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, November 14, 1961, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Hayes, Vice Chairman
Mr. Allen
Mr. Irons
Mr. King
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Swan
Mr. Wayne

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

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

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Baughman, Coldwell, and Ratchford, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Koch, Adviser, Division of Research and Statistics, Board of Governors
Messrs. Furth and Hersey, Advisers, Division of International Finance, 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

Messrs. Eastburn, Hostetler, Parsons, and Tow, Vice Presidents of the Federal Reserve Banks of Philadelphia, Cleveland, Minneapolis, and Kansas City, respectively
Mr. Link, Assistant Vice President, Federal Reserve Bank of New York
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta
Messrs. Anderson, Bryan, and Runyon, Economists, Federal Reserve Banks of Boston, St. Louis, and San Francisco, respectively

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on October 24, 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 October 24 through November 8, 1961, and a supplemental report covering the period November 9 through November 13, 1961. Copies of both reports have been placed in the files of the Committee.

In supplementation of the written reports, Mr. Rouse made the following comments:

> As the written reports which you have received indicate, the System Account supplied a substantial volume of reserves to the market in the period between meetings. During the early part of the period, Treasury bill rates were under considerable downward pressure, and we were fortunate to be able to acquire $330 million Treasury bills from foreign accounts, including $280 million from the British as

they sold in order to make a payment to the International Monetary Fund. In the latter part of the period, our efforts were devoted to keeping things steady while the Treasury carried out the exchange refunding of its November 15 maturity. There were difficulties in this respect because the dealers' needs to finance their purchases of rights, as well as their already large holdings of bills, tended to focus reserve pressures on a few large money market banks; also the reserve estimates again proved to be rather unreliable. We made repurchase agreements against rights and other issues so far as was practicable to relieve the situation.

The three-month Treasury bill rate ran as low as 2.27 per cent bid at the time of the Treasury refunding announcement, but subsequently rose sharply to close last night at 2.49 per cent bid, or 19 basis points above the level at the time of the last meeting. The upward push on bill rates was the result of the build-up of dealer positions in anticipation of heavy demand for Treasury bills in connection with the Treasury refunding operation that failed to materialize, the pressure on dealers to find financing as they took on over $1 billion of rights, which in turn put pressure on the money market, and the Treasury's special auction of an $800 million strip of bills. In that auction, on November 9, dealers were the main bidders and were awarded $510 million of the total offered. With no tax and loan account privileges, the smaller banks, at least in the Second District, virtually ignored the auction. The Buffalo Branch, in fact, did not receive a single tender. There was little demand from nonbank sources and only limited participation by the larger banks. In yesterday's weekly auction, average issuing rates for three-month Treasury bills were established at 2.52 per cent, and on six-month bills at 2.72 per cent. Dealers were not very aggressive bidders because of their already swollen holdings but there were indications that other potential bill buyers, mostly nonbanks, were much more interested at these higher rates. Whether the rate will stay at this level without our help will depend on whether there is a significant follow-through of buying from these sources. As you know, nonbank lenders are currently providing dealers with about $2 billion; whether they will continue to be lenders on this scale or whether they will commit funds for investment remains to be seen.

The refunding of the $6.9 billion 2-1/2 per cent Treasury bonds due November 15 worked out successfully from the Treasury's point of view. Exchanges, through last night, amounted to $3.6 billion for the new 15-month 3-1/4 per cent note, $2.4 billion for the reopened 4-1/2 year 3-3/4 per cent notes, and $0.5 billion of the 3-7/8's of 1974. Attrition was kept low, at about $430 million, and was more than covered by the auction of the strip of Treasury bills, while some much needed debt extension was accomplished. There was, of course, considerable selling of "rights" by holders who preferred not to exchange and dealers were willing to take on large amounts at the modest premiums which prevailed. They acquired gross over $1.1 billion "rights at the peak on Wednesday, against which they had made when-issued sales of over $300 million of the new issues. After the exchange, dealers had net long positions of $305 million 3-1/4's, $234 million 3-3/4's of 1966, and $139 million of the 3-7/8's. At the same time, their total borrowings (including about $700 million funds employed by bank dealers) rose to over $4 billion, an all-time high. With this extended position, dealers were especially prone to feelings of apprehension; the booming stock market on last Wednesday and the relatively low reserve figures released on Thursday led to considerable speculation that the outlook for long-term bond prices was not as favorable as it had appeared and that System policy may have already undergone some change. The market yesterday afternoon was quite soggy and conditions looked unfavorable for the Treasury to attempt a "junior" advance refunding which it has been thinking of doing in the next few days. Unless the market settles down and something along this line can be done shortly, the Treasury will probably be out of the market, except for an offer of an intermediate bond to holders of the "F" and "G" bonds maturing in 1962, until early January when cash borrowing of $2-1/2 - $3 billion is anticipated.

Mr. Mitchell inquired of Mr. Rouse whether the change in rates that had occurred should be interpreted as a response to the Open Market Committee's instruction at the October 24 meeting or whether the development was inadvertent.

Mr. Rouse replied that it was in part inadvertent; some part of it, he believed, was a reflection of the free reserve figures.

Mr. Robertson said he considered it extremely unfortunate that the free reserve figure had dropped as low as it did in the midst of the Treasury refinancing operation. It was his feeling that this may have had some restraining influence on the subscriptions for the longer-term securities offered by the Treasury. He seriously doubted whether such a drop was contemplated by the Committee consensus. It may have been unavoidable, but if it reflected a gearing of open market operations to the bill rate, that was unfortunate.

Mr. Hayes commented that it was his impression that for October the average free reserve figure had been something like $450 million, and that the figure of $418 million for the past week could therefore hardly be regarded as radically lower than the level to which the market had become accustomed. Mr. Robertson replied that the over-all figure was good. The over-all average was, he felt, in accordance with the consensus at the October 24 meeting, but the $418 million figure was not.

Mr. Rouse said the Account Management shared the feeling Mr. Robertson had expressed. The Management would have preferred not to have had the situation develop as it did; that was inadvertent. However, he felt this had had only a very minor

effect on the amount of the exchange for the 3-7/8s of 1974 and the 3-3/4 per cent 4-1/2 year notes. He guessed that the amounts involved would be less than $100 million, perhaps less than $50 million. As far as the 3-7/8s were concerned, most estimates of the amount that would be exchanged had not gone over $500 million at the outside, and the exchange turned out about as expected.

After further comments, Mr. King said he did not think the Treasury should have been bothered too much by the fact that events transpired as they did or that the Treasury had room to feel unhappy about the role of the System. He noted that the Treasury had announced in connection with the refinancing the auction of an additional strip of bills thereby exerting some upward pressure on the bill rate.

Mr. Rouse said that he would agree.

> Thereupon, upon motion duly made and seconded, the open market transactions during the period October 24 through November 13, 1961, were approved, ratified, and confirmed.

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

> In assessing domestic economic conditions, interest continues to focus on the spending activities of the consumer and the Federal Government. Net exports are declining; inventory accumulation is not expected to add as much to economic expansion in the near future as in the recent past; and capital expenditures depend, to a certain extent at least, on the strength of demands

for goods generally. With this focus in mind, I shall concentrate my remarks this morning on these two sectors of the economy, but before doing so let me highlight the key economic statistics that have become available since the last meeting of this Committee. They have been mixed.

On the plus side, our industrial production index for October is now estimated at either 113 or 114 per cent of the 1957 average, thus recovering its September decline and possibly exceeding the recent August high. Automobile production increased sharply, and industry schedules indicate a further seasonally adjusted rise of about 15 per cent in November. New orders for machinery and heavy engineering contracts are up. Employment showed moderate improvement. The rental housing vacancy rate dipped a little. Stock prices have advanced sharply in recent trading. Finally, total retail sales, particularly automobile sales, rose substantially, breaking out of the narrow range prevailing since midyear.

On the minus side, steel production, which usually rises seasonally in October, was little changed this year. The unemployment rate remained at 6.8 per cent of the labor force, virtually unchanged now for almost a year. Some decline has occurred in a few sensitive commodity prices, indicating continued ample supplies. Corporate profits in the third quarter apparently were not up to earlier expectations. Finally, the McGraw Hill survey of business plans for spending on new plant and equipment in 1962 showed a rise of only 4 per cent over this year. This is a smaller figure than many had forecast earlier and is about the same as anticipated spending in the current quarter. Similar surveys conducted in the comparable phase of the 1954 and 1958 recoveries, however, underestimated expenditures in the succeeding year considerably.

Turning now to a closer look at the consumer, first, the rise in personal incomes that characterized earlier months of the year has slowed down more recently. He has more to spend but not as much more as had been anticipated.

As for his spending, it has been sustained but not as high as many had expected. As I mentioned earlier, October sales were strong, but it is still too early to say whether this strength is likely to be maintained in the months ahead. Furthermore, total retail sales are up only a little from a year ago.

Recent automobile sales have been strong and the trade expects a very satisfactory 1962 model year. Sales of homes have also picked up despite the existence of relatively high rental vacancies. Mortgage financing continues to be quite readily available and at rates little higher than their recent recession low.

Consumer saving and holdings of liquid assets are quite high. Consumer borrowing power is also still substantial. Buying plans data, however, are not encouraging. Preliminary data from the most recent quarterly survey conducted in October give little evidence that consumer demand will be a strong independent factor in furthering expansion.

I conclude with reference to the consumer that although we may be getting a sharp rise in his spending this quarter, it is still not certain how much more than seasonal it is, or whether it is rising enough to support the optimistic forecasts for GNP next year. The consumer's wherewithal for stepped-up spending is at hand, but he still remains largely a potential expansionary force.

Turning to the Federal Government, I think most of us were surprised to discover that Federal purchases of goods and services barely increased in the third quarter following earlier sharp advances, and despite substantial increases in defense ordering. These third-quarter figures, however, are likely to be revised upward somewhat. Moreover, tentative October figures suggest a pick-up in Federal spending consistent with the recent stepped-up defense ordering and with the Autumn Budget Review.

The Budget Review also shows a sharp rise in Federal receipts over fiscal 1962 which may well be larger than that in expenditures, thus dampening the expansionary effects of the higher Federal spending. However, these budget estimates are based on programs passed by the last and earlier Congresses. They make no allowance for possible additional or expanded programs of the next Congress.

So much for the latest available information on the current economic situation. Let me conclude by saying two things. First, the consensus at last week's meeting of the System's Current Business Developments Committee was that the next six months would probably be a period characterized by expanding economic activity and employment without strong upward pressure on prices. Second, in framing monetary policy today, more than ever one has

to look beyond the figures and make some judgments. Cycles in economic activity are never exactly alike and this one certainly has its distinguishing characteristics. For example, it seems to be closely intertwined with a longer-run problem of satisfactory manpower and resource use. It is also set in a framework involving more acute international political problems, larger military commitments, and more adverse international economic relations.

In this setting, one is torn between one monetary policy that the domestic economic situation seems to call for and another one that the international situation seems to call for. At home, the existing unutilized labor and material resources suggest the appropriateness of credit and monetary ease and are a justification for the continuation of more or less current policy.

