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, July 11, 1961, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Balderston
Mr. King
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Swan
Mr. Wayne
Mr. Johns, Alternate for Mr. Irons

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

Mr. Molony, Assistant to the Board of Governors
Mr. Koch, 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

Messrs. Eastburn, Hostetler, Jones, Parsons, and Tow, Vice Presidents of the Federal Reserve Banks of Philadelphia, Cleveland, St. Louis, Minneapolis, and Kansas City, respectively

Mr. Marsh, Assistant Vice President, Federal Reserve Bank of New York
Mr. Eisenmenger, Acting Director of Research, Federal Reserve Bank of Boston
Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 6, 1961, were approved.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period June 20 through July 5, 1961, and a supplemental report covering the period July 6 through July 10, 1961. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Supplementing the written reports, Mr. Marsh commented as follows:

Money market conditions have remained reasonably stable and comfortable over the past three weeks with Federal funds rates averaging around 1 per cent with fewer extreme swings than in some previous periods. Rates on 91-day Treasury bills moved between 2.20 and 2.35 per cent. Open market operations consisted principally of supplying reserves to meet reserve drains around the month end and the July 4 holiday. At the start of the period, it seemed that we might have some difficulty in putting enough reserves into the market during the statement week ended July 5 to keep money conditions easy without putting undue downward pressure on the bill rate. However, the drain of reserves due to market factors was not as great as had been anticipated, and the market supplied ample Treasury bills to help us meet most of the buying need at reasonably stable rates. Dealers have held fairly substantial positions in Treasury bills acquired in recent auctions, and the prospects for heavy Treasury financing during July apparently induced dealers and others to sell readily.

To supplement the purchases of bills and spread the effect of these operations throughout the maturity range, faily sizable amounts of other issues were purchased from June 29 through July 3. A good supply of longer issues was available on June 29, but the supply dwindled sharply thereafter. We made considerable efforts to uncover additional offerings but these efforts produced only a minimum of securities with the result that prices of intermediate- and longer-term issues rose sharply on Friday, June 30, by as much as 1/2 point, with a further rise of 10/32 on Monday.

Our projections indicate a need for absorbing a substantial amount of reserves in the next statement week and we have already provided for a redemption of $121 million of bills this Thursday, July 13. It may be feasible to redeem another $121 million of our holdings of bills maturing July 15 to absorb additional reserves. (This redemption would actually take place on Monday, July 17.) But we will still have more selling to do, possibly including short-term issues other than bills to spread the impact of the sales at a time when the Treasury is involved in its current financing. Looking further ahead, there will be no reason to make any purchases until the week ending August 2 when projected average free reserves decline to around $200 million.

The atmosphere in the longer-term market has not changed greatly in the past three weeks, as ideas about the future trends of business and interest rates are still quite mixed. In the absence of need to supply reserves or deal with short-term rates, the System had no occasion to go into the longer-term market during most of June, which apparently confirmed the feeling of many observers that the System had no intention of pushing longer-term rates down. Growing expectations of an offering in the intermediate range in the Treasury's August 1 refunding added a further note of caution. On the other hand, pressure from the corporate bond market relaxed as the calendar of forthcoming new issues was reduced to moderate proportions and some of the older accounts began to be cleaned up. Activity in intermediate- and longer-term Government issues was at a minimum, however.

I want to comment further on our operations in longer-term issues as I think the Committee will be interested in our recent experience. But I should first like to say a bit about the Treasury's current financing plans for July. The first operation, an auction today of one-year bills to roll over the $1.5 billion July 15 maturity, should proceed without undue difficulty despite the addition of $500 million bills, making a total of $2 billion to be auctioned without tax and loan credit. The market expected the Treasury to pick up this additional cash and is taking the auction in stride, anticipating an average rate in the auction between 2.95 per cent and 3 per cent, which is in line with current market rates. Dealer awards of 6-month bills in the auction yesterday were somewhat larger than the usual ($218 million) which may affect today's auction. The next move will be the refunding of the $9.9 billion August 1 maturity of which the System holds $4.8 billion. This refunding will probably be announced Thursday, July 13, but the Treasury has not yet decided whether to make this refunding on a cash or exchange basis, whether and how to include the $2.2 billion September 15 maturity (all held by the public), and whether to offer an issue with a maturity longer than, say, 15 months. The market seems to feel there would be a good bank interest in an issue around 5 to 7 years and if such an offering should be included, a decision will have to be made whether the System should put part of its holdings into the longer issue.

The third Treasury operation will be to raise about $3.5 million of new cash around July 27. The market expects this will be done through an auction of March 1962 tax anticipation bills, with payment through tax and loan account credit. Just how this will work out will depend on the state of the Treasury's balances after the preceding refunding operation; that is, whether there is any substantial attrition to be covered.

Getting back to our recent operations in longer-term issues, I mentioned that our efforts to buy these maturities in the last part of June produced very few offerings after the first attempt. We even tried to buy more of the very longest maturities than before, since the Treasury is no longer in a position to continue with its purchases in that area. You may wonder how it is that offerings have not been readily available and how the recent long-term market situation differs from earlier conditions when we were able to buy more substantial amounts. To give the Committee an idea how the amounts of long-term offerings have dried up, we have compared the offerings received on some of the large purchase days back in April and May with those on June 29, June 30, and July 3. It is not easy to specify exactly why these recent experiences were so different because of the many factors involved--not only investor and dealer attitudes but also the way in which we had been operating in the market. However, among the reasons for the heavier offerings earlier was the somewhat more robust outlook in the business situation, which led to a desire to shorten maturities in advance of a rise in interest rates. Also, some profit-taking occurred as prices moved higher after the System's entrance into the bond market. Furthermore, there was a large amount of swapping by investors who were switching into the heavy volume of new corporate and municipal issues. An additional factor was that most Treasury purchases of long-term issues were against sales of short-term securities. As the market recognized this pattern, dealers were able to propose swaps to investors and thus develop a source of longer issues that would not have been available on an outright basis. Finally, substantial dealer holdings in the earlier period enabled dealers to make offerings out of their positions.

More recently, dealer holdings have been low. Moreover, some investors may in effect be "frozen in" to their positions since further sales might involve losses they are unwilling to take. Also, some doubts have begun to accumulate in the market as to the strength of the recovery and there is apparently somewhat less pressure to "get out" of the bond market. Also, during recent weeks, with the System and the Treasury generally out of the market, some dealers may have gotten out of the habit of showing offerings to the Desk.

In this connection, Mr. Marsh cited some figures on the volume of offerings in intermediate and longer-term issues received on selected days in April and May, and compared these with the volume of offerings of intermediate- and longer-term issues received on five selected days in June and July. Generally, the figures showed that in the earlier period offerings ranged between $140 million and $240 million, while in the later period offerings ranged between $11 million and $55 million.

Mr. Mills said that, since Mr. Marsh had opened up the problem of System open market operations outside the short-term area, this seemed a logical time to explore the subject against the background of the memorandum submitted to the Committee by the New York Bank under date of July 7, 1961, which proposed a broadening of the criteria for operations in the intermediate- and longer-term areas of the market. The suggested additional criterion was that operations outside the short-term area should be undertaken on those occasions when congestion appeared to be developing in the capital markets or when market expectations as to the future course of rates seemed to be having clearly exaggerated effects, with the objective of facilitating the flow of capital into productive investment activities.

On February 7, 1961, when authorization was granted to operate outside the very short-term sector, Mr. Mills said, the reason given was that the effect of such purchases would be to nudge the long-term rate structure downward, as a result stimulate financial borrowings in the longer-term capital market, and therefore permit capital expansion. From what could be observed of the operations since that time, he felt a real question could be raised as to whether that purpose had been accomplished. What appeared to have happened was that Government security market operators had been handicapped and confused by the unpredictability of what the System was attempting to do, and this had not been helpful to the general tone of the market. Since February 7 there had been a general change in the business climate, with greater strength in evidence, and in consequence there had been a strong demand for longer-term capital funds. This had tended to offset the influence of System operations in the longer-term sectors of the market; the movement of interest rates had tended to be upward rather than down. This could account in part for the lack of effectiveness of the System's attempts to bring the longer-term rate structure down. But the whole result, in his judgment, showed quite conclusively that the "bills only" policy was the correct and appropriate policy for the System to follow in withdrawing and supplying reserves. If the Committee engaged in the longer-term sectors of the market and confined its purpose to supplying and withdrawing reserves, it was automatically limited in the magnitude of its operations. The New York Bank had now, as he read the July 7 memorandum, set aside the reasoning that originally prompted the operations outside the short-term area, which he gathered was tacit acknowledgment that the results of operations in pursuance of the original purpose had been disappointing. Instead, the Bank now suggested that engagements in longer-term securities should be for the purpose of facilitating the flow of funds through the capital markets.

Such a proposal, Mr. Mills suggested, deserved special scrutiny. If one looked at the matter in terms of the amounts involved and took, for example, the condition report of the Federal Reserve Banks as of July 5, 1961, the figures showed that during the preceding year the System Open Market Account portfolio was increased by a total of $847 million, of which only $443 million represented maturities of one year or longer. Against the amount which the System had acquired, in the six months through June 30, 1961, there had been new issues of corporate securities of $6,330 million and new issues of State and local government securities of $4,434 million. This raised the question whether a mere $443 million released into the longer-term capital market by the purchase of securities for the Account could have had any impact of importance. It would seem to him more likely that it could not have accomplished any very constructive purpose. Moreover, if one traced through the kind of operations in which the System had engaged and bore in mind that the System had limited opportunities to supply and withdraw reserves, it was apparent that to purchase longer-term securities for the Account the System would have to provide funds to buy such securities by selling Treasury bills out of the Account portfolio, and the purchasers of those bills would have to supply themselves with the funds to purchase them. He did not know whether those funds would have found other media of investment. However, on the assumption that they might have been invested in longer-term securities of some kind, the effect of the System's sales of the bills nullified to a degree the effect of its purchases of longer-term Government securities.

Since this was a subject that he judged would be taken into full account when policy was determined, he felt it might properly be borne in mind in advance of those discussions.

Chairman Martin agreed that the matter should have full discussion. He disagreed, however, with Mr. Mills' view that the operations in the longer-term area had been proven to be a failure. The Committee, he felt, ought to balance dispassionately the case on both sides, for this was a complex and complicated problem. He had visited in New York several times trying to get the sense of the securities market, and he found the problem more difficult, probably, than anything he had yet tried to evaluate. The point that had to be considered was that the policy of "bills only," "bills preferably," or whatever one wanted to call it had been the principal stumbling block over a period of time in attaining an understanding of System operations. Whatever the reasons, the System had failed in his judgment in explaining to the public the basis of its operations. In the circumstances, he considered it extremely important for everyone to bear in mind what was involved and not to jump to conclusions.

In regard to the additional criterion for operations in longer-term securities set forth in the July 7 memorandum from the New York Bank, the Chairman said he was not prepared to accept it, at least at this time. However, as to the operations in Government securities in the longer-term area since February 20, he felt it was possible to make just as good a case that they had been successful as that they had been a failure, depending on one's evaluation of their impact on the Government securities market. That, he thought was still an unknown factor. It was necessary, as he saw it, for everyone to try to evaluate the matter in terms of the problem of explaining System operations to the public and in terms of the legitimacy of the charge of a doctrinaire attitude on the part of the System. As he had said, he would not want to accept at this time the suggested additional criterion. However, he noted that the flow of funds into the capital markets in the second quarter of this year was at a record level. It would seem difficult to say that this had occurred in spite of Federal Reserve policy rather than on account of it. In short, there was no open-and-shut answer. However, it was vital to resolve the problem--not hastily but carefully-- and to do so in the perspective of the role of the System in the market.

