to a low level. Strong sustainable growth of the economy required continued attention to the money supply, narrowly defined, and also to near-money substitutes.

Continuing, Mr. Balderston noted that in the first quarter of this year profits of industrial firms seemed to have dropped about 20 per cent. About 69 per cent of those firms reported profits lower than in the corresponding quarter of a year ago; in the case of durable goods firms the figure was 78 per cent. However, he was convinced that a turnaround of the economy had occurred, and it might be assumed that the larger volume and better production usually accompanying the early months of recovery would improve corporate profits. That in turn would add to Treasury receipts at a future time.

In view of the concern he had expressed at the past two or three meetings, he was gratified that the money supply at last had responded. As inventories were rebuilt, the impact on bank lending would doubtlessly enhance the money supply further. Now that the money supply had responded, he would not press reserves on the banking system quite as strongly as during the past three weeks, particularly if the result was to press short-term rates any lower than in recent days. Earlier, as long as the money supply was not responsive, he had been willing to risk showing to the world a somewhat different posture as to the bill rate. However, now that the money supply had responded, at least for the time being, he would not like to see the bill rate go any lower than it was at the moment.

Mr. Balderston said he thought it doubtlessly was true that interest rate differentials were no longer pulling funds abroad. The forces active at the moment appeared to be those outlined by Mr. Sammons. Nevertheless, the bill rate is a signal watched closely by persons abroad and in this country. It presents to the world a posture reflecting the views of the central banking system. Consequently, it should be kept in mind, especially during a period when international negotiations were under way looking toward minimizing the flow of funds from country to country.

In conclusion, Mr. Balderston said that for the reasons to which he had referred he would favor a free reserve target of about $500 million. He would not change the discount rate. In sum, his present position represented a retreat from the position he had advocated at recent Committee meetings.

Summarizing the meeting, Mr. Hayes said that although a fairly broad range of opinions, or shades of opinion, had been expressed, he did not feel that it would be too difficult to come to a reasonable consensus. There had been general recognition of the appropriateness of a policy of ease, although there were some interesting characterizations of the kind of ease that had prevailed recently. There was also general recognition that in the past few weeks unforeseen circumstances had resulted in somewhat greater ease than anticipated. A minority of the Committee was glad that that had occurred, but the majority felt the degree of ease had gone further than would have been desired.

There had been some interesting comments on the possibility that excessive reserves might at some juncture combine with fears of a revival of inflation, or expectations thereof, and lead to speculation in the Government securities market. Also, there had been references to the effects in the area of System operations, and especially on rates, of pronouncements made outside the System.

Mr. Hayes went on to say that the opinions of those who had commented on long-term rate objectives and operations in longer maturities were divided. Some would press this program forward as a useful device, while others already were beginning to have qualms about the usefulness of continued operations in the longer-term area of the market. As to short rates, there was again quite a variety of opinions. A few of those who had spoken would not be reluctant to see the short-term rate go a bit lower, but a clear majority would prefer to see the short-term rate remain within the present range and one or two would like to see it move a little higher. A clear majority felt that continued attention should be given to the short-term rate because of international considerations. It appeared to be the general view, Mr. Hayes said, that the atmosphere of the market must play a role and, although it may not have been stated in so many words, this would require continuing to give reasonable leeway to the Manager of the Account.

With regard to the directive, Mr. Hayes said it was clearly the consensus that there should be no change at this time. He then inquired whether anyone wished to dissent from continuing the directive in its present form, and no 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 expansion of bank credit and the money supply so as to contribute to strengthening of the forces of recovery that appear to be developing in the economy, while giving consideration to international factors, 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.

Turning to free reserves, Mr. Hayes said that he always hesitated to center views around any particular target because some preferred to de-emphasize this and some did not comment. However, although a few would prefer a range around $600 million, a good many more had spoken in terms of $500 million, or possibly a shade lower.