On the other hand, the likely expansionary and inflationary implications of the international political situation do not as yet appear to have been appreciated adequately. Nor does the worsening of our balance of international payments seem to have been fully recognized. On their face, these factors would call for less monetary ease.

However, the expansionary and inflationary implications of the international situation are still in the future. They are not pressing at the moment. If inflation does develop as a consequence of actual developments abroad and at home, the posture of monetary policy can shift quite promptly. As for the balance-of-payments problem, it appears that some progress is being made toward its basic solution in the wage and price area, even though cyclically higher imports are making the figures look worse currently.

Thus, in my view current monetary policy can appropriately be based mainly on one's assessment of the domestic economic situation. This situation still seems to me to call for relative monetary ease even though I recognize that there are lags in spending and investing responses to monetary policy changes as well as dangers in relying unduly on liquidity and debt creation to stimulate the economy.

Mr. Thomas presented the following statement with respect to credit developments:

Perhaps the most significant recent developments in the financial area are the further sizable expansion in the money supply, accompanying only moderate increase in bank loans, and the rise in the short-term Treasury bill rate during the past week, following a down-drift in interest rates, particularly in the long-term sector. In this climate, the Treasury has successfully effected a large refunding operation, involving some extension of maturities, and has raised some new cash.

System operations made possible an increase in member bank reserves available in amounts sufficient to support a continuation of private deposit expansion at a 5 per cent annual rate. At the same time, required reserves increased at an even greater rate, and free reserves remained below $500 million for more than a month. In the week of November 8, required reserves, seasonally adjusted, dropped below the 5 per cent expansion line, and total reserves declined even further. System operations, though large, were insufficient to meet the drain on reserves from other factors. Free reserves declined to little over $400 million and brought about some tightening in the money market.

Money markets have been relatively easy during most of the past month, notwithstanding the pressures of bank credit expansion and the lower level of free reserves. Although rates on Federal funds averaged somewhat higher in October than in September, bill rates generally continued near recent lows until the past few days, when yields on short-term bills rose to around 2-1/2 per cent, and prices of other issues weakened.

Bank credit and money market changes have been influenced to some extent by sizable operations of dealers in U. S. Government securities. In September and the first half of October, dealers substantially increased their positions in longer-term Treasury bills and also added to their holdings of coupon issues maturing within a year. They financed these holdings by increased borrowings from banks, both in New York and outside, as well as from corporations, including repurchase contracts. In the past week dealers have added a large amount to their positions in short-term bills through bidding in the auction for the new strip of bills. In early November, in connection with the latest Treasury refunding operation, dealers added further to their holdings of coupon issues maturing in 1 to 5 years and in over 10 years.

At present dealers' total positions, including a large volume of long-term repurchase contracts, are at a new high.

These various rather large holdings by dealers represent a source of potential pressure on different sectors of the Government securities market, unless the market demand for securities should be strong.

In capital markets, new corporate issues continued in moderate volume during October at about $800 million, and a similar amount is estimated for November. State and local government issues have continued large, with over $900 million likely in November or early December. Bond yields in both of these sectors have declined in the past month, and the new issues have been floated at relatively low yields. Although yields on U. S. bonds also declined, the spread between yields on high-grade corporates and those on Government bonds has been unusually narrow.

Common stock prices have risen to new high levels with rather active trading. Average yields on common stocks, at recent dividend rates, have declined to a new low level of 2.80 per cent. With corporate profits failing to come up to expectations, earnings-price ratios must also be exceptionally low. This may be an influence tending to give some support to bond prices.

In banking, following a record expansion in total loans and investments in September, there was a further moderate increase in October. Loans to commercial and industrial businesses, to security dealers, and on real estate increased somewhat, while those to sales finance companies declined. At city banks in the week ending November 1, there were substantial further increases in loans in nearly all categories, while partial data for the week of November 8 indicate declines in both loans and investments. After increasing sharply in September, holdings of securities showed only moderate further increase at all commercial banks in October, with some decrease at city banks during the month and also into November.

In general, it would appear that banks have been putting available funds to use, either in response to loan demands from customers or through purchases of securities. They have seemed willing to operate with a somewhat lower level of free reserves. Operations in Federal funds have been rather large.

Money supply, seasonally adjusted, increased further in October and at $144.2 billion in the last half of the month slightly exceeded the July 1959 peak. This figure

is less than 2 per cent above the level that generally prevailed from late March through August and is little more than 3 per cent larger than the low level of mid-1960. Some of the increase in private deposits in October resulted from a decline in U. S. Government deposits from the exceptionally high level outstanding at the beginning of the month. The growth of time deposits seems to have slowed down to a low rate after the middle of October. Savings deposits at city banks continued to increase, but other time deposit accounts declined. These shifts in other deposits help to explain why the private money supply increased so much in October, although the growth in bank credit slackened.

Review of over-all credit developments for the year to date indicates that credit has been generally available in amounts adequate to support substantial economic recovery. At the same time, measures of credit and of liquidity relative to general economic activity indicate that credit and monetary availability is rather low by historical standards. Interest rates have been exceptionally steady.

An important question for consideration is how much more credit expansion may be appropriate in the period ahead. Estimates based on projections of further economic recovery toward fuller, but not over-full, utilization of resources call for continued expansion in bank credit at close to the rate of recent months. On the basis of these computations, an increase in reserves available for private credit expansion at a rate of at least 5 per cent per annum continues to appear appropriate. Estimates of reserve needs at this rate have been supplied the Committee in a staff memorandum.

The System might, without risk of overstimulation, follow a policy of supplying that amount of reserves through open market operations. If actual monetary and credit demands fall short of the amounts indicated, interest rates would presumably tend to decline. If this occurs and encourages an outflow of funds abroad, then the growth in reserve availability can be slackened somewhat, keeping free reserves only large enough to encourage expansion without depressing interest rates.

If, on the other hand, credit and monetary demands tend to exceed the amounts projected, then banks could be required to borrow any additional reserves needed. In this event interest rates would tend to rise. Should credit

demands expand at a pace that seems excessive or should the expansion appear to contain speculative or other unsustainable elements, further member bank borrowing might be restrained by raising discount rates. A discount rate increase, however, would presumably not be needed until there is evidence of excessive or unhealthy credit expansion based on member bank borrowing and the Treasury bill rate has risen to the level of the existing discount rate.

Under a program of this nature, the target of policy would be the amount of total reserves available, rather than the volume of free reserves. Free reserves would result from the relation of credit and monetary demands to the available supply of total reserves. Restraint on credit expansion and the course of interest rates would be similarly determined by the level of demands for credit. To be sure, the relationship between interest rates in this country and those abroad and international movements of funds and of gold might be a limiting influence. As long, however, as domestic credit demands are sufficient to exert some upward pressure on interest rates, international money market considerations may be less decisive. If economic expansion continues as projected and the volume of reserves supplied is limited to the amounts suggested, interest rates are likely to be firm and might even rise moderately.

Mr. Hersey presented the following statement with respect to the United States balance of payments:

A rise in the level of U. S. imports in recent months has been a major factor in the balance of payments. Some such rise in imports has been foreseeable for some time past, but the degree and timing of the rise was not easily predictable.

Early in the year imports were running at a rate of $13-1/2 billion. In relation to GNP this was a little lower than in previous recession periods. In April and May imports of materials rose a little, and in June total imports moved up a little. In July came a very sharp rise. For that month by itself, in annual rate terms, imports were at $16-1/2 billion.

Fortunately, this peak rate has not been maintained. In August and again in September imports were at a rate

of $15 billion, well below the July peak and also--which is more significant statistically--somewhat below the June-July average. Nevertheless, the August-September rate is 10 per cent above the rate in the earlier months of this year, and this change has a fairly big effect on the over-all balance of payments.

An interpretation of the recent changes in imports must still be highly tentative. It seems likely (1) that there were some accidental features in the heavy concentration of imports in the month of July, and (2) that the rise to June-July, involving orders placed somewhat earlier, was closely associated with the sharp upswing after February and March in the buying and output of domestically produced materials, and with the unusually early and sharp shift in this recovery from decumulation of inventories to accumulation. (3) This line of thought, together with the probability that inventory accumulation in the domestic economy is not accelerating greatly in the current quarter, leads to an hypothesis that further changes in imports this year may be relatively small--though next year rising consumption is likely to push imports up more.

The rise in imports was the largest single factor increasing the over-all deficit in the balance of payments in the third quarter as compared with the first half of 1961. Estimates for other items are still very preliminary. There were apparently other adverse factors besides imports, including a small decline in exports not financed by economic aid (while economic aid and exports financed by it apparently increased), and a drop in the foreign purchases of U. S. corporate securities. However, the adverse factors were partly offset by a shrinkage in unrecorded outflows. The result was a deficit, on the seasonally adjusted basis, at an annual rate of somewhat over $3 billion.

For the year 1961, the over-all balance-of-payments deficit now looks like being not far from $2-1/2 billion without counting the advance debt payment by Germany last spring, or about $2 billion if that is counted. There is still a considerable margin of uncertainty in these figures. Of the $2-1/2 billion adjusted deficit, the current account, Government aid with normal repayments, and long-term private capital movements may give a debit balance of about $1 billion--which will have been concentrated, at a much higher rate, in the

second half of the year--while short-term U. S. private capital outflow and unrecorded transactions will have produced the rest of this year's over-all deficit.

For 1962, the deficit on current account, Government aid, and long-term capital will undoubtedly be much above the $1 billion estimate I have just given for this year, and probably quite a little above the rate in recent months. In round terms, to get a balance on current transactions, Government aid, and long-term capital account would require a merchandise trade surplus of about $7 billion if there were no inflow of foreign long-term capital, as was the case in the third quarter this year, or of $6-1/2 billion if that inflow resumes. These figures must be thought of as subject to a rather wide range of uncertainty. The $6-1/2 billion requirement results from economic aid (net of repayments) now apparently at a level of about $4 billion a year and military expenditures abroad (net of foreign military purchases here) running at about $2-1/2 billion a year. In addition, there is the movement of long-term capital. If foreign purchases of U. S. corporate securities resume, the net outflow of long-term capital might be as little as $1-1/2 billion. This might be more or less offset by the credit balance on other items such as receipts on services less payments on civilian services and remittances.

There is no prospect whatever of the merchandise export surplus approaching $6-1/2 billion next year. In the first half of 1961, the rate of export surplus was $6 billion, but with the rise in imports the third-quarter rate of export surplus was about $4 billion.

It is impossible to forecast within a billion or so how far short next year's merchandise export surplus may fall of the requirement (itself uncertain) for balance on current account, Government aid, and long-term capital. Measures affecting the tying of aid may help a little, and so too may the new program of export credit insurance. A continuation of price stability in this country, which is absolutely essential for restoring equilibrium in the long run, may begin to show some results on the trade balance next year. But the dominating forces in the short run of a year or so are bound to be cyclical movements in demand here and abroad. U. S. imports are virtually certain to rise further.

U. S. exports have been fairly stable this year, in the $19-1/2 billion to $20 billion range; to forecast them in 1962 is particularly difficult. At the moment, it looks as if the current account, Government aid, and long-term capital account may show a deficit next year in the range of $3 to $4 billion, but it may be less or more than that.