The Chairman commented that his remarks had been intended to be of an introductory nature. Unless the Committee wanted to pursue the topic further at this time, he would suggest that it might be best to wait until the go-around and afford everyone an opportunity to express his views.

After brief discussion it was decided to proceed in the manner suggested.

> Thereupon, upon motion duly made and seconded, the open market transactions during the period June 20 through July 10, 1961, were approved, ratified, and confirmed.

Mr. Koch presented substantially the following statement with regard to economic developments:

> Since the chart show presented at the last meeting of the Committee covered economic developments over a rather extended period of time, I shall concentrate my remarks this morning on the current picture. There is general acceptance now of the idea that the recovery phase of the current economic cycle probably started in February, or at the latest in March. So far it has been V-shaped, as in 1958, rather than saucer-shaped as in 1954. As a matter of fact, by June the pre-recession highs of mid-1960 had been reattained or even surpassed in the case of most major over-all measures of economic activity.
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> The seasonally adjusted annual rate of the gross national product expressed in current dollars, for example, rose from a low of about \$500 billion in the first quarter of this year to an estimated \$513 billion in the second quarter. This was \$8 billion above the previous peak reached in the second quarter of last year. Most of this rise, however, was accounted for by higher prices. The recent rise reflected a turnaround from substantial inventory liquidation to small inventory accumulation,

and an increase in consumer spending on all types of goods as well as services. Exports, although remaining high, are no longer giving added impetus to the economy. Government spending, both Federal as well as State and local, is still rising, but at a somewhat slower pace than earlier, thus contributing less to a higher gross national product. Exports and Government spending rose sharply during the recession, helping to keep it from deepening.

It is still a bit early in July to have very good figures on June developments. Our industrial production index probably rose another two points, following three point rises in each of the two preceding months. It now appears to be 110 per cent of the 1957 average as compared with the recent low of 102 in February and with a pre-recession level of 110 in the middle of last year. The rate of increase in industrial production thus far in the current recovery has not been quite as rapid as in the comparable phase of 1958, although considerably faster than in 1954.

Production growth in June was widespread, including consumer as well as industrial goods and finished products as well as materials. Steel production decreased, but only about seasonally, to just under 70 per cent of estimated capacity. Trade reports indicate a further decline of about seasonal proportions this month. New orders for durable goods have increased further to the highest level in a year and a half. Backlogs have been increasing.

Recent price developments appear fairly satisfactory. The general average of wholesale prices has continued to drift down. The consumer price index has shown almost no change since last October. With the rise in the prices of services more moderate than earlier and with food prices likely to decrease nearer the year end, prospects are good that the consumer price index will show relatively little change over the balance of the year.

Turning to the labor market, both employment and unemployment increased in June, as is typical for this time of year. The rise in employment, however, was considerably sharper than usual. With the large influx of teen-agers entering the labor market at the end of the school year, the seasonally adjusted unemployment rate continued at 6.8 per cent, around which it has fluctuated over the past half year or so. The current unemployment rate is below that prevailing during the comparable phase of the 1958 recovery although above that in 1954.

Looking ahead, there is still considerable disagreement as to the probable speed and extent of the current expansion. Questions focus mainly on the likely vigor and strength of future consumer demand and on the stickiness of the unemployment rate.

As for the strategic consumer, his recent purchases of goods, although improved, have continued below earlier highs although personal income has been above last year's level since April. Department store sales rose sharply, total retail sales slightly in June. Automobile sales, which had increased in May, showed little further change in June. Consumer demand for housing continues to be a fairly neutral factor in the economic situation, whereas in 1958 and 1954 it was a factor of great strength.

Developments in the recovery to date continue to provide some basis for hope that expansion will be solid and sustainable. Thus far it has been quite broadly based, not dependent, as some past recoveries have been, on sharp growth in limited sectors of the economy. Speculative developments have been kept in check reasonably well. Early ebullience in the sensitive commodity markets and in the common stock market has recently subsided somewhat. There have actually been some price declines in finished goods markets, and wage settlements thus far this year have been quite moderate. All this abstracts, of course, from a worsening of the international political situation, highlighted as it is currently by the threat of a new crisis over the status of Berlin.

Mr. Thomas presented substantially the following statement on credit developments:

Bank credit increased further by a significant amount in June. As in May, the increase reflected to a considerable extent acquisition by city banks of Government securities at times of new cash offerings, followed by little reduction in such holdings. Loans did not increase as much as they usually do in June. The increase in total loans and investments has been associated with expansion in Treasury deposits at banks. Private demand deposits, seasonally adjusted, showed no net increase from the last half of May to the last half of June, and, in fact, have shown no increase on balance since the latter part of March. As a result the money supply is one of the indicators that has not returned to its peak. Time deposits continued to expand and this, combined with increased Treasury deposits, brought total deposits to a high level.

Long- and medium-term interest rates rose further in June and are now near or above the highest levels of the past 12 months. Short-term rates, however, continued to fluctuate within the relatively narrow range that has prevailed since the latter part of 1960. The rise in longer-term rates evidently reflects the continued substantial volume of borrowing by corporations and by State and local governments through public offerings of securities and through private placements. The stock market has subsided considerably from the exuberance of last spring, with both prices and volume of trading at somewhat lower levels.

What does this brief summary of the financial situation signify for Federal Reserve policy? In the first place, it appears that monetary expansion--the main objective of current policy--has not been achieved, if the concept of monetary expansion is limited to private demand deposits and currency. The money supply has increased by barely 2 per cent in the past year, with no further growth since March. Yet member bank reserves have expanded by nearly 4 per cent and there has been expansion in bank credit at what might be considered a satisfactory rate. In fact, total loans and investments of commercial banks have increased by over $13 billion, or about 7 per cent, in the past year.

The difference, of course, lies in the growth in time deposits, which has exceeded 15 per cent in the past year. Since February, considered to be the low point of the recession, although private demand deposits have increased only slightly more than seasonally, time deposits at member banks have increased by over 6 per cent--an annual rate of 18 per cent. In that period reserves were made available in an amount sufficient to provide the basis for a 5 per cent annual rate increase in demand and time deposits, and total bank credit increased correspondingly. The public, however, has chosen to place more of its cash in time deposits. At the same time, shares in savings and loan associations have increased almost as much as time deposits. Although nonbank holdings of short-term U.S. Government securities have declined and those of savings bonds have shown little change, the public's total holdings of liquid assets are about 5 per cent larger than a year ago.

To obtain a faster rate of monetary expansion, there are a number of requisites. In the first place reserves must be available. If customer loan demand is strong enough, banks might be willing to borrow some of the needed reserves. In the absence of a strong loan demand, reserves have to be supplied at the initiative of the System in amounts adequate to keep excess reserves somewhat larger than country banks ordinarily want to hold--apparently about $500 million. Only when they have redundant reserves will banks add to their holdings of Government securities or actively seek other investments or loans.

The next requisite--and one less susceptible of control--is the desire of the public to build up cash in the form of demand deposits or currency, rather than to hold time deposits or Government securities or other forms of savings. The traditional means of influencing these desires is through interest rates. Unless there is a growing need for cash working balances, insertion of additional money into the economy will tend to push down interest rates until economic activity and borrowing demands are stimulated. Question may, therefore, be raised as to whether the System policy of endeavoring to hold up short-term interest rates has worked against its expressed objective of encouraging expansion of bank credit and the money supply. The next question, of course, is whether lower interest rates would have induced funds to flow abroad, which is the reason for the qualifying phrase in the policy directive and for the policy that has been followed.

What are the prospects for credit demands that might encourage expansion in bank loans and investments without a decline in interest rates? Analysis of prospective corporate sources and uses of funds suggests that business borrowing may continue relatively moderate in the months ahead. This conclusion is based upon the substantial recent and current volume of new capital issues, the indicated moderate increase in expenditures for plant and equipment and possibly also for inventories, the existing high level of depreciation allowances, and the likelihood of some increase in profits and retained earnings. There is as yet little indication of an increase in consumer credit or of much expansion in mortgage financing. Thus loan demand at banks might continue to be relatively moderate even with substantial economic recovery.

Principal sources of credit demands in the months ahead will be governmental borrowing. State and local government offerings of securities have been large and seem likely to continue so. The Federal Government will likely have net borrowing needs of close to $9 billion in the latter half of this year, compared with about $3.5 billion in the same months of 1960 and about $7 billion each in the corresponding periods of 1959 and 1958. However, the 1958 figures were distorted. Although the Federal Government had a bigger deficit in 1958, it was able to finance part of it by drawing on the very large cash balance held at the end of June.

In the 1958 period, which is comparable from a cyclical standpoint to the present, over half of the net increase in the public debt was absorbed by business corporations and most of the remainder by the banking system--largely by banks outside leading cities. Bank loans increased only moderately until late in the year. Throughout 1958, however, there was an unusually rapid increase in the money supply, as well as in time deposits, which furnished much of the cash basis for the recovery that began in that year and continued into 1959. Reserves that served as a basis for the 1958 expansion were abundantly supplied early in the year through reductions in reserve requirements.

Repetition of the 1958 experience, with its sharp decline in interest rates to very low levels early in the year and the sharp increase around midyear, is not necessary or desirable. Yet a continuation of credit expansion at perhaps a faster pace than in recent months is essential. The task of System policy will be to maintain a supply of reserves adequate to support further monetary expansion in order to encourage the processes of recovery. An estimate of the volume of reserves that might be needed for this purpose has been presented to you in the staff memorandum dated July 7, 1961. The estimate was based on a projected increase in private demand and time deposits at a 5 per cent annual rate.

In the current week and the two weeks following, required reserves will decline as Treasury balances are sharply reduced, unless the funds flow into private deposits in greater than seasonal amounts. The projected figures allow for a fairly substantial increase in such deposits. If System operations should absorb all the reserves released by the decline in Treasury deposits, as well as those that will be supplied by float and other factors next week, then private deposit growth would not be encouraged. Also, purchases needed in the last week of the month to cover very large reserve needs at that time would be enlarged by any sales made before that time.

On balance, over the next four months additions to the System portfolio of close to $400 million are likely to be needed to support the projected program. Gross purchases made at different times during the period might equal $2 billion, while gross sales made at other times might exceed $1.5 billion.

It is essential that adequate reserves be available at all times to encourage banks to purchase Government securities in the absence of sufficient loan demands. This would require that excess reserves of close to $600 million be available; this would mean free reserves of around $550 million. If there are clear indications that credit expansion is proceeding at a rate more rapid than is necessary or desirable, then a lower level of free reserves could be permitted. The figures of required reserves projected on the tables presented should be a minimum goal for at least the period covered; if required reserves do not reach this level, then free reserves should be kept abundant.

Mr. Young presented the following statement on international financial developments:

The United States balance of payments in the second quarter (excluding German debt repayment of nearly $600 million) appears to have turned more adverse, but the increase in the over-all deficit was not large. Main factors in the change, such as a moderately reduced trade balance and a continuing net outflow on capital account, may reflect temporary influences largely, so that earlier official expectations for the year of a relatively small over-all deficit may still be realized.