Mr. Hayes said it appeared that the consensus was essentially to maintain the same degree of ease as had prevailed, apart from the unusual ease that developed inadvertently during the past few weeks. The Desk should continue to pay attention to the short-term interest rate structure, and the atmosphere of the market would have a great deal to do with day-to-day operations. He then inquired whether this was a reasonable statement of the consensus.

Mr. Robertson asked whether this was equivalent to saying that the consensus was for a degree of ease indicated by a free reserve figure somewhere between $400 and $500 million.

Mr. Hayes replied that he would think so. He wished to point out that a number of factors might call for deviation from any fixed free reserve target. Other things being equal, however, the range mentioned by Mr. Robertson would appear to reflect the tenor of the comments around the table.

Mr. Hayes then inquired again if there was agreement that he had stated the consensus accurately, and there were no comments to the contrary.

Accordingly, Mr. Hayes inquired whether anyone wished to record a dissent from the implementation of the directive in the manner indicated by the consensus, and Mr. Robertson stated that he would dissent.

Secretary's note: Mr. Robertson subsequently submitted the following statement for inclusion in the record of the meeting in explanation of his dissent:

Mr. Robertson dissented from the decision to request the Manager of the Account to so conduct open market operations as to achieve a degree of ease comparable to that which prevailed prior to the last meeting of the Committee rather than the higher degree of ease which has prevailed from that time to this. It was his belief that the recent level of around $600 million has promoted a turn-around in the money supply and brought about an increase in bank credit without unduly depressing yields on Government securities. It was his view that the downswing in yields which did occur was attributable more to the West German discount rate reduction and comments by persons outside the Federal Reserve System than to System open market operations.

All members of the Committee agree that this is a time when the American economy ought to move upward toward a more satisfactory rate of employment and toward a fuller use of its resources. While current information suggests that this may be happening, it would be dangerous to take it for granted that recovery is going to proceed vigorously upward without significant interruption, which has never been the case after a downturn except in the spring of 1958.

With the gold outflow apparently halted for the time being, and with inflationary pressures seemingly less dangerous just now than at any time in recent years, he believed that in order for the Open Market Committee to make certain that the System does its full part in stimulating recovery to more nearly satisfactory levels of production and employment, the degree of ease achieved during the past three weeks should not be diminished (and if anything, increased slightly) during the next four weeks until the next meeting of the Committee.

In view of the likely monetary and credit needs which will accompany business recovery, he felt that a volume of free reserves in the neighborhood of $600 million during this period would not result in any sloppiness in the money markets or an unduly low bill rate.

Mr. Swan said that he also wished to dissent, although with much more reluctance than at the previous two meetings.

Mr. Deming referred to the range of free reserves mentioned by Mr. Robertson (between $400 and $500 million) and inquired whether the consensus was not toward the high side of that range.

Mr. Shepardson stated that he would favor the low side of that range.

Mr. Hayes indicated that he would rather not try to be too specific. If a general range could be agreed upon even for purposes of this conversation, he thought that was doing quite well.

Mr. Hayes then referred to the special authorization covering operations in other than short-term securities and said he assumed it was the intention of the Committee to continue the authorization in effect until the next meeting.

Messrs. Allen and Robertson stated that, for reasons given at previous meetings, they would want to be recorded as dissenting.

> Thereupon, the Committee authorized the Federal Reserve Bank of New York, between May 9, 1961, and the next meeting of the Committee, within the terms and limitations of the directive issued at this meeting, to acquire intermediate and/or longer-term U. S. Government securities of any maturity, or to change the holdings of such securities, in an amount not to exceed $500 million.
>
> Votes for this action: Messrs. Hayes, Balderston, Irons, King, Mills, Shepardson, Swan, and Wayne. Votes against this action: Messrs. Allen and Robertson.

Mr. Hayes inquired of Mr. Holmes whether he had any comments or questions in the light of today's discussion, and Mr. Holmes replied in the negative.

Mr. Hayes then referred to the inclusion on the agenda for this meeting of a preliminary discussion of the publication of the record of policy actions of the Federal Open Market Committee more frequently than on an annual basis; for example, on a quarterly basis after a lag of one full quarter.