On top of this, there are wide uncertainties about short-term U. S. capital outflow and unrecorded transactions, which have been left out of account so far. Although preliminary estimates for the third quarter place the net total of these other elements at a very low figure in that period, the picture in the very latest months is not very reassuring. Specifically, net transfers of gold, convertible currencies, and liquid dollar liabilities to the rest of the world in September were about $400 million, and incomplete figures for October suggest a similar figure for that month. Such high figures as these may possibly reflect a renewed unfavorable balance, at least for the moment, on unrecorded transactions. Some allowance for this is contained in the estimate I have given for the total deficit this year. Considering the uncertainties, it would be pointless to try to pin down now any estimate for unrecorded transactions next year, or for the final over-all deficit next year.

Chairman Martin stated that Mr. Hayes had just returned from a trip to Europe to attend the monthly meeting of the Bank for International Settlements and that in the circumstances Mr. Trieber would make the statement on the business outlook and credit policy usually presented by Mr. Hayes. However, Mr. Hayes had agreed to comment informally on impressions gained from his trip.

In his comments, Mr. Hayes said that some European countries, such as Italy and perhaps Switzerland, appeared to

be moving ahead as strongly as ever. There were some slight signs of a slowing down of the boom in Germany, and France was moving ahead at a somewhat less rapid pace than a while ago. A striking item in all of these countries was the shortage of labor, with attendant pressure on costs, which in the longer run would be helpful from the standpoint of the United States. As to the balance-of-payments picture, the major development of the past few months had been the big swing in leads and lags of payments involving the United Kingdom and Germany. Whereas just prior to a few months ago, this had been working against Britain and for Germany, the opposite situation now prevailed. The United Kingdom was now in heavy surplus in its over-all balance and Germany was losing reserves fairly rapidly. Other countries gaining reserves included France, Italy, and Belgium, with Switzerland about in balance at the moment.

As to the dollar, Mr. Hayes sensed that there was generally a considerable feeling of confidence, although in private circles chinks in this confidence were beginning to be seen, as reflected in articles in the press. While he did not believe central bankers were thinking in those terms as yet, they were paying close attention to the balance-of-payments problem and the efforts of this country to correct it. They were encouraged by the experience of the first half of 1961,

especially the improvement as compared with 1960, but there was uneasiness about the more recent trend. The third-quarter figures had not, of course, as yet been publicized at the time. In essence, the central bankers were still giving this country the benefit of the doubt, but questions were being raised as to how the country expected to improve the situation. They were encouraged to note the better ability, apparently, to cope with the wage problem and the greater wage stability than had prevailed in other years. They were also glad that some progress was being made on the military side, even though at the expense of some of the European countries. The central bankers felt that some arrangements should be entered into to equalize that burden to some extent. The Federal budget figures were being watched closely, and the central bankers were not quite sure what to make of the prospective $7 billion deficit for fiscal 1962. In this latter respect, Mr. Hayes said he had tried to give reasons why, under present conditions, this should not be a dangerous development.

Mr. Hayes went on to say that the European central bankers were acutely conscious of capital movements and the level of interest rates. They were conscious of the amount of lending abroad, short- and long-term, that this country had done over the past year. Some reactions as to what might be done reflected different traditions in the countries of those speaking; there

was even the suggestion that moral pressure should be exercised to get the banks and underwriters out of this kind of lending, and Mr. Hayes had attempted to explain how such action would be contrary to the mores of this country, and potentially dangerous.

The rise in the bill rate had been too recent to be the subject of comment, Mr. Hayes said. There seemed, however, to be a feeling on balance that a fairly good job had been done in keeping the bill rate where it was. On the other hand, it was felt that rates were somewhat on the low side.

There was much evidence of a desire to cooperate internationally at various levels. There was awareness that the United States gold stock had special international significance, and that the gold inflows and outflows were watched all over the world. Although every opportunity had been taken to assure the Europeans that United States gold was available to all central banks that asked for it, there was no doubt but that some central banks had been refraining on a unilateral basis from taking as much gold as they would like to have if they were to feel completely comfortable with their reserve positions. This meant, of course, that they were holding more dollars than they really wanted.

The British felt that their bank rate reduction was a part of this international cooperative effort. There was also a cooperative attitude evident in the approach most central banks took toward the London gold market. They felt that purchasing in

that market when price pressures were considerable was not appropriate, and there was a general disposition to stay out and not create additional price pressure.

As to International Monetary Fund developments, Mr. Hayes said that he purposely stayed away from discussions of that subject. From what he heard, however, it seemed to be felt that there was a good chance of reaching a reasonable compromise that would be satisfactory to everyone on expanding the Fund's resources.

In further comments on the United States payments deficit, Mr. Hayes said he did not like to think of what the Europeans would have to say if they thought it was really possible that the basic deficit next year would be in the area of $3 or $4 billion. He also noted that gold sales as the result of dollar accruals abroad were likely to step up in the next few months. All of this added up to a very sensitive situation. The crucial point was whether foreign observers saw evidence that this country had the determination to prevent continued heavy deficits and to bring them down to reasonable figures, which to his mind would be something in the order of $1 billion or less. It was very much up to the Government, and certainly the Federal Reserve System, to give some evidence of such determination.

Mr. Young presented the following statement concerning the recent meeting, which he had attended, of a Working Party of the OECD Economic Policy Committee:

Since the last meeting of this Committee, there has been another meeting of Working Party 3 of the OECD Economic Policy Committee. This time the entire session was devoted to a consideration of the U. S. balance-of-payments problem. While the discussion was friendly and sympathetic, a genuine concern was evident at all stages of the talks about the U. S. payments deficit and about how its correction might be achieved. It is necessarily difficult to summarize so wide-ranging an exchange of information and viewpoint as took place, so the following points provide only a capsule sketch of substance.

(1) The persisting deficit in the U. S. balance of payments threatens to undermine market confidence in the existing international payments system.

(2) Strengthening of market confidence is urgently needed and can probably be accomplished by U. S. demonstration that relevant policies are being consciously directed to the correction of its payments deficit.

(3) The problem of correction is immensely complicated and correction can only be slow at best, considering the large load that the U. S. is carrying for the defense of the Atlantic Community and for aid to less-developed countries.

(4) The surplus countries of Western Europe have a role to play in accomplishing correction: first, in pursuing expansive domestic financial policies; second, in further removing quantitative barriers to imports and reducing tariffs; third, in opening wider the doors of access to capital markets by foreign borrowers; fourth, in assuming a larger responsibility in providing developmental aid; and fifth, by increasing their share of the defense burden of the Atlantic Community. Other committees or working groups in OECD can properly be called upon to help in eliciting European cooperation with the U. S. towards these ends.

(5) As reported to us, specific concerns of the European financial community about U. S. economic developments relate to the Federal Government's sizable budget deficit, a too easy monetary and interest rate policy, the absence of a governmental wage policy and our continuing upcreep in wage rates, the over-all competitiveness of U. S. producers in world markets, and our high rate of unemployment and generally wide margin of unutilized or

underutilized resources. At the same time, there is patently a consensus of view favorable to U. S. policies that appear likely to foster further economic recovery and step up the pace of our domestic growth.

No conclusions were reached as to policies deemed right and necessary to correct the U. S. payments imbalance, considering the need for economic recovery and growth. The whole problem, it was felt, needed further study, discussion, and analytic consideration by the Working Party. Accordingly, the U. S. problem was continued on the agenda for the next meeting, to be held early in December. At that meeting, the U. S. deficit will be discussed in relation to the surpluses that various major European countries have been experiencing. The outcome of that discussion will be reported to you at the Committee's mid-December meeting.

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

The domestic business and credit situation continues to develop satisfactorily. The basic outlook continues to be for a strong, but not overly exuberant, expansion in business activity. The picture has been somewhat obscured by the special factors of weather and strikes that led to the dip of one percentage point in industrial production in September and continued to be a factor limiting the improvement in October. The upward movement in over-all activity since the trough in the first quarter of the year has been substantial; there has been little sign of a slowdown despite the adverse factors operating in August and September.

There are signs, still too fragmentary to be conclusive, that the results for October will be better, perhaps giving a boost to business confidence. In particular, the retail sales picture strengthened noticeably in October. While the McGraw-Hill survey of business plans for plant and equipment spending in 1962 indicates only moderately larger expenditures next year, it should be borne in mind that previous surveys taken in similar periods following a recession seriously underestimated the advances that actually took place; the current survey is encouraging. At the same time, prices are steady and there is some evidence that the over-all unemployment picture is improving. Unused resources, as reflected in the

unemployment figures, however, remain large and the speed with which they will be put to use remains uncertain.

In contrast with the domestic scene, our balance of payments is a cause for concern. The increased deficit for the third quarter made the first page newspaper headlines this morning. Preliminary incomplete data for October give little ground for hope that the deficit was reduced from the high September figure. The payments deficit in the third quarter of 1961, adjusted for special transactions, increased to $3.2 billion (seasonally adjusted annual rate) despite the fact that the volatile short-term capital and "errors and omissions" accounts came into balance. Without the considerable improvement in these two accounts between the first and third quarters, the over-all adjusted deficit for the third quarter would have been much larger. Furthermore, there is some likelihood that we may experience rather substantial gold losses in the next few months, as some of the countries that have been accumulating dollars rapidly tend to convert some of these accruals into gold. The dollar is still vulnerable.

During the last two months there was a large expansion in the investment portfolios of the commercial banks. There was a good demand for bank loans in October. Business, real estate, and security loans all showed strength.

The money supply, as measured by currency in the hands of the public plus checking accounts, has risen a bit more than 2 per cent since a year ago. This is certainly not an undue expansion; the nonbank sector of the economy is not exceptionally liquid. On the other hand, banks are more liquid than at the comparable stage of the previous business expansion; they have a larger proportion of short-term assets in relation to total assets. Their loan-deposit ratios, although higher than they were in the corresponding period of 1958, have declined substantially in recent months.

The Treasury's refunding operation and its offering of $800 million Treasury bills in strip form were well received. With the conclusion of these operations the Treasury will be out of the market until early next year--unless it decides to try a junior advance refunding which is now being talked about in the market. If the Treasury

were to decide promptly to undertake such an operation, the System would have to take such decision into consideration.

The most disturbing factor now before us is our poor balance of payments. The problem of the balance of payments must command the close attention of various parts of Government and of various sectors of the private economy. The recent encouraging signs regarding the business expansion and the comfortable position of the banks enable us to give greater weight to the international situation.

The rise in short-term rates since the last meeting of the Committee should be helpful from the international viewpoint. The average rate on the three-month Treasury bill auctioned yesterday was 2.516 per cent. We think this is a desirable development. The rate on three-month bills is still below the top of the range of 2-1/8 - 2-5/8 per cent which has existed for more than a year. We think it desirable that the market rate on three-month bills move into a modestly higher range--say 2-1/2 - 2-3/4 per cent. Such a move certainly would not signal a policy of credit restraint. Yet it should help in a small way in the international situation. To accomplish this end, a lower level of free reserves is likely to be necessary. With this in mind, we would be prepared to see free reserves in a $300-$400 million range should this prove necessary. We see no reason to change the discount rate. We believe that the authority to engage in transactions in longer-term securities should be continued.