International markets have been reflecting profound concern about the future of sterling. The discount on forward sterling has recently exceeded 4 per cent, making the yield on covered U.K. short-term investment in U.S. Treasury bills nearly 2 per cent higher than in British Treasury bills. British Consols now yield about 6-1/2 per cent and the War loan 6-3/4 per cent. British stock prices have been declining for about eight weeks.

British balance-of-payments data show that the surplus on trade and private services account in the first quarter fell short of normal government external payments and private long-term capital outflow by nearly three-quarters of a billion dollars. Last year a large deficit on these combined accounts was covered by a short-term capital inflow, but this year, despite continuing high interest rates in the London market, the short-term capital flow has been outward.

Demand pressures on British productive resources are heavy, particularly on skilled labor and on construction capacity, and wage costs have been showing further rise relative to productivity. In view of the limited capability for export expansion when domestic demand is running so strong, British officialdom is said to be giving serious thought to a comprehensive corrective program, which would have the following objectives: cutting back on domestic demand via fiscal measures; curbing further rise in construction activity; restraining further rise in wage rates and costs; raising the all-around competitiveness of British industry; and reducing or postponing government expenditures domestically and overseas. To reinforce this program, a tight monetary policy would be maintained.

An important counterpart of the large British balance-of-payments deficit is the large German balance-of-payments surplus. Whether the latter is being corrected is still in doubt, but German developments are being influenced by the following sets of forces: (a) the modest revaluation of the Deutsche mark; (b) a significant reduction in short-term interest rates and some lowering of long-term rates; (c) attainment and maintenance of some fiscal surplus; (d) tolerance of wage increases about double productivity increases; and (e) a decision to let the exuberant boom run its course. These forces are resulting in a relative inflation in Germany vis-a-vis the balance of industrial Europe. As one German official suggests, judgment as to a corrective process in motion must be tentative and reserved, so that about all one can say now is that the developments are in the "right" direction. Meanwhile, the current flow of German economic data is suggestive that internal pressures are relaxing somewhat.

Regarding balance-of-payments developments in the rest of Europe, note should be taken of the substantial improvement in French monetary reserves in the past six months. For several major industrial countries abroad, including Japan, expansive tendencies in export trade have become less marked, perhaps pointing to some loss in upward momentum in the external trade of these countries.

Recent Canadian exchange rate depreciation is rationalized officially as a measure to curtail both merchandise imports and capital inflow while new domestic policies to stimulate recovery and activate growth forces are given time to come into operation and become effective. Regardless of motivation, the action did inject new uncertainties into international markets as to existing exchange rate alignments. This consequence has resulted in considerable international criticism of Canada's action and prompted various demands that Canada soon establish a fixed rate of exchange. The fact that the depreciation in the Canadian exchange rate is the result of active government intervention distinguishes it from a depreciation resulting from market forces and exposes the Canadians to criticism for competitive devaluation.

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

The business expansion continues to broaden, although its pace in June was somewhat slower than in April and May and a seasonal slowdown may lie ahead. Government spending is sure to be a source of strength in the second half of the year. While inventory liquidation has probably ended, the rise in inventories in the second half is unlikely to be very sharp in view of stable and even declining prices, ample capacity, and improved inventory management. The big question remains to what extent consumer spending and plant and equipment outlays, together with government spending, will fill the place of inventory change as the principal stimulus to expansion of the gross national product in the months ahead. As yet consumers show no signs of willingness to embark on a spending spree by increasing their indebtedness and reducing liquid asset holdings. The serious unemployment situation will continue to be a dampening influence, and both unemployment and unused capacity will remain high at the end of the year.

The short-term price outlook is encouraging, in view of the strength of foreign competition, a leveling off of food prices, and the good chance that unit labor costs may decline further--unless the new auto contract due early in September reverses this tendency.

The level of total commercial bank loans, which held up quite strongly during the recent recession, has since weakened somewhat. This, together with a moderate pick-up in Government security holdings, has resulted in some improvement in bank liquidity, especially in New York. Nevertheless, loan-deposit ratios remain quite high by past standards, and although they have had free reserves for over a year, the banks have not built up a very substantial liquidity buffer. Many banks, particularly the larger ones, are uneasy concerning their ability to meet the loan demands that are bound to arise as the economy moves upward. In spite of the easy money market in recent weeks, loan rates have been firm and the banks are not aggressively soliciting loans.

With the Treasury on the verge of announcing large refunding and cash financing programs, it is clear that there should be no change in our basic policy, which in any case continues to be fully justified by the state of the domestic economy. I can see no need for a change in the discount rate or the directive.

In the international sphere the situation remains touchy. While most of the market nervousness centers on sterling, the atmosphere of distrust of exchange rates could later have adverse effects on the dollar, especially if we fail to make greater progress than we have to date with the over-all balance of payments. Hence, while domestic conditions clearly call for maintenance of ample monetary ease, with doubts resolved on the side of ease, we must continue to give close attention to the danger of excessive pressure on short-term rates. Thus, from the standpoint of international considerations, maximum flexibility with respect to maturity ranges is still essential for open market operations.

Beyond this, I think we should recognize that purchases of intermediate- and long-term securities by the System Account and the Government investment accounts have performed an important function in helping to loosen up the flow of credit into corporate and State and local Government securities. A record volume of such offerings in the second quarter was accommodated with only moderate upward pressure on rates. Now, however, the Government investment accounts are for all practical purposes out of the market, while it remains as important as ever that long-term capital should flow smoothly to nourish the recovery in business. As set forth in the memorandum on this subject which the members of the Committee have already received, I believe it is incumbent on us to exert an influence on capital markets similar to that exerted by the Treasury before its virtual withdrawal from the market, and to adopt a rather more positive approach to the question of how and to what extent to use the special authorization. Sizable open market purchases will in any case be called for over the next six months. Not only should the special authorization be used to inject needed reserves without putting pressure on the bill rate, or to offset sales of short-term securities designed to moderate pressure on that rate, but it should also be used when congestion appears to be developing in the capital markets or when market expectations as to the future course of rates seem to be having exaggerated market effects. I would hope that there would be no reluctance to use the long maturities as well as those of intermediate term. The size of these operations would of course be held well within the limits of the market's capabilities, and there should be no attempt to hold long-term rates at or below some preconceived level. Offsetting sales of short-term issues could be used, as and when this seemed desirable, to neutralize the reserve effect of such purchases of intermediate- and longer-term issues.

There should be no doubt in the public mind that the System is making a genuine effort in the area of longer-term operations; and the market should be educated to recognize that

> the System envisages this as a normal procedure to be used in greater or less degree as future circumstances require, and to understand the objectives toward which the System is aiming in these operations, including the objective of moderating excessive swings in interest rates and other conditions affecting the availability of funds. Unless we move forcefully in this direction, we shall play into the hands of those critics of the System who maintain that our efforts to promote recovery and expansion have been at best sporadic and half-hearted. There is no doubt in my mind that criticism of this kind, unless effectively answered, could lead to serious long-term damage to the System. I trust that this Committee will recognize the danger and will move to head it off along the lines which I have proposed.

Mr. Hayes said he would like to add a few remarks at this point in response to Mr. Mills' earlier comments. In his (Mr. Hayes') judgment, the operations in longer-term securities had not been a failure or a disappointment. Mr. Mills, he noted, had spoken only of the "nudging" aspect, as distinguished from the international aspect. However, from the international aspect alone, these operations had been distinctly successful in preventing excessive pressure from being exerted on the short-term rate. As to the domestic aspect, while it was difficult to prove, he firmly believed--and thought it was probable--that these operations, along with the purchases by the Treasury for Government investment accounts had facilitated portfolio adjustments undertaken by investors placing funds in new issues, thus stimulating the flow of funds into useful and productive efforts. He wished to stress again, in regard to Mr. Mills' comments, his opinion that the fact the long-term rate moved up was not a sign of failure. It had moved up less, probably, than it would have in the absence of the operations in longer-term securities. In brief, a useful and valuable operation had been going on. He was a little concerned only in the respect that the Committee itself had not been quite clear enough and positive enough about the value of the operation. The Committee, he felt, had been tending to take too apologetic an attitude.

Mr. Johns said that although the facts pertaining to the recent behavior of the money supply had already been well exposed and were well known to everyone at this meeting, it seemed to him worthy of emphasis that since March, that is, in the past three months, the money supply had been virtually unchanged. This was in contrast to an increase at an annual rate of about 4-1/2 per cent from November through March. It might also be contrasted with an increase at an annual rate of about 5 per cent in the early stages of the 1954 and 1958 recoveries. Further, during the three-month period since March the money supply, as narrowly defined, plus time deposits had risen at an annual rate of only 5.2 per cent, compared with an increase at an annual rate of 9.1 per cent from November through March. The lack of growth in the money supply during the past three months seemed to him inappropriate for two reasons. First, it did not reflect appropriate policy at this stage of recovery. Second, it was not consistent with the Committee's directive, in effect throughout the period, which called for open market operations with a view to encouraging expansion of bank credit and the money supply.

He was inclined to believe, Mr. Johns continued, that with about 7 per cent of the labor force unemployed and output of major materials running at about 78 per cent of capacity, it would be difficult to explain holding the money supply constant on the basis of any fear that the fires of inflation might be relighted. It was his view, therefore, that vigorous steps should be taken, without further delay, to encourage a substantial increase in the money supply. This could be done only by adding to bank reserves, yet total reserves of member banks, adjusted for seasonal fluctuations, were about the same in June and early July as they were last winter. If the Committee really meant what it said in the policy directive, namely, that it wanted monetary expansion, it must supply the reserves without which such expansion could not occur. He would also suggest that this required more concentration on the objective of monetary expansion and less preoccupation with attempting to smooth out short-run fluctuations. If, however, the Committee was unwilling to supply the reserves necessary to obtain monetary expansion, then he would suggest that the directive be altered to say what the Committee was actually willing to do. As to the means by which the objective now stated in the directive might be attained, he would suggest referring to the staff memorandum on member bank reserves that had been distributed prior to this meeting. As he read the memorandum, and the tables submitted therewith, the content and approach were somewhat different from previous issues of this memorandum. According to the text accompanying the tables and the footnote to table 3, there had been built into the projection of required reserves an allowance of $15 million a week for expansion of demand deposits adjusted and time deposits at an annual rate of 5 per cent. While this was commendable, he doubted that it was adequate. He would prefer that the expansion factor be larger by some $10 or $15 million a week.

Mr. Bryan stated that the Sixth District continued to exhibit a pattern of economic developments quite similar to that of the nation. Substantial gains had been scored in nonfarm and manufacturing employment, department store sales were up for June, and bank debits were sharply up. Construction contract awards were also sharply up, and construction employment was up after a long decline. Average weekly hours worked and manufacturing payrolls were up, but the loans and investments of member banks were slightly down.

One of the bright spots in the District picture was the agricultural situation. Farm income was increasing and apparently would continue to increase substantially for the rest of the year, a development attributable chiefly to livestock and citrus marketings. In crop production there was a good cotton situation, with an increase in the cotton allotment and the support level raised. The tobacco allotment had likewise been increased.

Turning to the national economic scene, Mr. Bryan said it appeared to present a satisfactory recovery, outscoring at this stage in production, employment, and income two of the three last recoveries. He still judged it impossible to determine whether the recovery had the makings of a super boom or simply a more moderate expansion.