Mr. Hayes said it had seemed appropriate to Mr. Balderston, to him, and to Mr. Sherman to consider this question, which he knew had been thought about from time to time by most of those around the table. He noted that under the present procedure of publishing the record of policy actions for each calendar year in the Board's Annual Report, the time lag before publication of the respective actions ranged from roughly three months to 15 months. This time lag had led to quite a bit of criticism from outside the System, and some comment within the System. Therefore, the question arose whether, without taking undue risk in the execution of policy, it would be possible to release the policy record on a regular quarterly basis with approximately a three-month time lag. This might be accomplished, perhaps, through publication in the Federal Reserve Bulletin or by means of a special release.

Mr. Hayes then turned to Mr. Balderston, who commented that it seemed rather difficult to answer criticisms of a 15-month time lag, when in some cases there was only about a three-month lag before publication of actions in the Annual Report. He was not too much interested at this point in the question of procedure for publication, but he had in mind that perhaps the record for each of the first three quarters of the year might be the subject of a press release. As he saw it, a time lag of at least three months would be desirable, which would mean that in July the record of policy actions taken during the first quarter of the year would be released. Presumably, the policy record would continue to be presented in the usual manner in the Annual Report, with the record of actions taken during the fourth quarter of the year being released initially in the Annual Report.

In further discussion, Mr. Deming suggested that some of the criticisms directed toward the System on this general subject would not stand up under examination. It was not a fact that the public was unaware of what the System was doing for a period of as long as 15 months. Rather, it was simply that the public did not have access to the official record of policy actions and the specific wording of the directives that had been given by the Committee to the Federal Reserve Bank of New York. On changes in the discount rate, reserve requirements, and margin requirements, notices were given to the press immediately, and within limitations there were explanations of System actions, often in the form of comments by System spokesmen. Therefore, the public was kept reasonably up to date on System policy. Accordingly, although he would have no particular objection to publishing the record of Committee policy actions at three-month intervals, with a three-month lag, he doubted that some of the criticisms that had been heard would be satisfied thereby to a much greater extent than under present procedures.

Mr. Hayes suggested that in addition to specifying the directive, the policy record entries served to explain the rationale of Committee actions. While certain interpretations of System actions were made during the course of any given year, an explanation released by the System through publication of the policy record would have the advantage of being fully authentic.

Mr. Deming noted that Chairman Martin testified regularly before Congressional committees and that other official statements were made from time to time with regard to System policy. Given this situation, he doubted that quarterly release of policy record would add much to the knowledge of the Congress or others. As he had said, he did not wish to quarrel particularly with the idea of quarterly publication, but he doubted whether it would fully satisfy some of the criticisms that had been made.

Mr. Robertson inquired whether the reason for placing the matter on the agenda had not been to call attention to the fact that this possibility was under consideration rather than for the purpose of debating the matter today.

Mr. Hayes replied that no action had been contemplated at today's meeting. He added that he had mentioned the matter in telephone conversation with Chairman Martin, who seemed generally sympathetic in principle but felt that timing was important and that any decision on implementing the suggestion should be considered carefully.

In further discussion Mr. Wayne suggested that the possibility of more frequent publication of the policy record be studied primarily from the point of view of a move on the part of the System to develop better public understanding of its policies. From this standpoint an argument could be made in favor of such an approach apart from endeavoring to meet any criticisms that had been directed at the System.

Mr. Hayes stated that he thought this was an important point and that he was glad Mr. Wayne had brought it up, following which Mr. Bryan expressed the view that a decision to release the record of policy actions at frequent intervals would have dangerous implications. Therefore, he said, he would want to debate the matter vigorously at the proper time. Messrs. Mills and Irons indicated that they concurred in the view expressed by Mr. Bryan.

Mr. Hayes then stated that the matter could be included on the agenda for the next meeting of the Committee with a view to further discussion. Meanwhile, if anyone cared to do so, he could let the Secretary of the Committee have his comments.

It was agreed that the next meeting of the Committee would be held on Tuesday, June 6, 1961.

The meeting then adjourned.

Assistant Secretary