As for the directive, it seems to us that in the light of the international factors and the basic strength of the domestic economy, the Committee could properly change the directive so as to put less emphasis on encouraging credit expansion and greater emphasis on international factors. This might be done in two parts: first, by substituting the words "to providing reserves for further credit expansion" for the words "to encouraging credit expansion," and second, by substituting the words "special attention" for the word "consideration" in the clause which now calls for the Committee to give consideration to international factors. As so revised, the directive would read:

> "to providing reserves for further credit expansion so as to promote fuller utilization of resources, while giving special attention to international factors."

Mr. Johns commented that the statement of Mr. Thomas had covered in detail the point that he himself had expected to use in beginning his remarks; namely, that in the most recent past, say the past two or three months, there had been rates of increase of reserves and of money that could be characterized as extraordinarily rapid. If one looked at a somewhat longer period, he would get quite different rates of increase. For example, going back to March, one would derive a rate of increase in reserves, both before and after considering those behind Treasury deposits, of about 6 per cent, and an increase in the active money supply of about 3 per cent, or about 6 per cent if time deposits were included. On the whole, however, the state of the economy was such that the maintenance of the extraordinary rates of monetary expansion that had occurred in the past two or three months were not needed. At the same time, the amount of unemployment remained large, there were significant amounts of unused capacity in many lines, and prices seemed to be behaving rather satisfactorily. On the basis of these and other relevant considerations, he was of the opinion that an unusually low rate of monetary expansion would not be appropriate at this time. Therefore, he was inclined to agree with the staff memorandum on the outlook for member bank reserves that a further increase of total reserves, exclusive of those behind Treasury deposits, at a rate of about 5 per cent per annum would be appropriate.

In other words, he would be inclined to go along with the projections in column 3 of table 3 attached to the staff memorandum. However, in order to get a lessening of the rate of expansion, it would probably be necessary for excess and free reserves to be permitted to decline, and perhaps substantially. This could not be predicted with confidence, of course, because it would depend on the decisions of others.

Mr. Johns said he would like to point out that the free reserve figures might be quite misleading at this particular time as a guide to monetary policy. He was inclined to think that Committee objectives should be put in terms of total reserves, as in the staff memorandum, and that excess and free reserves be allowed to fall wherever they might, depending on the decisions of others; for example, the decisions of banks as to what they did with the available reserves. Since the decisions to be made by others could not be predicted with confidence, it would be necessary to watch developments closely and to be poised to make quick changes in policy in either direction depending on the circumstances.

Mr. Bryan said that Sixth District statistics seemed to indicate a continuation, though perhaps at a somewhat less rapid rate, of the expansionary movement. He could point out, for example, the considerable increase in department store sales, the rise in nonmanufacturing employment, the rather sharp rise

in manufacturing payrolls, and the expansion of bank credit, taking both loans and investments into account. However, the most striking development that had come to his attention was the difference in sentiment at the Reserve Bank directors' meetings this month and a month ago. As borne out also by the comments at the most recent meeting of the Birmingham Branch directors, there seemed to have been a striking improvement in sentiment. If this could be taken as a token of things to come, one could look forward, at least for some months, to a continuation of the expansionary movement. The agricultural situation was noteworthy in that there were bumper crops almost throughout the whole District; the only difficulty was that the generally prevailing drought situation forecast some trouble from the standpoint of fall pastures and fall seedings.

At this point Mr. Bryan summarized a report made recently by a top textile executive in the Sixth District who had just returned from an extended visit to Japan. The substance of the report was that the mills he had visited made those in the United States obsolete by comparison in terms of automated machinery.

As to policy, Mr. Bryan said he had come to this meeting prepared to advocate lowering the free reserve target because of factors already mentioned by others. These included the increase in the money supply recently, which was especially large if time deposits or some fraction thereof were taken into account. Also,

total reserves were now above the 3 per cent trend line running back through the postwar period. He would agree with those who felt that the free reserve target was a particularly treacherous concept at this point, and he would prefer to adjust in terms of total reserves. Taking total reserves, he thought it would now be appropriate to drop down from a 5 per cent growth increment to something like a 3 per cent figure. If he had to suggest something in terms of free reserves, he would drop the target at least to the $400-$450 million level, which would be a gradual step in the direction of getting tighter control of the money situation.

Mr. Bopp reported that both business and banking in the Third District had been hesitating somewhat. There had been some slowing down in the advance of business, as indicated by steel operations, labor force figures, and freight car loadings. A number of labor market areas were still classified as having substantial unemployment. However, retail sales improved in September. The banking picture still failed to show a pickup of business loans, and total bank credit had actually declined recently. Reserve positions were comfortable.

In view of the balance-of-payments problem and the fact that the Treasury refunding operation was still in process, Mr. Bopp said that he would not recommend moving toward further

monetary ease. Whether the recent hesitation in the economy was anything more than that remained to be seen. It might be found that the economy was already moving ahead along a moderately expansionary course. Under the circumstances, he would continue essentially the policy that had prevailed. He would not change the discount rate or the directive, and he would continue the special authorization covering operations in longer-term securities.

Mr. Fulton said that there had been no marked change in the pace of business in the Fourth District since the previous meeting of the Open Market Committee. In the steel industry, there had been no observable pickup in orders; the automobile industry was buying steadily, but at a rather low level. The cessation of the auto strikes had not encouraged the buying of steel because the auto companies took all of their deliveries during that period and now must use their inventories before increasing scheduled deliveries. The steel industry expected production in the fourth quarter to be about the same as in the third quarter, that is, around 26-28 million tons, which would make a total of approximately 97 million tons for the year as a whole, much less than anticipated at the beginning of the year. The industry hoped for a pickup in the first quarter of 1962 and projected about 110 million tons for the year. The industry was expecting a strike at the end of June, but of rather

short duration. It was felt that prices would have to be raised if any costly settlement was made; the industry could not continue to expand plant and modernize facilities at the present rate of earnings. Foreign steel was again becoming a problem, with prices quite soft. Scrap prices were down substantially, reflecting the low rate of production in the United States and the somewhat declining rates of production abroad.

In further comments on the District economy, Mr. Fulton said that the paperboard industry was strong, with new highs in output, reflecting the flow of material into the form of finished goods. However, in view of the present rate of retail sales, there was some question as to how long the existing rate of production of finished goods could continue. While retail sales in the District were up somewhat, consumer buying still lacked vigor, perhaps due to some extent to lingering fears of unemployment, much of which was still in evidence. Also, the calls of men to active military duty might be exerting some effect. Department store sales for the year to date were still 1 per cent below a year ago.

The automobile industry, Mr. Fulton said, was looking forward to a good year. The industry expected to produce better than 1.8 million cars in the fourth quarter, making a total of 5.5 million for this year, and expectations for next year ranged

from a minimum of 6.3 million to around 7 million. Sales were good, dealer stocks were low, used car prices were high, and few price concessions were being made.

The unemployment situation was still a major factor; it had improved slowly, but only in accordance with seasonal expectations. Of the 14 major labor market areas in the Fourth District, 9 continued to be classified as areas of substantial unemployment, along with 25 of the smaller areas. The machine tool industry was one that had experienced no real push. It had a fair backlog of orders, many of which were for foreign shipments; domestic orders were not up to par. Summarizing conditions in the District, Mr. Fulton said he did not feel that a boom was imminent.

As to open market policy, Mr. Fulton expressed the view that the level of free reserves had been too low, particularly in the latest week. He would like to see free reserves in the range of $450-$550 million, with something around $500 million as the target. With respect to the recent rise in short-term rates, he noted this would appear from the historical record to be a normal occurrence in mid-November with rates falling back to lower levels soon thereafter.

Conversations with persons in the Fourth District reflected a feeling that a wage-cost push must be expected, and that prices inevitably were going to be increased. This was felt to

reflect the lack of any national wage policy. Mr. Fulton concluded that monetary policy could not do anything about price adjustments due to this particular phenomenon. Therefore, he felt that the System should make a calm appraisal of the situation, not put the brakes on precipitantly unless the whole economy appeared to be moving toward a fuller utilization of resources, both plant and manpower, and not be overly concerned about price movements if they resulted only from the wage-cost push. Mr. Fulton added that he would not favor changing the discount rate or the directive and that he would renew the special authorization.

Mr. Mitchell commented that the Committee continued to face some real uncertainty in the area of consumer behavior. Perhaps things had now moved far enough along in this cyclical swing that the Committee ought to make up its mind as to what consumers were doing or were going to do. On the other hand, perhaps it was still too early. In his opinion, however, consumers probably were not going to make much contribution to the growth of the economy, at least until they got over their present frame of mind. He did not regard a change in consumer takings from the range of $18.0-$18.3 billion that had prevailed for several months to a rate of $18.6 billion as a substantial increase in spending. Even though consumer income had been rising and consumers had adequate access to credit, they appeared apprehensive. Therefore, they were not likely to spend in the next few months as freely as necessary to

give business the encouragement it needed to expand inventories, plant, and equipment. In the circumstances, the lack of enthusiasm that had been evident in inventory policy and capital expansion might well continue. Mr. Bryan had observed a change in sentiment in the Sixth District recently, and this might be the point where such a change was about to take place generally. However, corporate profits in the third quarter were disappointing and the McGraw-Hill survey of business plans for capital investment reflected the kind of sentiment on the part of businessmen that existed at the time the survey was taken.

In the circumstances, Mr. Mitchell believed that monetary policy should not be changed. He was disappointed that recent developments in the bill rate had created speculation about a change in policy having occurred. This seemed to be leading to an expectation of changes in financial markets generally, which he did not think would help to achieve economic growth and stability. In short, he saw nothing to gain by arousing public expectations that monetary policy was tightening or about to tighten.

Mr. Mitchell noted that the Chairman of the Council of Economic Advisers had said recently that if unemployment did not decline, it would be up to the Administration to create jobs. However, he (Mr. Mitchell) felt that it would be better if the private economy could be persuaded to create jobs. Monetary policy

should do whatever it could to make this possible, and its major contribution at this juncture would be to maintain an even keel, with interest rates kept as low as possible consistent with the dilemma presented by the international situation. In that respect, a major problem, apparently, was that foreigners wanted to know how this country was going to get its payments position into balance, but he did not feel that anyone in this country knew the answer to that question. As he saw it, the Federal Reserve could do just one thing about the balance-of-payments problem. It could encourage foreigners to leave their money in this country by making interest rates competitive with those in key Western European countries. In his opinion, however, carrying this policy much farther than it had been carried in recent months would be too high a price to pay at the moment, considering the importance of a somewhat lower level of interest rates to stimulate the domestic economy. All things considered, he came out in his thinking to the conclusion that monetary policy should not change at this juncture. As to free reserves, he felt that he could go along with a target of about $500 million. More important, however, was the need to get back to the psychology and rate relationships that existed before last week and to stay there for the time being.