As Mr. Bryan saw the proper posture of monetary policy, a free reserve position of $500 to $600 million on the average would be appropriate for the next three weeks. He noted, of course, what he judged to be the easy reserve position of the banking system; and the comfortable bank liquidity position. Accordingly, he saw no point in an all-out forcing of additional free reserves into the banking system at this time. In fact, he believed the Committee must be alert to the possibility that it might need, in the not too distant future, to reduce the level of free reserves, and not endlessly to maintain them at a preconceived level in the face of total reserves and required reserves that might well go up rapidly.

Mr. Bryan then commented that the money supply, narrowly defined as demand deposits adjusted and currency, appeared to be about 2 per cent higher than it was a year ago. He believed this figure to be misleading for policy purposes. Time and savings deposits, he pointed out, had increased to a level 14.9 per cent above May 1960. While he would not contend that the total of these deposits should be included in the active money supply, he did believe it entirely clear that at present some substantial portion of such deposits must be included in thinking about the money supply; and if such a mental adjustment was made, he believed the money supply was adequate to a sustained recovery. Even a narrowly defined money supply, demand deposits adjusted and currency, was likely in his opinion to show in the near future a tendency to increase via the route of bank-supported Government borrowings.

After stating that he saw no reason to change the discount rate at this time, Mr. Bryan said that he shared the complimentary expressions of Mr. Johns regarding the staff projections of reserve needs. He was glad that a cumulative amount of reserves had been included to allow for a growth of reserves and, at this time, an amount reasonably calculated to assist the recovery.

Mr. Bopp reported that business recovery was apparent in the Third District, but only spottily. Production was increasing, as indicated by the fact that consumption of electric power had been rising, especially in durable goods industries. Steel output had held up well in recent weeks, while it was declining nationally, and in May the District made up a good part of its lag behind the United States in construction activity. Yet consumer demand had not reacted strongly. Department store sales improved in June but were still under year-ago levels, and unemployment was still widespread. In two-thirds of the District's labor market areas, the unemployment rate was higher than the national percentage. Neither did banking figures reflect a strong business upswing; business loans, after seasonal adjustment, actually declined in June. Banks were relatively comfortable in their reserve positions and had borrowed little from the Reserve Bank. Philadelphia banks, however, had continued to borrow Federal funds and to run a deficit in their basic reserve positions.

Even aside from the heavy Treasury calendar ahead, Mr. Bopp said, observation of the economy indicated clearly to him that policy should continue to promote monetary ease. It was gratifying that interest rates had risen as little as they had, and he hoped that funds would be plentiful enough to slow down any further upward tendencies in the immediate future. It would be desirable, in his opinion, for policy to foster a resumption of expansion in the money supply, and if this required higher levels of free reserves, he would not be disturbed.

Mr. Bopp said that he would recommend no change in the directive or the discount rate, and that he would favor renewal of the special authorization to operate in all sectors of the Government securities market, for more extended purposes.

Mr. Fulton reported that Fourth District business activity was quite favorable in the past three weeks. Although the record for the first half of 1961 did not measure up to the same period in 1960, nearly all measures of business and financial activity except steel production showed some improvement in June. A part of the generally favorable trend was due to seasonal influences, and in the past couple of weeks there seemed to have been some leveling off; that is, a lack of continuation of the upward surge that had been noted earlier. However, this might be due to the vacation periods that come in July and August in the heavy industries.

Insured unemployment continued to decline, Mr. Fulton said, and two major cities, Cincinnati and Dayton, had been removed from the substantial labor surplus category. In this respect, the improvement in the District appeared to have been better than the national average. Building permits rose sharply in June in the Cleveland area, due primarily to a large permit issued for a veterans' hospital, but the situation slipped back a little in Cincinnati. Sales of new cars advanced substantially in June, although such sales were still under the year-ago figure. While department store sales were rising, for the year as a whole they were about 2 per cent below last year. A number of bankers with whom he had talked seemed to think that people simply were not buying as they would like to buy. Money was being saved, apparently to be brought out when the atmosphere changed and people were more confident that their jobs were secure.

The output of electric power, which earlier had been increasing, had now leveled off, Mr. Fulton said, indicating that the production of industries using such power was leveling off. In the machine tool industry, new orders in May and June were below the average for the first quarter of the year. Total orders for the year as a whole were expected to be about the same as in 1960, with no definite uptrend anticipated until the first quarter of 1962.

Mr. Fulton went on to say that there was no evidence of any substantial accumulation of inventories. At the present time, buying seemed to be on a hand-to-mouth basis, or to build up to operating levels where inventories had been maintained below such levels. There was nothing to indicate accumulation of inventories as a safeguard against price rises. In the steel industry, foreign pipe and that type of commodity was still coming in in quantity and was very competitive with the production of domestic mills. Galvanized sheets and roofing were in heavy demand, while sheets and strips, used widely in the auto industry, were in fair demand. The steel industry, however, was deeply concerned about the profit squeeze. While more goods were being turned out, profits were not commensurate with the increased activity. There would be another wage increase in October, and it was felt quite generally in the industry that a price rise would have to go along with the wage increase.

Mr. Fulton commented that loans at Fourth District weekly reporting banks had been up in each of the past four weeks, the rise being the largest for a like period in more than a year. Savings deposits were at an all-time high and were increasing.

Summarizing, Mr. Fulton said he felt that the recovery was progressing, but without the ebullience that had marked some previous recoveries. The profit squeeze was a problem of major importance and could inhibit industries from going ahead with expansion programs.

As to policy, Mr. Fulton felt that free reserves should be maintained at a level between $500-$600 million, that reserves should be made freely available, and that any doubts should be resolved on the side of ease. He would not recommend changing the discount rate or the policy directive, and he would continue the authorization to operate in longer-term securities. He would not want to withdraw that authority from the tools available to the Manager of the Account.

Mr. King said he was inclined to agree with Mr. Bryan's analysis of the money supply problem. Like Mr. Bryan, he felt that various factors other than the money supply, narrowly defined, must be considered. Under present circumstances and considering the atmosphere in the business community, he did not believe that monetizing more of the debt would produce prosperity.

After noting that he would not recommend a change in the discount rate or the directive at this time, Mr. King commented that he had just returned from a European trip of about four weeks during which he visited seven countries. In general, the business boom appeared to be still going on, although there were beginning to be signs in some countries that the boom might be leveling off somewhat. He had returned with the definite impression, Mr. King said, that the European central banks believed the maintenance of the U. S. Treasury bill rate during the past year or so had been a most constructive factor. When he went to Europe, he was beginning to waver a little on that score, but he returned with the impression that there was not too much room for decline in the bill rate.

In a concluding comment, Mr. King said that his thinking about going into operations in longer-term securities had been based largely on attempting to maintain the bill rate, with other possible objectives, on the domestic side, more doubtful of accomplishment and of less importance. Maintenance of the short-term rate should, he thought, still be the primary guide in the weeks ahead so far as such operations were concerned.

Mr. Shepardson expressed the view that monetary policy had been appropriate. As reported by the Account Management, and as indicated by the Federal funds rate, there had been a reasonable degree of ease and ample availability of funds. The fact that loans had not risen more was perhaps not too disturbing when the volume of activity in the capital markets was considered. He did not know exactly how much of the funds obtained in the capital market might have been used to reduce bank debt. To the extent that they had, however, he felt that was a wholesome and constructive development, for it indicated that businesses were putting themselves in a better position.

With regard to the suggested discrepancy between the language of the directive and the behavior of the money supply, Mr. Shepardson said he would align himself with the view expressed by Mr. Bryan that account must be taken of the expansion that had occurred outside the money supply, narrowly defined. For that reason, and in light of the pending Treasury operations, he considered it desirable and appropriate to continue the policy that had been followed recently.

Mr. Robertson said that he would align himself almost completely with the views of Mr. Johns, subject to the qualifications subsequently introduced by Mr. Bryan. The combined approach of Messrs. Johns and Bryan seemed to him good.

In his judgment, Mr. Robertson said, open market operations since the June 20 meeting had not been sufficiently aggressive to comply with the consensus of views expressed at that meeting, and certainly not sufficient to carry out the directive, which specified that operations should be conducted with a view "to encouraging expansion of bank credit and the money supply so as to contribute to strengthening the forces of recovery."

As he saw it, this was certainly a time to be adding to the money supply in order to promote economic growth at a faster rate in view of the absence of inflationary movements. Yet, with exceptions so rare as to indicate they were accidental, operations during the past six months had in his view been so far on the cautious side as to preclude an adequate expansion of the money supply. In his opinion, the Committee should strive for a higher level of free reserves ranging from $550 to $600 million, between now and the next meeting.

Mr. Robertson then said that in view of what he understood to have been the Committee's decision to disengage from operations in longer-term securities "as rapidly as possible without unduly impairing the structure of the market", he was astonished at the acquisitions in the long-term area ten days or so ago. While it was true that securities had to be acquired in order to provide reserves in a substantial measure, the appropriate volume of reserves could have been added through the purchase of bills without unduly depressing the yield. If the objective of the "nudge"operation was to hold up the short-term rate, there was no need for the "nudge"operation during the period in question. If the objective, on the other hand, was to push down long-term rates, the quantity of acquisitions in the long-term area was insufficient to affect any rates other than the rate on long-term Governments. Consequently, it seemed to him that the acquisition in the long-term area must have been for purposes of "show"rather than "effect", and that they were hardly in keeping with what he understood to be the Committee's decision to disengage from the operation as rapidly as possible.

Already, Mr. Robertson continued, there had developed a definite thinness in the market for long-term Government securities. If official purchases were continued, picking up the "bargain offerings" in the market and depressing Government yields relative to other securities, prospective private buyers of Governments would be discouraged. Some might divert funds permanently to other markets, and some might postpone acquisitions of Governments until a later date in the hope of a sufficient advance in yields to more than compensate for any loss of return in the interim. Such tendencies would be reinforced by the prospect of a forthcoming general cyclical advance in market rates.

Mr. Robertson noted that during several weeks in April and May official purchases had accounted for as much as 50 per cent or more of dealer sales of long-term Governments, and retail purchases had often dropped to one-fourth or less of the total. During the recent period when the System acquired intermediate- and longer-term securities, other buying was negligible. If this trend of participation should continue, beyond some point private buying actions would lose their influence upon market rate determination (although private selling actions were not likely to do so) and official purchasing action even when accomplished within the quoted consensus of dealer prices, would become the effective determinant of the prices posted by the dealers. That is, whenever securities could not be moved to official buyers at existing prices, dealers would be likely to proceed to adjust offering prices downward until some official buying interest could be elicited. This development, while not yet firm "pegging," would enormously complicate Treasury attempts to lengthen the maturities of public financings and might lead to a reliance upon official bids for "cues" as to current market price levels in disregard of the changing balance of private supplies and demands. The continuation of official buying could widen the gap between prevailing market yields and those yield levels which would be sustainable on the basis of private buying interests alone. The wider this gap became, the more market turbulence would be in prospect if and when the "nudge" operation was finally halted or overwhelmed.

Quick cessation of official purchases in intermediate- and long-term securities was, Mr. Robertson believed, the only sure way to avoid possible concentration of sales (even short selling) by dealers, other professionals, and large sophisticated investors endeavoring to transact all possible business at supported price levels in anticipation of later sharp rate advances. Comments were heard to the effect that sustained blocks of such holdings were overhanging the market. An attempt to continue official purchases when such sale efforts materialized would undoubtedly lead to a focusing of market prices around the bids of the official buyers for as long as they were maintained. Avoidance of official purchases would allow the traditional restraint of price declines to curb the liquidation program of these and other holders of Governments.

In short, it was his belief, Mr. Robertson said, that the special "nudge"operation should be terminated now. It had already brought about a thinness in the market for intermediate- and long-term Government securities which would make much more difficult the task of the Treasury to finance in the intermediate and long end of the market because of the most impossible job of determining objectively a rate at which to offer such securities. Such an obstacle should not be placed in the way of the Administration (with or without its consent and encouragement) in its effort to get the maturity schedule of the public debt into a more manageable position.

After stating that he would not recommend changing either the discount rate or the directive at this time, Mr. Robertson returned to the subject of operations in longer-term securities and expressed himself as surprised at the July 7 memorandum from the Federal Reserve Bank of New York which suggested a new criterion for such operations. While this proposal seemed to be based almost entirely on the idea of maintaining maximum flexibility, he had a feeling that this was mere camouflage. It appeared to him to be more a matter of playing a game than providing reserves according to the needs of the economy.

Mr. Mills said he wished to join those who had expressed agreement with the comments of Mr. Bryan regarding the money supply problem. He shared what he sensed to be the concern of Mr. Bryan about the inflationary danger that was implicit in maintaining a constant high level of positive free reserves over a long period of time. It disturbed him that some members of the Committee had fallen into the habit of devoting attention almost exclusively to the money supply, as conventionally defined, for he believed the Committee would be much better advised to focus its attention on the expansion of bank credit. Within the past year bank credit had expanded by some $13 billion, which, to the extent that the actions of the Federal Reserve System had contributed to it, was a major accomplishment. Not too long ago, he recalled, considerable concern had been expressed within Committee circles about the magnitude of the near-money substitutes that were then contained in the financial system in forms such as time deposits, savings and loan shares, and mutual savings bank deposits. Now, however, the comments had turned in the opposite direction, with apparent abandonment of concern about injections of liquidity into the financial system. These could have explosive qualities at such future time as accelerating recovery might ignite them.

As to the money supply, per se, Mr. Mills said he wished to repeat the sentiments he had expressed previously to the effect that in the present climate of economic activity Treasury financing through the commercial banking system offered itself as the appropriate vehicle for expanding the money supply, through the opportunity it afforded to supply reserves on the occasions of Treasury cash financing and through the tax and loan account procedure.

Mr. Mills said he could see no reason to change the discount rate at this time. While he would renew the special authorization covering operations in longer-term securities, again, as at the June 20 meeting, he would implement the authorization by abstaining from operations outside the bill sector of the Government securities market. For the period immediately ahead, he could see no objection to a level of free reserves ranging from $500 million to $575 million, or thereabouts, provided the Desk was careful to observe the reactions of the Government securities market and of the commercial banking system to the availability of so substantial a base of reserves on which credit expansion could proceed. Again, as he had said at the June 20 meeting, he felt the Committee had committed an error, from which it was difficult to recede, in having the policy directive include reference to the money supply. It was the question of bank credit expansion on which the Committee should focus, in his opinion, and bank credit expansion had been occurring. In his judgment the Committee could be exposed to criticism later if the money supply had not risen. It would have been forgotten that there had been a major expansion of bank credit, which had served the purpose of stimulating the economy under present conditions.

Mr. Wayne reported that business activity in the Fifth District during recent weeks was perhaps somewhat less vigorous than appeared to be the case in the nation as a whole. Employment showed increasing gains through May but manufacturing man-hours were smaller than in previous months. Both figures remained below last year's highs. Production increases were noted in some sectors, but lumber output had slackened recently in the face of weak demand. In general, manufacturing industries were firm or improved. The pace of construction work remained high and the favorable volume of contract awards portended strength for the near future. Bituminous coal production and loadings had been up sharply, but the troublesome longer-run problem remained unsolved. Retail sales, including those of automobiles in particular, had been strong. The agricultural outlook was fairly good, except in certain areas that had been affected by heavy rains.

Mr. Wayne noted that the textile industry, which provides over a quarter of the District's manufacturing jobs, currently was facing more than the usual number of problems. Significant areas of demand were still weak, particularly the demand for certain lines of woven goods. Prices were down substantially, yet rising costs were virtually assured as the result of higher support prices and the prospective minimum wage increase. In short, demand would have to increase considerably before the additional costs were recovered. In the long run it seemed that the mills were likely to turn more and more to automation, with less and less employment provided.

District banks continued to be in a comfortable position, Mr. Wayne said. Borrowings from the Reserve Bank increased moderately in the first week of the most recent period but then declined, so that borrowings approached the low levels typical of the past winter and spring. While District banks were net buyers of Federal funds for most of the period, their purchases were less than in May.

Business loans and most other loan categories showed seasonal gains, and gross loans increased in the manner typical of this period of the year. The banks reduced their total investments about seasonally, but holdings of short-term Governments increased substantially.

Mr. Wayne expressed the view that the Desk should be commended for a good job during the past three weeks in consistently maintaining an appropriate degree of ease despite wide swings in the forces affecting reserves. There appeared to have been no tightness at any time. While free reserves rose sharply and the Federal funds rate fell on occasion, the Desk correctly appraised these movements as temporary and there was no sloppiness. The bill rate had been quite stable, and the rate on Federal funds was continually well below the discount rate. Such conditions, he felt, were appropriate at a time when there was not yet assurance that the recovery would continue and expand. In his opinion, the situation called for continued ease.

Mr. Wayne said he would like to associate himself with the view of Mr. Mills that any move in the next three weeks toward realizing the goal of the directive should concentrate on the expansion of bank credit rather than the money supply, narrowly defined. It would be necessary to work through expansion of investments, and the Treasury operations would afford an opportunity. He would favor the maintenance of free reserves at a level that would help banks participate, and if free reserves went above \$550 or \$600 million he would not be disturbed.

Mr. Wayne said that he would not recommend changing the directive or the discount rate at this time. As to the special authorization covering operations in longer-term securities, he was not aware that the Committee had concluded to disengage from such operations. While he was not prepared at this time to accept the New York Reserve Bank's proposed new criterion relating to transactions in longer maturities, neither was he prepared to label the special operation a failure or to abandon the program on which the Committee had embarked in February. He was not persuaded that the Committee should now or at some date in the near future return to the so-called "bills only" policy unless better supporting arguments were available than had come to his attention or unless the Committee was prepared to withstand an onslaught of criticism directed against the System.

Mr. Clay commented that in the current period Treasury financing activities apparently would dominate the financial scene so far as monetary policy is concerned, which suggested that Committee operations should be geared to the maintenance of an "even keel." This did not preclude, however, continuance of the general direction of monetary operations that had been the Committee's objective in "encouraging expansion of bank credit and the money supply." Rather, it meant that there should be no significant change in that policy. In the course of its operations over the past three weeks, Mr. Clay noted, the Open Market Account had acquired securities having various maturities longer than one year, and it seemed to him desirable that the Manager have discretion with respect to this type of operation in the period immediately ahead.

So far as the state of the economy was concerned, apart from Treasury financing considerations, it seemed to Mr. Clay that the Committee should continue its expansionary policy with a view to stimulating economic activity and growth. The Committee, he pointed out, was not encumbered in its current operations by a conflict between its price stability objective and the objective of fostering a higher level of economic activity, by reason of the favorable price developments that were occurring in the commodity markets.

Continuing, Mr. Clay remarked that the expansion of bank credit in June would have been more encouraging if it had represented private credit demands to a greater extent rather than Treasury financing. Nevertheless, as Treasury tax and loan accounts ran down, bank reserves should be maintained in sufficient volume to foster the growth of credit. Since banks had not reduced their rates on loans significantly over the recent period of contraction, it seemed all the more desirable that credit availability be maintained and improved.

No change appeared to him to be called for in either the directive or in the discount rate, and he felt that the authorization covering operations in longer-term securities should be renewed. In the latter respect, Mr. Clay added that he had not been aware of any decision on the part of the Committee to disengage from operations in longer-term securities. In his opinion, there had been no proof of failure; nor would he expect that, considering the conditions and the period of time in which the special operations had been conducted, there would be proof of great success. However, the Committee had been successful, certainly, in the area of preventing excessive pressure on short-term rates, which he regarded as one of the necessary reasons for which the operations in longer-term securities were undertaken. From the opinions he had heard at Committee meetings, members of the Committee did not appear to have changed their minds significantly from the positions they took when the special authorization was first granted. In his view, the Committee should use all of the instruments available to it for attainment of the objectives of monetary policy. It should continue to engage in operations in the longer-term area long enough to obtain some real indication of results one way or the other.

Mr. Allen said that his comments could be summarized in the words "more of the same." That was the situation in the Seventh District, where economic activity continued to rise gradually and employment was improving. Most businessmen were optimistic, as evidenced by the statements of business leaders published by the First National Bank of Chicago on July 1. The spokesmen for steel, electrical machinery and appliances, merchandising, construction machinery, petroleum, and automobiles all expected improvement in the second half of the year. In covering credit and interest rates, the Chairman of the First National Bank of Chicago (also President of the Federal Advisory Council) foresaw growing demands for funds, private and government alike, with a gradual shift in Federal Reserve policy from the relative ease of recent months, and a rise in the interest rate structure with pressure greatest at the short end. He did not expect any change in the prime rate during the next six months, because "the rise in short-term commercial borrowings from banks probably will lag the business recovery as it has in the three previous postwar cycles."

Mr. Allen noted that ten cities in the Seventh District, Chicago and Detroit among them, had recently been moved by the U. S. Department of Labor to a lower category of unemployment. In the farm areas, crop conditions were generally good to excellent throughout the District. Both corn and soybeans looked very good.

Automobile production was 560,000 units in June. Present schedules called for only 400,000 in July, 200,000 in August, and 475,000 in September--a total of 1,075,000 in the third quarter--but production for the fourth quarter was estimated at 1,700,000. New model introductions were scheduled to begin in mid-September and to be completed by October 1. The possibility of a strike was, of course, important; if a strike should begin on August 31, the industry probably would not have more than 550,000 1961 models and 100,000 1962 models to sell at that time.

With respect to banking and credit, Mr. Allen said he could think of little to add to the staff review distributed prior to this meeting. The expected pickup in private credit demands was still not much in evidence, and he saw little reason to expect strong demands for bank credit for several weeks yet. Seventh District banks, the money market banks in particular, had considerable leeway to accomodate loan demand when it did develop. In the last statement week the Chicago central reserve city banks showed a surplus basic reserve position of over $100 million, most unusual historically.

As to monetary policy for the next three weeks, Mr. Allen felt again that "more of the same" was in order. Conditions generally seemed to him to point to such a course, and the Treasury financings provided another reason. He would favor continuing the current degree of ease, from the standpoints of both statistics and atmosphere, so far as that was possible, and he would not change either the directive or the discount rate. At the same time, he thought the Committee must be vigilant and prepared to move. The fires of inflation might be only embers, as many seemed to say, and it was to be hoped they were right. However, some pretty dry timber was being piled close by, and there were fire bugs around as always, so the System might have to use its equipment, for what it was worth, before long.

In conclusion, Mr. Allen said he would not favor continuing the special authorization to operate in longer-term securities because in his view that operation had proven as ineffectual as it was indefensible and represented an undesirable and unwarranted authorization to interfere with the free operation of the market.