Mr. King commented that at the start of the downswing in activity over a year ago he was one of those who had talked

considerably of international factors, and he thought rightly so. Today, however, he did not weigh those factors quite as heavily. In his view, difficulty was being experienced because of an illusion that the System perhaps had helped to create. He had read in some of the financial papers that the System had been pursuing too easy a monetary policy for too long. However, the real impact of monetary policy, he concluded, is on the borrower, being measured by the interest rates charged the borrower by commercial banks. There was rather general agreement, he thought, that interest charges of banks actually had not dropped very substantially during the recession. Nevertheless, the System had been satisfied, for rather obvious reasons, to live with the illusion that it was pursuing an easy money policy. Criticisms were now being heard from persons concerned about the international situation who believed that interest rates were not moving up fast enough, but the System was failing to assert that actually it did not have an easy money policy. He could not conclude that policy was quite as easy as some of the press articles would suggest, or as it was made out to be by some foreign sources. This, he thought, was basically the difficulty with which the System really was struggling. If the System were to give an indication at this stage of the game that it did not subscribe to the view that monetary policy had been overly easy, and instead felt that it had maintained

a reasonably prudent course up to the present time, a start could be made toward demolishing the illusion that he though existed. Also, if the situation were viewed in this context, he believed that there would be less difference of opinion within the Committee as to the appropriate thing to do at this time.

Mr. King said he would hope that the general degree of ease that had prevailed up until recently might be continued. This would be characterized by a Federal funds rate under 3 per cent, but without being too specific since he thought it was not reasonable to instruct the Desk in terms of exact figures. He saw no need to change the directive at this time.

Mr. Robertson commented that there was still a great amount of unutilized resources, both in terms of manpower and productive capacity. There had not been the growth and expansion that might have been expected. In the circumstances, he saw no reason for a tightening of policy at this time. The stage of the cycle had been reached where a tightening of credit probably would be needed in the relatively near future, but as of now he felt that the Committee ought to maintain the same degree of ease that had existed, excluding the most recent week. An impression that policy had been changed would give rise to a great deal of concern. This might be necessary by the time of the next meeting, or two meetings hence, but as of today he would favor maintaining the degree of ease that had been typical during the past two or three months, whether stated in terms

of free reserves, total reserves, or nonborrowed reserves. If any doubts should arise, he would hope that they might be resolved in such manner as not to be indicative of any tightening on the part of the System.

Governor Mills said that he was in general agreement with the interest rate and reserve targets proposed by Mr. Treiber in the latter's comments. However, the top-heavy positions of the Government securities dealers indicated that such objectives must be approached cautiously to avoid, as far as possible, disruptive effects on the Government securities market. In capsule form, his views on policy would run about as follows:

> On balance, the parlous monetary and credit situations to which I have drawn particular attention at the last two meetings of the Open Market Committee have since worsened and the difficulty of escaping unfortunate consequences has been correspondingly increased. For the reasons that I have previously cited, it continues to be imperative to develop a point in the supply of reserves, the effect of which will contain the expansion of commercial bank loan credit largely within the bounds of the resources now at the banks' disposal at the same time that a firmer structure of interest rates will serve to discourage the transfer of gold and dollars abroad. In combination, the scissorlike effect of these policy actions should give public evidence of a determination to follow orthodox principles in defending the international exchange value of the United States dollar.
>
> Unequivocal adoption of the kind of monetary and credit policy outlined will need to be declared in a revision of the directive to the Manager of the System Open Market Account so as to read
>
> ". . . . (b) to giving precedence to combating international factors that tend to destabilize the exchange value of the United States dollar, while minimizing bank credit expansion to the end that

increases in bank loans will largely be financed out of existing bank resources."

The special authority to operate outside of the U. S. Treasury bill market should be continued, and an increase to 3-1/2 per cent in the discount rate at the Federal Reserve Banks should be made if and when upward pressure on interest rates has made a raise appropriate.

Mr. Wayne reported that Fifth District business had continued to improve, but at a very gradual pace. Seasonally adjusted nonfarm employment, following a slight August decline, reached a new high again in September. Among nonmanufacturing enterprises, employment increases had been most marked in mining, services, and government. Employment decreases occurred in trade and contract construction. Construction activity seemed to have leveled out at near-record employment, supported by a good backlog and a fairly good volume of new contract awards. According to September man-hour statistics, all important classes of durable goods manufacturing except two continued to gain, while important nondurable goods industries, except tobacco manufacturing and textiles, suffered losses. The fact that man-hours in all major industries, except transportation equipment, were still below 1960 activity peaks pointed up the gradual pace of this recovery to date.

Encouraging developments had occurred recently in the furniture industry, which staged its most successful fall market in years; in textiles, where improving demand had strengthened

certain prices; and in the coal business. The bituminous coal industry appeared to have emerged from a long period of adjustment in which new, highly efficient equipment was being utilized to meet the pressures of rising costs and stiff competition from other fuels and power sources. Significant additions of coal miners to unemployment rolls were not expected, nor would many new mining jobs be opening up in the foreseeable future to help solve the problem. The industry expected to hold its present domestic markets and to expand them eventually with the aid of coal research. In the meantime, costs were now low enough to compete successfully in virtually all world markets, and demand was strong in Europe, in the Far East and, to an increasing extent, in Latin America, so the future looked very good for exports.

On balance, businessmen contacted in the past ten days in a survey of recent business trends reported increases in manufacturers' new orders and shipments, a downward trend in inventories, slight gains in employment and hours of work, and generally stable wages and prices. Unemployment had continued to decline, and both total and insured unemployment rates, except those of West Virginia, were substantially below the comparable national rates. District banking developments of the past three weeks had been dominated by seasonal factors.

Turning to policy, Mr. Wayne said that while October data suggested a small pick-up in the rate of recovery, the persistence

of a relatively high level of unused resources and the continued absence of inflationary pressures were strong arguments against any lessening of ease. On the other hand, increasing vulnerability of the dollar in the international market argued against additional ease. He was not persuaded that System action at this time to force short rates higher was necessary. This was not to deny the importance of the unfavorable balance-of-payments developments, but in his opinion the Committee would not yet be justified in gearing its actions primarily to those pressures.

Mr. Wayne noted that he was not present at the Committee meeting three weeks ago. From the record, however, the consensus as to the amount of free reserves to be maintained was not entirely clear to him. In any event the level of free reserves since that time, and especially the level that prevailed last week, was somewhat lower than seemed appropriate to him. Considering both the domestic economy and the international situation, he would favor a target in the neighborhood of $500 million in the weeks ahead, with a considerably smaller departure on the downside than occurred last week. He thought it was premature to lower free reserves out of solicitude for the dollar's position abroad. For the present, he would favor no change in discount rates and renewal of the substance of the present directive. He would also favor renewal of the special authorization.

Mr. Clay commented that evidence continued to be lacking as to the pace of economic activity ahead. While the temporary restraint of the automobile strike was now behind us, and it should be possible to obtain a more accurate picture of the underlying strength of the economy, it was too early for these developments to be fully reflected in the economic data. This was one time when it was reasonable to anticipate that economic visibility would be better at the time of the next meeting of the Committee than today.

Indications were that economic activity would continue to expand, but the rate of expansion could not be foretold. Substantial expansion in government demand for goods and services appeared assured, but the timing and impact were not clear. Consumer demand was expanding. The important test of a sustained expansion in the consumer durable goods area lay just ahead, however, as the strike settlements would make new cars readily available to the market. The recent projections of business demand for inventories and capital goods did not appear to be strongly expansionary, but a strong upsurge in consumer demand, with its accompanying effect on plant utilization and corporate profits, could materially alter those developments.

When this situation was considered along with the large volume of unutilized manpower and other resources, it became

clear to him that this was not the time to lessen the degree of monetary ease maintained by the Federal Reserve System.

Credit expansion at the rate of recent months and a level and pattern of interest rates in line with recent weeks would be desirable, Mr. Clay felt, until economic visibility improved. The international flow-of-funds problem continued to call for watchfulness regarding the Treasury bill rate. However, it was unnecessary to compromise domestic economic objectives to attain the desired bill rate. This could be avoided by carrying out operations in longer maturities to whatever extent was necessary to maintain reserve objectives.

Mr. Clay expressed the view that no change was required in the Committee's directive or in the Reserve Banks' discount rate. The special authorization for operating in longer maturities should, in his opinion, be renewed.

Mr. Allen reported that economic activity in the Seventh District continued to improve slowly. Employment, automobile sales, new orders of durable goods manufacturers, and loans at weekly reporting member banks had strengthened somewhat further since the last meeting of the Committee. Samplings of opinions of businessmen indicated very general expectations that the recent trend would continue during the remainder of this year and well into 1962. There had been no recent reports, however, indicating expectations of a boom-like expansion.

Retail deliveries of new autos (domestically produced) in October totaled 535,000 and were only 1 per cent below the record number last year, when a large inventory of 1960 model autos was being liquidated at reduced prices. During the last third of October, retail deliveries were at a record rate, 2 per cent above those of a year earlier. One of the major manufacturers estimated that current sales were equivalent to an annual average of 6.5 million. While prices of used cars had weakened recently, this was thought to be an adjustment from recent high levels rather than an indication that the demand for new cars would weaken.

Further gradual improvement of industrial employment in the Seventh District was reflected in the reclassification of four labor market areas in October. Two of these, Muskegon and Flint, were in Michigan; one, South Bend, was in Indiana; and one, Madison, was in Wisconsin. All except Madison were predominantly industrial areas, and even in Madison the improvement was attributed in part to higher employment in manufacturing.

Steel production in the Chicago and Detroit areas had shown no decisive move either up or down but some improvement was expected if production of automobiles continued at a high level during the remainder of the year. The failure of the expected volume of orders from the auto industry to materialize in September and October was attributed in part to the possible effects of the new labor contract on scheduling of auto production. The "annual wage" features of the contract

might tend to reduce seasonal fluctuations in the production of autos. This would also tend to stabilize purchases of steel by that industry.

Banks in the Seventh District reported that they were still waiting for the rise in loan demand, Mr. Allen said. Also, they were becoming increasingly restless with their large holdings of short-term Treasury securities, indicating possible moves to lengthen the maturity of their portfolios unless loan demand should rise sharply before year end.

There was some evidence that loan demand had been strengthening. The over-all rise in loans of weekly reporting member banks in the District during September and October was about $300 million. This was double, or more than double, the increase in the corresponding period in each of the three preceding years. If loans on securities were deleted, the relative increase was smaller but still substantially greater than in other recent years. The country showed much the same pattern as the District, except that the increase in total loans was greater relative to the preceding three years while the increase in business loans was not so strong as for Seventh District banks.

At Chicago banks the effect of the rise in loans on reserve positions had been more than offset by sales of securities and modest gains in deposits. Government securities held by weekly reporting banks in Chicago had declined about $250 million since October 18,

with nearly all of the decline in Treasury bills. Chicago central reserve city banks had improved their reserve position since mid-October (from a basic deficit of $276 to $187 million). They had continued to purchase Federal funds in amounts ranging from $100 to $300 million per day and had borrowed from the Reserve Bank at the close of each of the past three weeks.

Mr. Allen said the operations of the Desk during the past three weeks had been consistent with his understanding of the instructions given at the October 24 Committee meeting. However, questions had been raised as to whether the operations signalled a change in policy. He believed the current information available to the Committee as to trends in the economy indicated that its policy objective should be to maintain the status quo and to avoid if possible giving any signals which might be construed as indicating either greater or less ease. Therefore, he would recommend no change in the directive, no change in the discount rate, and a free reserve target of around $500 million. He continued to oppose the special authorization.