Mr. Swan said that in the Twelfth District somewhat less than vigorous recovery appeared to be continuing, against the background of a high and persistent level of unemployment and excess capacity. In the District, as in the nation, a cautious attitude on the part of consumers seemed to be reflected in the steady rise of savings deposits at banks and share accounts in savings and loan associations. Incidentally, the rate of 4-1/2 per cent being paid by savings and loan associations in California was firm for the second half of the current year.

Mr. Swan went on to say that the Committee seemed to be confronted on the one hand by a still moderate business situation and moderate demands for bank credit, and on the other hand by a relatively heavy Treasury financing program. In his opinion, both of these factors led to the position that the present policy of ease should be continued, with any doubts very firmly resolved on the side of ease. To him this would mean a bill rate of around 2-1/4 per cent and free reserves in the range of $500-$600 million. However, in view of the wide swings anticipated in the period ahead, with market factors supplying reserves the next two weeks and a turnaround in the week ending August 2--and in line with Mr. Robertson's analysis at the June 20 meeting of the effect of such swings in market forces, particularly float, on reserves--for the next two weeks he would not try to offset entirely the additions to reserves supplied through market forces.

Mr. Swan said that he would not recommend any change in the discount rate or the directive and that he would favor continuing the special authorization covering operations in longer-term securities. He would not be prepared at this point to accept the new criterion suggested by the New York Bank, but neither would he want to disengage from operations in the longer-term area. He recalled that when the Committee went into these operations it had some discussion of the possibility of swap transactions. Although he was not sure just how far the Committee intended to go in that regard, there was explicit recognition of the possibility of such transactions. As to the matter of disengagement, he did not see how this could be considered without opening up again the whole question of the Committee's statements of operating policies.

Mr. Ellis commented that in New England there had been some recovery and some expansion. As to manufacturing, which was still in the stage of recovery, the index was up further in May after seasonal adjustment, and there was evidence of further increases in manufacturing activity in June. Construction contract awards in May were 2 per cent above last year, but the employment figures were below last year. For three successive months through May there had been monthly increases, but this was just recovery because the figures were still below year-ago levels. Initial unemployment insurance claims had gone down further, to the lower points of 1959 and 1960, which indicated that the unemployment situation was beginning to look much better. Total insured unemployment, however, was still above last year. On the expansionary side of the picture, department store sales had continued to rise and were exceeding the 1960 figures. On the other hand, resort business was off to a slow start, traceable largely to adverse weather conditions.

Mr. Ellis said that business loan demand did not show the usual strength in June, this being traceable largely to the category of loans to sales finance companies. Deposits dropped during the past three weeks, and the cumulative gain in demand deposits was now down to 3 per cent since the start of the current year. District banks were net sellers of Government securities in June and were net buyers of Federal funds on balance. In contrast to the national picture, loan-deposit ratios rose in June.

Mr. Ellis expressed the view that monetary policy had been about correct, both in terms of policy and procedure. The banks had adequate lending capacity to support credit expansion as needed, but they were not excessively liquid. Therefore, it would not be difficult to make an effective shift in policy at a later date if somebody should blow on the embers of inflation.

In light of the successful functioning of the private capital markets, Mr. Ellis said he would judge that interest rates were not out of balance with domestic needs and that they were not, of themselves, causing upsetting capital flows internationally. He would avoid concentrating exclusively on expansion of the money supply as an objective of monetary policy, especially if time deposits were excluded from consideration.

The concern that occupied his thoughts currently, Mr. Ellis said, was that the Government securities market might be upset by misunderstandings about Federal Reserve participation in the longer-term area. Such a situation could develop if the market were led to believe that the Open Market Committee had undertaken an abrupt dis-engagement from transactions in longer-term securities. This would be particularly unfortunate in view of the imminent Treasury financing.

Mr. Ellis said he would agree with Mr. Wayne concerning the conduct of open market operations during the next three weeks. As Mr. Thomas had pointed out, projected changes in required reserves, Government deposits, and other operating factors might bring about a heavy supply of reserves in the next two weeks. Therefore, the job facing the Manager was to absorb some reserves in this period. Reference had been made to running off maturities, but action aside from that might be needed. It would not be necessary, of course, to absorb all of the reserves. Perhaps it was time to look more carefully at the impact on the market in terms of the tone of the market and interest rates, rather than to pay too close attention to free reserve levels, in judging the effect of System operations.

Mr. Ellis pointed out that there was a question as to the extent of the Committee's present concern with short-term rates. At previous meetings the Committee had been concerned that the bill rate not drop too far, but perhaps that thinking was a little out of date in terms of the changing international situation. Both for international and domestic purposes, the Committee might perhaps accept a somewhat lower bill rate. If that was true, perhaps whatever purchases the Desk needed to make in the next few weeks would not necessarily have to be confined to short bills. As indicated by Mr. Rouse at the June 20 meeting, and by Mr. Marsh today, at some time the Committee should consider the possibility of selling some of the securities in the Account portfolio other than bills. Such sales should not be undertaken in the same maturity areas as those in which the Treasury was conducting its financing. However, to maintain contact with the market and to show that it could operate on both sides, the Committee should at least consider this possibility as a tool available to the Desk.

Mr. Ellis expressed the view that this was not the time to change the discount rate or the directive. While he would favor continuing the special authorization relating to operations in longer-term securities, he had not yet had time to study the third criterion suggested by the New York Reserve Bank to such extent as to reach a conclusion.

Mr. Balderston said it seemed to him that a failure to supply the reserves for an adequate increase in the money supply would create a drag on the speed and the amount of recovery. The analysis presented by Mr. Thomas consoled him somewhat, but only in part, for he recalled that the active money supply was now at about its historic relationship to gross national product. In the earlier cycles since the war, the relationship was above the historic norm. He remembered also that the banks had increased the incentive to accumulate cash in the form of time deposits; the rates now offered were quite different from those offered in 1954. Accordingly, the fact that the money supply had risen at only half the annual rate that was true in the 1954 and 1958 recoveries seemed to him a matter of some concern, despite the consolation that could be obtained from thinking in terms of near-money substitutes. Consequently, in terms of free reserves he would favor a target of about $600 million for the next few weeks.

Continuing, Mr. Balderston said that since the June 20 meeting he had begun worrying about the speed and degree of disengagement, so-called, from operations in longer-term securities. Therefore, he would like to present to the Committee a paper that he had put together because of this concern and the misunderstanding that he thought might be occasioned. Evidently, he shared some of the concern that had prompted the July 7 memorandum from the New York Bank, although he disagreed almost completely with the additional criterion suggested in that paper. Mr. Balderston then read the following memorandum:

> At this juncture it is important that such differences as may arise between the Federal Reserve System and its critics should focus upon questions of principle, and not of procedure. The most vital issue is to prevent the economic health of the country from being undermined by those who would make the money supply either too generous or too scanty in relation to the needs of the economy. This is the high ground on which the real battle over the integrity of the dollar should be fought, and the public will only be confused by sophisticated differences over

specific monetary and debt management procedures.

This preface is intended merely to make the point that the Federal Reserve can adhere to sound monetary policies whether its open market operations are conducted in the short end of the market, or in the long. There is no theoretical reason why a portion of the present Federal Reserve portfolio should not be illiquid, and the theoretical case against buying long-term bonds, if and when the System is buying something anyhow, seems to me inconclusive. From the point of view of monetary policy it can be argued that the acquisition of long-term bonds stimulates the flow of investment funds more directly than does the acquisition of short-term Governments, even if one accepts the argument that arbitrage makes quite small the lag between the infusion of added funds at the short end and the impact upon the flow of long-term investment funds. The market-place arguments against operating in the long end are more impressive, because of the risk that the breadth, depth, and resiliency of the Government securities market may be impaired, but nonetheless the movement abroad of short-term funds and the resultant gold outflow caused this Committee to experiment. The question to which I address myself centers in the word "disengagement," specifically its degree and amount.

In short, whether the central bank's open market operations are in the short or long end does not appear to me vital to the pursuance of sound policy; rather it is a matter of convenience and of impact upon the health of the Government securities market.

Convenience, in turn, is affected by the state of the market at a given time. It may be desirable to keep pressure off bill buying in order not to press downward the U. S. bill rate. (This is one part of the special open market operation that so far has seemed to me successful.) At various stages of the business cycle it may be convenient to the Account to buy short-, medium-, or long-term bonds. My conclusion that the matter is essentially one involving procedure, not principle or policy, brings me then to the question: what is the appropriate procedure for the present time?

Three factors seem relevant:

(1) Last February the Federal Reserve System announced that it was going to deal in other than short-term securities, and proceeded to implement this new procedure by buying chiefly intermediate Governments for its own account and chiefly long-term Governments for the account of the Treasury. By both its announcement and its actions, the System has

sought to make clear to the markets and to its critics that the oft-repeated charge that the central bank had boxed itself into a doctrinaire position was unfounded.

(2) The Treasury is about to engage in large refunding operations and during the fall must raise about $6 billion, and probably more, of additional cash. Consequently, there are frequent and extended periods between now and the end of this year when the Federal Reserve will need to facilitate Treasury operations by maintaining an "even keel" in the Government bond market and in the money market. Such a period is now upon us.

(3) By fall, the commercial banks will need reserves to meet the seasonal demand for loans which will last until Christmas. Whether the usual fall loan demand will be accentuated by the rebuilding of inventories or diminished by a heavy flow of funds from internal sources and from security flotations is uncertain. Whichever proves to be the case, the Federal Reserve will be buying Government securities heavily during the fall months.

Since the state of the economy will apparently call for the continued infusion of reserves between now and the end of the year, it is my present belief that open market operations should continue to be conducted in long-term Governments as well as in short. Having embarked upon this change of procedure in February, there would seem to be no valid reason for complete withdrawal from purchases of intermediate- and long-term bonds while monetary policy remains as easy as at present. It should be recognized, of course, that economic conditions may at any time call for a diminution of buying at the longer end, but at the moment weight should be given to the incompatibility of a Federal Reserve withdrawal from longer-term operations while its policy remains one of active ease. An abrupt withdrawal would cause sophisticated observers to conclude that even without formal announcement, the System had decided that what others have dubbed an experiment was a failure and was being abandoned. Thus, in effect, the System would lose whatever gain was achieved in public understanding that the System's attitude toward bills preferably was not doctrinaire and that it had not "closed itself into a box."

Moreover, although it is still too early to make a complete appraisal of the special project, if in fact this can ever be done with precision, certain tentative observations may be made:

(1) It is noteworthy that the bill rate has remained within such a narrow range so long. Helping to achieve this objective has been an increased supply of bills by the Treasury, and a somewhat restrained supply of reserves by the System.

(2) It is not yet demonstrated that System buying of intermediates and longs must inevitably lead to "pegging." In fact the procedure used so far inclines me to the belief that "pegging," far from being the inevitable result, will in fact be avoided if the practice is continued of buying only offerings below the market. British experience, too, would support the idea that when the bond level is falling as a result of economic forces, the participation of the central bank need not result in "pegging," but assist in making the decline somewhat more gradual. Witness the present downward drift of British bond prices to the low level reflected by the price of consols at less than 40.

(3) Now that the buying on behalf of the Treasury at the long end has diminished greatly, it would seem appropriate to me for the Federal Reserve to buy for its own portfolio amounts that will not be considered puny and insignificant even if they are less sizable than the quantities bought for the Treasury during April and May. The appropriate guide here would be the needs of the economy and the condition of the market. In short, the Desk's procedure should be guided by convenience.

Chairman Martin said he thought it was clear that the discussion at this meeting had revealed surprisingly little disagreement on policy for the forthcoming period. The comments were in terms of no change in the directive or the discount rate, and in terms of a free reserve level around $500-$600 million.

With reference to a recent conversation in which questions were raised with respect to the money supply, the Chairman remarked that the more he worked with this concept the more convinced he became that there were no clear-cut answers. It was dangerous, he suggested, for a person to profess that he did have the answers.

With regard to System operations in longer-term securities, Chairman Martin expressed agreement with those who had presented the view that there was not enough evidence to conclude in any sweeping way that the special operations had been justified or not justified. He was inclined to think that perhaps the area of truth might be somewhere in the middle ground. At this point, he said, no one should be asked to pass judgment on the July 7 memorandum from the New York Reserve Bank, to which he added that the papers presented by Mr. Balderston and Mr. Robertson also represented contributions on the subject that everyone would have to study. At the same time, he did not feel that as categorical a position as had been expressed by either Mr. Robertson or Mr. Allen could be supported on the basis of the record. In the view of Messrs. Allen and Robertson, the special operations had been a failure. It could be said, admittedly, that a lot of things might have happened anyway if the operations in longer-term securities had not been conducted. Nevertheless, the bill rate did not go below 2 per cent and in the second quarter of this year the flow of capital funds was at a record level.

Chairman Martin commented that some of his predilections in favor of "bills preferably" had been shattered by some of the contacts he had made in the market in his effort to get the right answer. In summary, thus far he had found three schools of thought in the street. One group, including some persons formerly associated with the Federal Reserve System, had strong and vigorous views in opposition to the special operations, and they might be right. On the other hand, there was another group of people who had tended to change their position with the passage of time. Also, some people who had given a great deal of thought to the matter felt that perhaps this country ought to turn to the Bank of England's type of market.

As a practical matter, the Chairman said, it should be realized that a number of people, including some who thought about the matter considerably, had convinced themselves that the "bills preferably" policy had been a failure, and was wrong, and that the only solution was to make purchases in the long end of the market. Of this he was skeptical. However, he did feel that in the past year or so the System had failed to explain its point of view satisfactorily to many people who were willing to be convinced. It was necessary to recognize the job that had to be done in this respect.

The Chairman said further that if the Committee should decide to rescind the special authorization, some conditioning would have to be done in terms of the market and the public. Personally, he did not believe the matter was at that stage. On the one hand, he would not want to embark on a program such as suggested by the proposed additional criterion of the New York Bank, for he felt that that would be going too far. On the other hand, in the summer of 1961, in the midst of Treasury financing, he felt it would be disastrous to close the book on the special authorization on the basis of the record. The Committee, he felt, ought to weigh the matter carefully. It had taken a good many years for the Committee to come to its decision of February 7, 1961.

In the period since the summer of 1959, Chairman Martin said, he felt that the System had lost ground in explaining its role to the public. In the summer of 1959 he had had no problem. What was then being sought through suggested purchases of longer-term securities was easier money, and on that he was not going to give an inch. However, at a time like the present, when a policy of monetary ease was in effect and when discussion at a Committee meeting included a number of views that there should be further ease, it became more difficult to espouse the theory that "bills preferably" was something on which the System ought to stand or die. As long as the System was pursuing a policy of monetary ease, he felt it was desirable to use whatever tools were effective toward that end. Whether and how the operations in longer-term securities might impair the Government securities market was still, in his opinion, an unknown factor.

The Chairman went on to comment that in May of this year he returned from a trip abroad and while in New York talked to a substantial number of people who were competent observers of the Government securities market. While he would not want to make a judgment on the basis of a poll of that sort, he had been amazed by the fact that there had been so many different points of view and differing attitudes. At present, he was not prepared to accept a thesis that the work to date had been a failure and that the System ought to paddle back to shore as rapidly as it could. The matter had not gone that far. Having embarked on something of this sort, he thought the System had a responsibility to the public not to get itself involved in a conflict over issues that were unclear. The judgment of the two members of the Committee who were against the special authorization from the start might turn out to be correct, but in his judgment those views had not been proven up to the present time. This was a matter, he felt, that those in the System must continue to work on and evaluate. By the time of the next meeting, there would have been a chance for everyone to study all of the papers that had been presented. In the meantime, he felt that the special authorization should be renewed.

The word "disengagement" had gotten into the picture, the Chairman noted, and it was necessary to recognize that phase of the problem. Unfortunately, this was an area where misunderstandings had been rife from the start. There had been erroneous impressions regarding his own attitude, it had been heard that "pegging" was right around the corner, and it had been heard that the System was prepared to tighten the money market. The fact that all of these things were said must be recognized; they were not what one would like, but they were realities. Therefore, his plea today was for everyone to be careful in discussions within the System, or without, not to take too positive a position. He was not asking anyone to change his views. However, the problem of public opinion was a difficult one. He had heard it said only recently there would have been virtually no recession if it were not for the failure of the Federal Reserve System to buy long-term securities. That was, of course, a distortion of fact, but the view was not confined to any one person. The System should be able to explain its actions, its modus operandi, and its rationale better than it had done to date, because it was his honest conviction that System policy had been quite good.

Chairman Martin expressed the view, in this connection, that the observations at this meeting about the money supply and the role of time deposits had been helpful. Personally, he was not alarmed by the lack of vigorous increase in the money supply. He believed that the supply of money was adequate and that the Committee was doing the job.

The Chairman concluded his remarks by saying that he had wanted to put the problem of operations in longer-term securities in the perspective in which he saw it today and to urge renewal of the special authorization, with, of course, two dissenting votes and with the understanding that there appeared to be no reason to suggest a stepping-up of activity in the longer-term area. As he had said, he would not be prepared to accept the suggested additional criterion. However, until there was a great deal more evidence than now available, until the economy was on sounder footing, and in a period when the System was pursuing a policy of monetary ease, he would want to eliminate any suggestion that the System was confining its activities to one sector of the market. Rather, it should be clear that transactions in all maturities, so far as they might contribute to the attainment of the Committee's policy objectives, were in order.

Also, although there were some differences of opinion, the problem of the short-term rate must be borne in mind, the Chairman said. In the course of his recent trip, for example, Mr. King had reinforced his thinking that the short-term rate should be maintained. That objective had thus far been successfully achieved; maintenance of the short-term rate had diminished the outflow of capital and thus had made a real contribution to the balance-of-payments situation. On the basis of the record, this could not be successfully refuted. He (Chairman Martin) had talked to a number of central bankers and had found them unanimous on the point. There was no one who disagreed.

In further discussion, Mr. Hayes said the main reason for preparing and distributing the July 7 memorandum was that he had thought there was not sufficient clarity in the Committee's instructions to the Desk and that the Desk had been given almost an impossible job in deciding how much to do in the longer-term area. The Desk was faced by the fact that the major stress had been placed on undertaking such operations when there was a need for putting reserves in the market and on maintaining the short-term rate. Further, although he agreed that the Committee had never taken action to disengage, the Desk was aware of the sporadic comments with regard to disengagement. In the face of those facts, the Desk had reason to be as inactive as it was in June. It was not necessary to add to reserves and the bill rate had held up well.

Mr. Hayes went on to say that he thought there were reasons for showing a continuing interest in doing what the System could to promote domestic recovery and expansion. Although the wording of the suggested third criterion might be subject to criticism and could be recast in somewhat different language, the purpose was to have some rationale to which the Committee could point in explaining to the market and to the public why the Committee was using the special authorization, if it was going to continue to use it. If the Committee did not believe there was any reason other than to hold up the short-term rate, there would be periods when the Desk would do little or nothing in the market and this might have bad effects from the standpoint of developing proper market attitudes and of public understanding of System operating objectives and policies.

In reply, Chairman Martin said that while he had a great deal of sympathy with the problems of the Desk, sometimes he felt that the Desk did not have quite enough sympathy for the problems of the Committee. The whole matter, he said, must be looked at in perspective. The special authorization was an evolving authorization. It began as an authorization to purchase securities with maturities up to ten years, but this was subsequently adjusted to permit operations in all maturities. Further, for a substantial period the Treasury was making large purchases of long-term securities for its investment accounts. The Treasury purchases, although they were offsetting to an extent and did not add to reserves in the same manner as System purchases, became a part of the pattern. The Account Manager had a rationale in his mind which included the Treasury operations, but now the Treasury had run out of money, so the rationale had to be changed. This was, then, the problem now facing the Committee, and it could not be overlooked.

Mr. Hayes replied by commenting that he would contend that a month or so ago the Open Market Committee did not contemplate going into the long end of the market in any relatively large way simply because the Treasury ran out of money. Nevertheless, the fact that the Treasury did run out of money created a real problem and tended to place more burden on the System to contribute what it could to the recovery process. The Chairman, he thought, had quite rightly put some emphasis on the Treasury aspect of the whole operation. When he (Mr. Hayes) spoke of an additional criterion, this could be rephrased to say under the circumstances that if the Treasury was not contributing as it had to the recovery process the System should do more. The Committee should face this problem realistically, as something it was willing to grapple with, and make some decision. Otherwise, the Desk was in a dilemma.

Chairman Martin agreed that the Desk should have as much clarification as possible. No one, he said, was more sympathetic than himself with the problems of the Desk; no one, he felt, had interfered less with the Desk. However, the Desk had to assume some sense of direction, and not only at the point when it wanted to accommodate itself. The Manager, he noted, did not agree with the use and implications of the word "nudge." He (Chairman Martin) did not supply it, but nevertheless it had gotten into the picture. All of these things were important, and it was necessary that the Committee recognize them.

The Chairman then repeated his suggestion that the special authorization be renewed until the next meeting of the Committee. The

Desk, he said, should understand that it had discretion in this area. No one was asking the Desk to go into the longer-term market on any broad scale; rather, it should maintain the status quo for the time being. As suggested earlier during the meeting, it was important not to have the market misinterpret what the System was doing: not to have the market understand that the System was becoming more active in the longer-term area in the midst of Treasury financing and not to have the market think that the System was disengaging completely from operations in that area. He believed the Desk could operate within such a framework, assuming that this represented the majority position within the Committee. There were two dissenting votes, he noted, and perhaps there were others who also would like to dissent.

Mr. Mills said that he wished to express a qualification. He had recommended that the special authorization be renewed. As at the June 20 meeting, however, his view on implementation would be that for the present the Desk should abstain from operations outside the bill market.

Chairman Martin stated that the qualification expressed by Governor Mills would be recorded in the minutes. He then inquired whether there were others who would like to enter qualifications, and no comments were heard.

In response to a question by Chairman Martin, Mr. Marsh said that he understood the basis of procedure quite well. The Desk would continue to have its difficulties, when it got into special situations, in deciding exactly what it could do. However, the Management of the

Account would face up to the problem, and he hoped it could come out as well as in the past.

Mr. Shepardson asked for verification of his understanding that Mr. Mills' qualification was an individual qualification and not the instruction to the Desk, and the Chairman confirmed the accuracy of this understanding.

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, 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.