Mr. Deming commented that it was again necessary for him to say that there was nothing particularly new in economic and credit developments in the Ninth District. Estimates of cash farm income indicated that 1961 income would approximate that for 1960 but would run 3 per cent below the 1958-60 average. U. S. cash farm

income, of course, would be higher than in 1960. The reason for the District showing was that gains in the first half would be countered by relative losses in the second half. For the third quarter, cash income was running 8 per cent below last year, as the effects of the drouth became evident. As he had noted previously, it was expected that District farm income would continue to lag year-earlier levels throughout the current crop year, ending next July 1.

In the nonagricultural sector, things were going along about as before except that the District's retail sales record seemed to be lagging the nation's a little bit. Bank debits for September were the same as a year earlier despite the fact that District personal income was 3.6 per cent ahead of September 1960. Debits increased appreciably in October. District banks continued to experience significantly smaller loan demand than the national record indicated, and the bank liquidity picture had improved further. In sum, the District continued to be typically atypical.

Mr. Deming then reviewed computations he had made of gains in GNP on a quarter-to-quarter basis and on a year-to-year basis beginning with the first quarter of 1961 and extending into the predictions being made by various sources for the first half of 1962. It had become fashionable, he noted, to characterize the expansion as modest. It was true that periods of expansion in the past had produced larger gains quarter to quarter and year to year than this

time. However, average gains of 7 or 8 per cent must be viewed, in his opinion, as something more than modest, and even the less optimistic predictions for 1962 looked quite good when annual comparisons were made. Of course, all of the projections rested partly, and perhaps in large measure, on what might happen in terms of consumer behavior in the course of the next six months. Obviously, the projections were far from solid. Nevertheless, all of the figures indicated something more than an economy in the doldrums; instead, they indicated fairly substantial, significant gains. It was said that gains of the order rather generally predicted in the first half of 1962 could be achieved without significant price pressures, but he was not so sure they could be achieved without such pressures if a potentially explosive build-up in bank credit was permitted. It was necessary for the Committee to be cautious at this stage of the cycle in approaching its work.

Mr. Deming said that his analysis was quite similar to that of Mr. Johns. He would be inclined almost to abandon free reserves as a target during the coming months, and to cling quite closely to total reserve figures. In this respect, he would be happier with a 4 per cent annual growth rate than with a rate of 5 per cent. Then, if the pressure of bank credit expansion should begin to mount, this would probably lead to a lower free reserve figure.

What he was suggesting, Mr. Deming said, did not really represent any striking change from present policy. The System would

continue to supply reserves to provide for further bank credit expansion, but not quite as liberally as in the past two or three months. However, in view of the considerations he had mentioned, he felt that it would be wrong for the System to proceed on the basis that since nothing had happened as yet, nothing was going to happen in the future. It would be better to get into a position to deal with problems as they might come along. His prescription, Mr. Deming added, perhaps did not come out greatly different from the recommendations of Mr. Treiber. Conceivably, the result would be free reserves of the order mentioned by Mr. Treiber, but he would prefer to stick to total reserves. As he saw it, the course he was suggesting would not represent enough of a change in policy to call for a revision of the directive at this time. On the other hand, he would have no strong objection to the change proposed by Mr. Treiber. He would not favor changing the discount rate at this time, and he would renew the special authorization.

Mr. Swan said that in the Twelfth District defense orders had exerted some impact on employment. Based on a breakdown of the September figures (October figures were not yet available in this detail), the increase in manufacturing employment was entirely in durable goods and primarily in defense-related industries. As yet, however, there was no evidence of secondary effects in other areas. The mixed situation was borne out by the fact that while total

manufacturing employment was up in September, the average work week, at 39-1/2 hours, was the shortest since March. This trend toward shorter hours was general throughout the nondurable goods category. In October, Seattle was reclassified from an area of substantial unemployment to an area of moderate unemployment due to increased activities at the Boeing plant, but 8 of the 15 major labor market areas in the District were still classified as areas of substantial unemployment, including the Los Angeles-Long Beach area.

Department store sales reached a record level in September; though still high in October, they were down somewhat from the preceding month. On the other hand, there was a sharp increase in automobile sales in the first 10 days of October, and dealers appeared quite optimistic. In agriculture, the crops were good and mild weather had extended the harvesting, particularly of some fruits and vegetables, with the result that farm employment was quite well maintained even after the usual seasonal peak.

In the three weeks ending November 1, District banks showed a considerable expansion in loans as well as investments, although bankers still felt that the demand for loans was not up to previous expectations. At the time of the October 24 meeting, it had been reported that the banks were still net sellers of Federal funds, but on a narrower basis. They were now net buyers, and for the week ending tomorrow the figures undoubtedly would show them to be net buyers on a fairly substantial basis.

In summary, Mr. Swan said it seemed to him that the recovery in the Twelfth District was proceeding, in some respects, possibly, at even a little faster rate than in the country as a whole. However, there was still no clear evidence of a markedly vigorous pick-up, or any general feeling that this was likely to develop. In no sense did it appear that the situation was likely to get out of hand in the near future.

As to policy, Mr. Swan then said in view of the rather moderate credit demands and the lack of significant price pressures, he did not yet see any reason, so far as the business situation was concerned, to tighten further. The situation could change rapidly, but it had not as yet. Further, a period of digestion was still necessary in connection with the Treasury refunding. Therefore, he would feel that for the next three weeks there was no reason for a change in prevailing policy, as reflected in the situation that had existed prior to the week of November 8. He had gained the impression from bankers and others in the Twelfth District that recent developments had been interpreted in terms of a change in policy, not so much because of the free reserve figure of $418 million for the week of November 8 but because this culminated a period of several weeks in which free reserves had run below $500 million. Nevertheless, the $418 million figure was the lowest for any of those weeks, and when looked at in combination with the free reserve figure for the last

day of the statement week and the high level of member bank borrowing on that day, it led to the general impression that he had mentioned. Accordingly, it seemed to him that a continuation of the sort of policy envisaged at the October 24 meeting would be desirable. While he shared some of the views that had been expressed about the unreliability of free reserves as a guide, he felt that it would be unfortunate if they ran significantly below $450 million in the next three weeks or if the 90-day bill rate ran consistently above 2-1/2 per cent. He would recommend no change in the discount rate and no change at this time in the directive. He would continue the special authorization.

Mr. Irons said that in the past three weeks the Eleventh District had experienced general improvement, not at a rapid rate but rather steadily. The slack in industrial activity resulting from Hurricane Carla had been recaptured. The chemical industry was back in operation, and the activities of other industries in the affected area had resumed. Thus, the industrial production index, which dropped seven points immediately following the hurricane, had now regained six of them. The agricultural situation was highly satisfactory, with good crops, moisture conditions, and pasture outlook, along with good prices for the products.

Mr. Irons went on to say that at last week's joint meeting of the Dallas Bank's head office and branch directors a number of directors reported on conditions as seen by them in territories

within the District. The reports, he said, were unanimously favorable and optimistic.

Employment was up, Mr. Irons said, and unemployment had dropped down a bit, the figure being a shade over 5 per cent in the State of Texas on an unadjusted basis. Department store sales were holding steady. It might be said, therefore, that the District economy was showing reasonable and satisfactory expansion. As to banking, loan demands had increased during the past three weeks. The banks were in a comfortable reserve position, however, and bankers seemed to feel able to meet any demands for credit that might reasonably be expected. There was no significant borrowing from the Reserve Bank. Federal funds purchases, although lower during the past three-week period than they had been, exceeded sales.

Mr. Irons said he did not think the System could hope to escape the hazard of guesses and anticipations about changes in policy. At the moment, while he did not favor any drastic change in policy, he found himself much in agreement with the position expressed by Mr. Treiber. He would continue a policy of ease but, as indicated by Mr. Treiber's suggestion regarding the directive, shift the emphasis somewhat to more consideration of the short-term rate structure and less to the free reserve figure. He would like to see the bill rate around 2-1/2 per cent and Federal funds trading around 2-1/2 per cent. Bank credit expansion would have to be

watched to see what was being done with the available reserves. Apparently, the banks had been using the funds that the System had been making available, as indicated by the increase in bank credit and the money supply. Recognizing all of the limitations of the free reserve figure, he would not be disturbed if that statistic ranged around $400 million, if that was necessary in order to achieve the rate position that he had mentioned. He would look upon monetary policy as one of ease rather than restraint if reserves were in the area of $400 million. However, he would drift, perhaps, toward a little less ease.

Although he did not regard a change in the directive as compelling, Mr. Irons said he rather liked the suggestion made by Mr. Treiber, which would tend to shift the emphasis a little. He would not favor changing the discount rate, and he would renew the special authorization.

At this point Mr. Hexter, Assistant General Counsel, joined the meeting.

Mr. Ellis said that in New England business conditions continued their sideways recovery. Business sentiment seemed to have overrun the statistic evidence, which was not very conclusive one way or the other. The manufacturing index dropped a point in September from August, the first decline since March, and stood four percentage points above the comparable 1960 figure. Shoe production in September was below the year-ago level. There had

been some continued strength in residential construction, which offset some weakness in nonresidential building, but there was no evidence of a real break-through in that category of activity. The same could be said for the employment pattern, there having been no substantial change in the employment or unemployment picture. No labor market areas were reclassified in October. Department store sales continued to run ahead of last year quite strongly, to provide the most outstanding record of any District in that regard, and the record on purchases of new automobiles also was relatively strong, although no firm recent data were available.

The pattern of a sideways movement also was evident in the credit picture. The consumer instalment credit index moved sideways in September and stood only 1 per cent above the year-ago level. Weekly reporting banks showed a modest gain in deposits in October, but business loans shaded off, and the banks were still awaiting the increase in loan demand that they had been expecting. Their liquidity positions had improved, and loan-deposit ratios had eased a bit. They had been net sellers of Federal funds since September.

Mr. Ellis reported that business sentiment had been tending to become more optimistic, this being traceable partly to the expected increase in defense procurement in the District. Also, there was an expectation among retailers of an increase in consumer

spending. At the regional outlook conference that had just been completed, the economists in attendance were a little less optimistic than the System economists who met recently appeared to have been.

As to policy, Mr. Ellis expressed the view that the variations from goals in the past few weeks would seem to have been comprehended in the consensus that doubts should be resolved on the side of less ease. That, he thought, might be the key to the trend in the future. He had come to this meeting prepared to accept slightly lower goals, for example in free reserves. Looking ahead, he saw the likelihood of a strong upward movement, feeling that the break-through in consumer spending probably would be in an upward direction. Recognizing the lag in effectiveness of monetary policy and wishing to avoid unduly sharp and abrupt action when credit began to spurt ahead, he felt that the Committee should begin gradually to put itself in a better position to apply the brakes when that became necessary. The economy still needed a stimulus, but a little less than had been the case. With this in mind, he concurred in the suggestion that there be a lowering of the growth increment in total reserves; he would favor an increment of 3 or 4 per cent. Then the Committee could see how other variables reacted. He would not be surprised if free reserves moved down from $500 million closer to $400 million, and he would be prepared to accept something around the $400 million level as

an appropriate expression of the continued stimulus that should be provided under current conditions. Likewise, he would not be surprised if the bill rate was nearer to 2-1/2 per cent than it had been up until a couple of weeks ago, and he would expect that the Federal funds rate might push near 3 per cent more frequently. In his opinion, this would still fill the prescription of resolving sympathies on the side of less ease. Further, he felt that such a policy would be within the range of the existing directive and that it would therefore not be necessary to change the directive at the present time. He saw no need to move on the discount rate in the immediate future, and he would continue the special authorization.