Thereupon, the Committee authorized the Federal Reserve Bank of New York, between this date 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. Martin, Hayes, Balderston, King, Mills, Shepardson, Swan, Wayne, and Johns. Votes against this action: Messrs. Allen and Robertson.

Chairman Martin noted that pursuant to the understanding at the June 20 meeting there had subsequently been distributed to the members of the Committee and the Presidents not currently serving on the Committee draft replies to 13 questions, based on the record of policy actions of the Open Market Committee for 1960, which were submitted to him at the hearing of the Joint Economic Committee on June 2, 1961, with regard to the Board's Annual Report for 1960. The Chairman said that all of the comments received following distribution of the draft replies had been taken into consideration, that revised answers to 12 of the 13 questions had been prepared, and that if agreeable to the Committee they would be sent to the Chairman of the Joint Economic Committee. Similarly, the answer to the remaining question would be sent as promptly as possible.

No objection being indicated, it was understood that the procedure suggested by the Chairman would be followed and that copies of the answers, as transmitted to the Joint Economic Committee, would be sent to the members of the Open Market Committee and the other Presidents for their information.

> Secretary's Note: The replies to the first twelve questions were transmitted to the Chairman of the Joint Economic Committee on July 11, 1961, and the reply to the thirteenth question was transmitted on July 21, 1961, along with the answer to a question that had been asked of Chairman Martin and Vice Chairman Hayes by Chairman Patman concerning the quickness of effects of reserve requirement changes and open market operations.

Chairman Martin then referred to the letter from Chairman Patman of the Joint Economic Committee dated June 14, 1961, confirming the oral request made by Mr. Patman at the hearings before the Joint Committee on June 1 and 2, 1961, that the minutes of the Open Market Committee for 1960 and certain other Committee material for that year be made available for examination by the Joint Committee. The Chairman noted that subsequent to the discussion of this letter at the June 20 meeting there had been distributed to the members of the Open Market Committee drafts of two possible replies. One, based on suggestions by Mr. Deming, might be used if the Open Market Committee should decide to comply with Mr. Patman's request for the minutes. The other, suggested by Mr. Irons, might be used if the Committee decided not to comply. After indicating that the draft based on Mr. Deming's suggestions was along the lines of the type of reply that he (Chairman Martin) had had in mind at the time of the June 20 meeting, the Chairman called for comments from the members of the Committee.

In the ensuing discussion, Mr. Clay said that he had endeavored to draft a possible reply which would explain a decision not to comply with the request for the minutes, but that he had been unsuccessful in formulating a draft he considered satisfactory. The draft submitted by Mr. Irons came closer than anything he had been able to draft himself. However, he was now inclined to believe that a reply along the lines of Mr. Deming's draft probably would be preferable.

Pursuant to a suggestion by Mr. Mills, Chairman Martin then placed the matter before the Committee in terms of whether any serious objection would be seen to a reply along the lines proposed by Mr. Deming. The resulting comments indicated that no member of the Committee would object strongly to this type of reply. There were, however, some suggestions for minor changes in the draft, and it was understood that at least some of the members of the Committee would like to have an opportunity to study the proposed letter at greater length. One of the questions raised concerned the desirability of including in the letter reference to the reasons for treating the minutes confidentially, there being a view expressed such references might be superfluous on the ground that the Joint Committee would be presumed to handle the minutes on a confidential basis. However, it was the consensus that there was something to be said for stating as a matter of record and for the information of the Joint Committee the reasons why the Open Market Committee had considered it important to preserve the confidential status of its minutes, particularly those for as recent a year as 1960.

At the conclusion of this discussion it was agreed that the reply made to Congressman Patman's letter of June 14 should be along the lines of the draft proposed by Mr. Deming, that in addition to the changes specifically mentioned at this meeting an opportunity would be provided for members of the Committee to submit further suggestions, and that the letter would then be sent in a final form satisfactory to Chairman Martin without further clearance with the Committee.

In the course of the foregoing discussion, several members of the Committee raised for consideration the question of the advisability of publishing the minutes of the Committee for some appropriate past period, it being suggested that the minutes would constitute valuable research material for scholarly purposes and that there would be some advantage in making the minutes available to all persons who might have an interest in studying them. The view also was expressed that the Committee should give further consideration to the possibility of publishing the record of policy actions of the Committee on a basis more frequently than once each year, after some suitable time lag. It was agreed, however, that these questions should have the benefit of mature deliberation on the part of the Committee before any decision was reached.

Secretary's Note: Pursuant to the procedure agreed upon by the Open Market Committee, the following letter was sent over Chairman Martin's signature to Chairman Patman of the Joint Economic Committee on July 21, 1961:

The Federal Open Market Committee has carefully considered the requests for copies of its minutes and certain other materials for the year 1960, made of Mr. Rouse and me during the Joint Economic Committee Hearings of June 1 and 2, 1961. You and I have discussed these requests by telephone, and they were referred to in your letter of June 14, 1961. It is the view of the Federal Open Market Committee that it should act as follows on your Committee's requests:

1. A memorandum outlining the considerations taken into account on the last occasion when the Committee instituted a policy of restraint is enclosed. In this connection, I should point out, as do the answers I have already submitted to the list of questions you raised at the Hearings, that the determination of monetary policy is a continuous process, and thus it is difficult to pinpoint the moment of a change. To repeat a comment I made on this subject more than five years ago,

> "Monetary policy...must be tailored to fit the shape of a future visible only in dim outline. Occasions are rare when the meaning of developing events is so clear that those who bear the responsibility can say, 'As of today, our policy should be changed from ease to restraint'--or from restraint to ease, as the case may be. What is true of a change in policy is also true of a shift in policy emphasis: it is rarely decided upon in a single day. More typically, as is evidenced by open market operations, the outline of a shift in policy emphasis, like the outline of the future, emerges gradually from a succession of market developments and administrative decisions. It is a poor subject for the photo-flash camera to capture as a clearly defined still life, or for a news story to etch in spectacular outline. Getting a perfect garment for the future may require several fittings."

Therefore, factors considered and analyses undertaken by the Committee during the meeting immediately preceding and during other meetings farther back in time might not seem strikingly different from those at the meeting that may be selected as marking the beginning of a policy of restraint.

2. Copies of the wires referred to in your letter as being from the Board to Mr. Hayes and Mr. Rouse are enclosed. These wires, prepared at the offices of the Board of Governors and sent to all Reserve Bank Presidents as well as Board members, contain a detailed summary of the 11:00 a.m. daily conference call which, you will recall, was fully described by Mr. Rouse in his statement that he read at the

hearing on June 1 and submitted for the record. Most of the information contained in each wire is a rundown of developments in the money and securities markets during the first hour of trading that morning. The last part of the wire indicates what the Account proposes to do that day, given the situation as seen at 11:00 a.m.

3. Regarding the notes and interpretative memoranda referred to in your letter:

(a) There is very little in the way of note taking beyond that done by the secretarial staff of the Committee and by a staff member of the New York Bank to record what actually transpires at the meetings. Any notes taken at the meetings by Committee members are usually no more than scribbled abbreviations for the purpose of keeping for the moment a running memory aid of the discussion as it proceeds, and such notes are not customarily retained. The minutes are prepared promptly by the secretarial staff and drafts thereof are usually in the hands of the Committee members and Mr. Rouse, as Manager of the System Open Market Account, within a week to 10 days. The Secretary of the Committee also furnishes Mr. Rouse by the morning of the day following a meeting a brief unedited synopsis of each member's policy recommendations and of the consensus of the Committee. The notes taken by the staff member of the New York Reserve Bank are recast in the form of an internal memorandum for working purposes, and this memorandum and the synopsis are available to Mr. Rouse as an aide memoir pending receipt of the preliminary draft of minutes and the final minutes. Since these are merely staff working papers and their content is fully covered in the minutes, it seems needless to furnish them separately.

(b) As to interpretative memoranda, these may be taken to include the economic summary prepared by the Board's staff, projections of reserve figures and factors, and the detailed record of open market operations undertaken since the previous meeting, all of which are furnished to Committee members prior to the meeting. Copies of these are enclosed, although their substance is covered to some extent in the minutes.

Also, there is enclosed the pertinent opening paragraph of a memorandum dated August 2, 1960, and sent by Mr. Rouse to the members of the Federal Open Market Committee and the Federal Reserve Bank Presidents not then serving on the Committee, expressing his understanding of the consensus of the Committee at its July 6, 1960 meeting relative to possible open market operations in short-term securities in addition to Treasury bills. This is included because it might be considered to be interpretative of a Committee discussion.

4. Verbatim records of the meetings of the Federal Open Market Committee are not made. The minutes, however, present a faithful and comprehensive record of the Committee's proceedings. The Open Market Committee is prepared to make these minutes of its meetings held in 1960 available to the Joint Economic Committee on the understanding that they will be treated as confidential. It should be noted, however, that some members of the Committee feel that normally it might be more appropriate for a request for the minutes to come from the Banking and Currency Committee of the House or of the Senate. With regard to the request that the minutes be handled as confidential, the Committee believes that it would not be in the public interest to have such minutes for 1960 made public in whole or in part at this time, and its reasons for this position are as follows:

(a) There are references in the minutes to information obtained on a confidential basis. This information, and its sources, should be kept confidential, certainly for a substantial time period.

(b) From time to time there are references in the minutes to long-term prospects and possible monetary policy action should these eventuate. To guard against a reduction in the effectiveness of Committee actions or potential actions, there should be some considerable elapse of time before the minutes of any given meeting are given public access.

(c) The minutes contain a full account of the proceedings at the meetings, including the participants' statements. However, a person will frequently compress his remarks by omitting matters of background perspective that are fully understood by others present at the meeting, but which might lead to misinterpretation on the part of one merely reading the minutes without the advantage of having been present.

(d) The minutes contain statements by individual members which are often made to raise points of discussion or to probe the possibilities of different courses of action in implementing System policies. These statements do not necessarily represent a firm view of the individual member and, in fact, the member may raise a particular matter merely to obtain discussion and clarification of the issues involved. Needless to say, individual views expressed early in a meeting may well be modified by subsequent discussion during the meeting.

> Therefore, the participants should feel free to raise questions and express their views--either tentative or firm--with the knowledge that their comments will not be released within a short period of time after the meetings. This freedom of discussion and the exchanges of viewpoints prior to the final decision are essential features of the process of decision-making.
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> It is largely for the foregoing reasons that the Open Market Committee believes that the public interest would not be served if the minutes for 1960 were to become public documents at this time, either in whole or in part. The Committee is particularly of this view, in the light of the comprehensive Record of Policy Actions made available some months ago in the 47th Annual Report of the Board of Governors of the Federal Reserve System.
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> The official records of the Federal Open Market Committee are maintained in the Board's offices, where the original copy of the minutes for 1960 is available for examination by representatives of your Committee. However, with the thought that it would be more convenient, the duplicate original signed copy of the 1960 minutes is being delivered herewith to the custody of your Committee for its perusal. It will be appreciated if this duplicate original is returned to us for safekeeping as soon as it has served its purpose.

There had been included on the agenda for this meeting discussion of a memorandum dated June 15, 1961, from the Steering Group of the Government Securities Market Study in which authority was requested to explore with nonbank dealers individually the possibility of a standardized system of financial reporting. However, it being understood that the matter was not particularly urgent, it was agreed to defer consideration of this memorandum until another meeting of the Committee.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, August 1, 1961.

The meeting then adjourned.

Ralph A. Young

Secretary