Chairman Martin expressed the view that the evolution of monetary policy had been proceeding satisfactorily and noted that his judgment appeared to coincide with that of a majority of the Committee. He felt that the System was moving satisfactorily in the direction of perhaps reaching a point when it might make an overt change in policy. In his opinion, however, the situation had not yet come to that point. Mr. Allen had referred to maintaining the status quo, and he (Chairman Martin) also would think that maintenance of the status quo would be the best general position that the System could take at this particular time. There would be another Committee meeting in three weeks and perhaps things would then be a little clearer. At present, however, the Committee was operating in an atmosphere in which misinterpretations existed.

A number of people had spoken to him in terms that System operations had severely prejudiced the current Treasury refunding. He did not believe that for a moment; instead, he felt that the Desk had handled things pretty well through this period. Nevertheless, there had inadvertently been a decline in the level of free reserves. It was unfortunate that the free reserve figures had come to attract so much attention, but the over-all picture involved a number of factors that had all worked in the direction of creating an atmosphere in which a change of policy was anticipated. Interest rate changes would have to be expected; that would be the natural way for things to develop rather than for the System to force matters. If the System had been going to force matters, it should have started some time ago. In his view, therefore, the Committee should not at this juncture change the policy that it had been pursuing for quite a period of time. As he had said, he felt that System policy was evolving quite satisfactorily.

The Chairman went on to say that he thought the consensus of this meeting was rather clear. It did not contemplate, perhaps, quite the maintenance of the status quo, but certainly it would not favor any change in the directive or the discount rate at this time. A minority leaned toward a shift of emphasis to total reserves, but he questioned whether the Committee wanted to shift its sights substantially until it knew more clearly what developments were going to occur.

The Chairman also said that he hoped the Treasury would not undertake an advance refunding in the present atmosphere. If it did, however, it would be most unfortunate for the Federal Reserve to take any overt action, and in any event he felt that the System would be in a better position if it did not upset the money market unduly in view of the misinterpretations in some quarters concerning the relationship of open market policy to the current refunding. In this connection, the Chairman noted that the Treasury had not made representations to him of any kind. Nevertheless, there had been enough comment from other sources for him to be aware that some feeling existed. In all the circumstances, he would consider it advisable for the System to go along for the next three weeks feeling its way to the best of its ability. It might be, of course, that market forces would automatically move in the direction that had already created an atmosphere of expectation of a change of policy. On reviewing the record of recent Committee meetings, one could see that the drag had been in the direction of lower levels of free reserves than probably was contemplated by the majority at the respective meetings. Thus, to some extent it might be said that policy had been made for the Committee.

At this point Chairman Martin stated that he would like to make certain comments on the balance of payments. First, he

wanted to make it clear that he thought the situation was serious. It is easy, he noted, to see ghosts in these things. However, the problem had existed for well over a year and was a deep-seated one.

It seemed clear to him from his recent trip abroad, the Chairman said, that the financial leadership of the western world had at this particular point shifted from the United States to Europe. For example, the discussion regarding expansion of the resources of the International Monetary Fund was basically in terms of a United States drawing on the Fund and a defensive position on the part of the United States. The change had been subtle, but clearly this country was in a defensive position; he had seen this developing over a period of time. This was a process in which the fundamentals were being carefully studied. The budget deficit, fiscal policy, and wage-cost policy were in combination becoming a paramount issue in the world. While there might be a tendency for Europeans to say that this country was following an unduly easy money policy, some of the critics were people who had a self-serving interest in the evaluation of the matter. Europeans were not yet persuaded en masse that this country was following an inflationary monetary policy. They were aware of the country's domestic problem, including the extent and persistence of unemployment. At least, the thoughtful persons were aware of it, along with the fact that there are relative degrees of inflationary

conditions and that no country can set interest rates alone. In conversations abroad, he had tried to point out that the payments mechanism at the present time is a privilege that carries responsibility for each country. Each country must think of its responsibility to the payments mechanism when it has the privilege of acquiring any amount of gold that it may want.

Monetary policy, the Chairman noted, had not been asked to carry the whole load of the balance-of-payments problem. The Administration was struggling with the problem of the Federal deficit, and it had made progress in terms of debt management all through the year. As to the wage-cost problem, he was not personally too optimistic. As he saw it, the steel industry was not refraining from raising prices so much because of the President's injunctions as because the industry could not get prices up. It was fearful of a strike and of the demands that might be made, particularly if there should be improvement in the economy during the first six months of 1962 to the extent that was generally anticipated.

The Chairman concluded his comments by saying that he had merely wanted to leave with the Committee the thought that no one ought to minimize the balance-of-payments problem. He was not trying to say that he thought there would be a crisis; he was hopeful that it could be avoided. However, he sometimes felt that only a crisis

would galvanize public sentiment to a realization of what was involved. The Administration had said repeatedly, he pointed out, that it would not place an undue burden on monetary policy. At present, with the supply of goods more than adequate, prices stable, and unemployment still quite high, he did not believe anyone could document a charge that the System was creating cheap money. If conditions reached the point where cheap money was being created, the System would have to take overt and clear action, but for a variety of reasons this was not the proper time, in his opinion, for such action. There had been a tendency toward a tighter money market simply through the play of market forces, and he considered this a satisfactory development under present conditions. In his view, the Desk should not be criticized for not having been more aggressive. Rather, he felt that the Desk had been handling things well in view of the forces in the market.

Mr. Mills requested that his dissent be recorded from the implementation of policy according to the consensus, which he strongly believed failed to grasp the initiative that the Federal Reserve System should take and failed to grapple with the situation.

Mr. Hayes said that he thought his position differed from the consensus to a considerably less degree than that of Mr. Mills. However, he could not help but feel that the System should be doing its part, though not through overt action at the present time, to contribute to a recognition of the serious international problem.

This was with the proviso that if the Treasury should undertake an advance refunding, then no change in policy would be appropriate.

Chairman Martin commented that the views of everyone would be recorded in full in the minutes. He then inquired whether there was anyone who wished at this point to change the emphasis in his comments, as expressed previously, and there was no such indication.

Accordingly, it was understood that the consensus, as stated earlier by Chairman Martin, was accepted as accurate and that Messrs. Hayes and Mills dissented from the implementation of policy along the lines of the consensus.

The Chairman then said he assumed that the Committee wished to renew until the next meeting the special authorization covering operations in longer-term securities, with two members (Messrs. Allen and Robertson) dissenting, and there were no comments to the contrary.

With respect to the directive, Mr. Mills commented that although he dissented from the implementation of policy according to the consensus, he did not wish to dissent from a renewal of the existing directive. Mr. Hayes commented to the same effect.

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 credit expansion so as to promote fuller utilization of resources, 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.

The Committee then 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 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, Irons, King, Mills, Mitchell, Swan and Wayne. Votes against this action: Messrs. Allen and Robertson.

Chairman Martin referred at this point to a set of staff documents relating to System operations in foreign currencies that had been distributed with a memorandum from the Committee Secretary

dated November 3, 1961. These documents, which had been prepared as a basis for further consideration of the subject by the Board of Governors and the Open Market Committee, included:

1. Proposed action of the Board of Governors to amend Regulation N, Relations with Foreign Banks and Bankers.

2. Proposed action of the Federal Open Market Committee to instruct the Federal Reserve Bank of New York on operations in foreign currencies, including the establishment of a subcommittee of the Open Market Committee to direct and supervise the day-by-day conduct of foreign currency operations of the New York Bank for System account.

3. Briefing paper for discussion with the Treasury on the division of responsibility for foreign currency operations between the Federal Reserve and the Stabilization Fund.

4. Initial action of the proposed subcommittee of the Federal Open Market Committee to establish guidelines for the conduct of foreign currency operations by the New York Bank for System account.

5. Explanatory paper on the aims and scope of System foreign exchange operations, perhaps to be discussed with members of the Congress and possibly to be used as a basis for a press release in case the Board and the Open Market Committee should decide to go forward with such operations.

6. Paper concerning legal aspects of the proposed System operations in foreign currencies.

Chairman Martin noted that the foregoing documentation had been prepared in the light of the preliminary discussion of the subject at the Committee meeting on September 12, 1961. He went on to recall that at the September 12 meeting he had expressed the hope that in due course the Committee might arrive at a clear

position on this subject. Since that time, he continued, he had become more and more convinced that in one form or another some operations in foreign currencies would have to be conducted. The changed conditions in money markets around the world and the progress that had been made since Bretton Woods, including the establishment of virtually full convertibility of European currencies, had changed the payments picture in such a way that some operations to deal with the problem of movements of funds between money markets seemed appropriate. The Under Secretary of the Treasury for Monetary Affairs had made a significant contribution to the thinking in this field. The System ought to pursue the matter in every way possible and determine the issues involved, including whether operations in foreign currencies should be conducted by the Treasury or the Federal Reserve. To repeat, he was more convinced than before he began his recent European trip that in some way or another this activity would have to be conducted.

The Chairman then turned to Mr. Young, who commented that the preparation of the papers that had been distributed represented a think-through exercise. The staff had endeavored to determine what specifically would be involved in initiating and conducting a Federal Reserve foreign currency operation. There had been intensive discussions by the staff in Washington and with the staff of the New York Bank, including the Foreign Department. There had also been exploratory discussions with the Under Secretary of the

Treasury for Monetary Affairs. These staff discussions may not have covered all of the technical issues involved, but it was felt that they had. It was thought that the question had been quite carefully worked out as an operational matter. There was no remaining issue between the staffs at the Board and at the New York Bank except one with respect to the expressed purposes of the operation, to which he would refer later.

Mr. Young went on to say that, as he had indicated, it had been necessary in the course of the staff work to have some discussions with Under Secretary Roosa. However, those discussions did not involve Mr. Roosa in consultation with the Treasury staff or with the Secretary of the Treasury at this particular stage. Rather, they sought to determine the lines along which negotiations with the Treasury might be started and carried out, and the third of the papers that had been distributed presented the staff views as to a basis for starting such negotiations. This did not necessarily mean that the understanding that would be worked out would follow quite along the lines suggested, for the Under Secretary would have to conduct discussions with the Treasury staff and review the matter thoroughly with the Secretary. After the matter had been discussed and worked out with the Treasury, it was contemplated that it would be placed before the National Advisory Council on International Monetary and Financial Problems for the Council's information and to provide an opportunity for any objections

to be registered. It was not anticipated, however, that there would be objections. Rather, it was anticipated that the Council would act on the matter in a way that would enable the operations to proceed without referring specific operations to the Council, but with an understanding that reports to that body would be made from time to time.

As to the one issue that remained between the staffs at the Board and the New York Bank, Mr. Young commented that everyone was, of course, much interested in providing a statement of the purposes of the operations in foreign currencies that would cover the objectives fully and would represent an adequate platform on which to stand, and on the basis of which an explanation could be made to the Congress and the public about the program. The New York staff felt strongly that there should be included as one of the purposes the objective of helping to protect and maintain the value of the dollar in international markets. On the other hand, the inclination of the staff at the Board was to view this with reservations because in the end the question whether there was confidence in the dollar was a matter of pursuing proper monetary, fiscal, and other governmental policies, whereas the operations in foreign currencies could at best have only a relatively small influence and could only deal with temporary developments in the exchange markets at times when those markets were unsettled.

This issue was, however, clearly of secondary importance in relation to the consideration of the plan as a whole.

Mr. Hayes then presented substantially the following statement:

> We are pleased with the progress of the proposal that the Federal Reserve System conduct operations in foreign currencies. The documents enclosed with Mr. Young's letter of November 3 are well prepared. While we have some specific comments and suggestions as to details, we are in accord in principle.
>
> We are satisfied as to the legal authority of the System to engage in such operations. Our counsel has carefully considered the legal aspects of the proposal; our counsel and counsel for the Board of Governors have conferred from time to time on various aspects of the matter; and our counsel concurs in the conclusions in Paper No. 6 regarding the authority of the Federal Reserve to conduct the proposed operations.
>
> We believe that the System is qualified by virtue of its personnel, its experience, and its resources to conduct the proposed operations. Having the legal authority and the necessary capacity and skills, the System should conduct the operations in coordination with the U. S. Treasury. We would consider it unwise for the System to conduct its operations under the direction of the Treasury. Paper No. 3, in our opinion, suggests a workable plan for the coordination of System and Treasury activity in this important field. As stated in that paper, the proposal would be submitted to the National Advisory Council on International Monetary and Financial Problems for discussion and comment, and the Council would be furnished with reports.
>
> We trust that the System will move forward with dispatch to discuss the proposal with the Treasury and to take such other steps as may be appropriate to put into operation this important proposal to help protect and maintain the value of the dollar in international exchange markets. (You can see from this phraseology how we feel at the New York Bank about the point to which Mr. Young referred. While this operation might be only a minor part of the total program to protect the value of the dollar, nevertheless it is clear that one of the reasons

for engaging in the operation would be to help in the process of maintaining confidence in the value of the dollar.) The imperative necessity of defending the dollar, coupled with the practical limitations on the Stabilization Fund, makes the proposal a priority project.

Turning now to the six documents enclosed with Mr. Young's recent letter, and particularly to Paper No. 2, which describes proposed action by the Federal Open Market Committee, we consider it highly desirable, as I just indicated, to retain paragraph numbered (1) at the bottom of the first page of Paper No. 2. It is important that the United States take whatever steps may be appropriate to protect and maintain the value of the dollar in international exchange markets. It is important that all arms of Government promote this objective, using whatever means are available to them. While the System acting alone cannot accomplish the objective, it can help to do so. Paragraph (1) properly describes the System's role as one of helping--of contributing as best it can within the area of its operations. The goal of paragraph (1) should be constantly before us.

The third sentence on page 3 would establish a maximum quota of holdings of foreign currencies. The Committee should be free to change the quota from time to time in the light of experience and changing conditions. We suggest a figure of $500 million initially. As pointed out in Paper No. 4, operations will be limited by the existence of a large balance-of-payments deficit which will make difficult the accumulation of large amounts of foreign exchange. On the other hand, such operations are necessary now; we should have sufficient ammunition to cope with exchange market disturbances of the likely magnitude suggested by recent experience.

The maximum quota would have to be allocated among six or seven currencies, as indicated on page 6 of Paper No. 4; thus the subquota for a particular currency would not be very large.

We have a few comments on Paper No. 3 regarding the responsibility of the Treasury and the Federal Reserve for foreign currency operations. We can submit these in memorandum form.

We also have several comments on Paper No. 4, which would constitute guidelines to be adopted by the Subcommittee.

We can also submit our comments on this paper in memorandum form. Since it is proposed that the substance of this paper be adopted by the Subcommittee, our comments could be discussed at a meeting of the Subcommittee, without going into detail today.

In summary, we favor the proposal that the System undertake operations in foreign exchange; we trust that the proposal will move forward toward prompt consummation; and we will submit memoranda suggesting certain modest changes in the language of the documents which would not involve any substantive change in the program.

Chairman Martin then stated that he had in mind that the subject of System operations in foreign currencies would be placed on the agenda for the next meeting of the Committee (December 5, 1961) with a view to some action being taken one way or the other. He then turned to Mr. Wayne, whose letter on the subject had been distributed to the Committee, and asked whether Mr. Wayne had any comments that he would like to make at this time in supplementation of his letter.

Mr. Wayne replied that he had no comment, except to say that, as indicated bv his letter, he was not yet satisfied on legal grounds with the Federal Reserve's authority to undertake the proposed operations.

Mr. Mills then presented the following statement:

The theory of central bank operations in foreign currencies is unassailable. Actions to stabilize the exchange value of a foreign currency can serve worthwhile domestic and foreign purposes. Where central bank operations in foreign currencies are undertaken by a nation whose currency is subject to investor distrust or to speculative attack, their effect can be to dissipate lack of confidence and arrest speculation in that the

nation whose currency is in question will have demonstrated its ability to meet the exchange difficulties which it confronts. Similarly, where several foreign currencies have simultaneously become unsettled on the international exchanges because of widespread emotional lack of confidence in their basic values, a group of central banks acting in concert can maneuver the exchange resources at their disposal, to the end that particular currencies subject to waning confidence can be restored marketwise to their normal status, by virtue of which public concern regarding their values will have been deflected. This sort of procedure already has proved its worth with respect to the Basle agreements having to do with the difficulties experienced by the pound sterling earlier this year. In essence, however, central banks operating in concert in foreign currencies can do no more than gain time for a particular nation whose currency has been supported to correct the fundamental problems which exposed its currency to question and in that way restore confidence in its international exchange value.

This line of reasoning is applicable to any engagement of the Federal Reserve System in operations in foreign currencies. Such operations can be suitable when conducted in ways that will smooth out relatively minor fluctuations in the exchange value of the United States dollar. If it should be contemplated that such operations would be engaged in as an attempted means of correcting basic weakness in the exchange value of the United States dollar, they can be open to question in that, unless such operations were entered into in conjunction with determined fiscal and monetary policy actions to maintain international confidence in the U. S. dollar, they will have done little good and, perhaps, might even have added to whatever distrust might be in evidence regarding the dollar's basic exchange value. Moreover, if Federal Reserve System operations in foreign currencies should be undertaken more as a palliative rather than as a cure to intrinsic weakness in the international exchange value of the United States dollar, less positive rehabilitative response could be expected at some future time if it became necessary to seek support from the group efforts of friendly central banks.

All of the above takes for granted that the Federal Reserve Banks have certain legal authority to engage in operations in foreign currencies. It is also assumed that the financial risks to be borne by the Federal Reserve Banks

> when engaging in such actions have been fully weighed and that recognition has been given to the fact that the adoption of the proposed procedures will mark the Federal Reserve System's entry into a province that has historically been an almost exclusive preserve of the United States Treasury, and in a manner that will inevitably subordinate the interests of the Federal Reserve System to those of the United States Treasury.

Mr. Mills added that his real concern was that if this kind of operation was intended to paper over cracks in policy mistakes or decisions, it would be worthless. It was his fear that that was about what was to be considered and ventured.

Mr. Hayes agreed that if what Mr. Mills had mentioned were actually the intent, the operations would be worse than worthless. However, if they could be used along with more fundamental efforts, they might serve on occasions to dampen trends that would lead, needlessly, to an intensification of fears and problems that were not justified.

Mr. Swan expressed agreement with the indication given by Mr. Young that the proposed System operations would be recognized to have a relatively small influence and should be focused on preventing temporary developments from accumulating in the wrong direction. However, this did not seem to him to square precisely with the statements in the papers that had been distributed which suggested the use of such operations in dealing with seasonal instabilities and cyclical swings in international payments, along with other temporary instabilities. He raised the question whether

the Federal Reserve might not create the impression that it would be doing more than it should. The phraseology with respect to promoting orderly conditions in exchange markets also would seem to suggest that the Federal Reserve was going to be operating on a continuing basis, in which case the System might rather quickly find itself, in view of certain basic problems, with a larger amount of holdings than anticipated, and no place to go from there. In this respect, Mr. Swan said, he did not have a real basis for arriving at a judgment on a maximum quota of holdings that might be appropriate for initial operations. However, his reaction was that $500 million, divided six or seven ways, was on the low rather than the high side.

Another point, Mr. Swan said, was that he felt it was important to have a clear understanding in terms of the authority of the Federal Reserve as opposed to that of the Treasury. Also, he would like to have some further exploration of the question of operating through a subcommittee of the Open Market Committee. It might be that this was entirely necessary; this was an area where expert knowledge was vital and close timing was necessary on a continuing basis. However, he was not sure that this could not be done more informally, without the creation of a subcommittee, on the basis of day-to-day consultation between the Board and the New York Bank. On the other hand, if the establishment of the subcommittee

was necessary, perhaps there should be an even more explicit recognition of the importance of the subcommittee in relation to the Committee as a whole. The creation of the subcommittee might be absolutely necessary, but he felt at the moment that he would like to go a little further in one of the two opposite directions that he had mentioned.

Mr. Allen recalled that at the time of the September 12 meeting he had made two statements. One of them had also been made by Chairman Martin at that time, and again today: somebody was going to do the job. With this statement, Mr. Allen said, he would not quarrel. However, he had also said in September that just because a given procedure might be considered legal, he might not necessarily want to do it. After reviewing the staff documents that had been distributed, he felt that there were just two alternatives. The first would be to take the position that this was the Treasury's job, and that the System would continue to act as the agent of the Treasury; if the Treasury needed more money, let the Treasury request the funds from Congress. The second alternative would be to report to the Congress that some agency should be specifically authorized to undertake these operations, and that the Federal Reserve, if the Congress should so direct it, would be willing to do the job.

Mr. Irons said he thought the legal question was probably quite marginal. In his opinion, some of the arguments advanced in

the staff document dealing with the legal aspects of the matter had to be stretched pretty far to be accepted. Nevertheless, he believed the question was marginal enough that the System could undertake these operations legally. However, he also had the three reservations that Mr. Swan had mentioned. Like Mr. Swan, he was somewhat concerned about the thought of going into foreign currency operations in order to deal with cyclical swings in international payments and for other purposes that raised similar questions. This point, and the others raised by Mr. Swan, should be given careful thought and study.

Mr. Irons went on to say that he was impressed by the documents that had been distributed. He felt that there was an appropriate place for the Federal Reserve in this area, and he would be inclined to pursue the matter with the Treasury to work out the details, with the possibility of moving in the direction suggested by the staff papers. There was, of course, the problem that whereas one group in the Treasury might be ideal to work with, working with another group might give rise to various problems. He did not know how to get around that; by the nature of things, some groups would be easier to work with than other groups over a period of time. He would not consider that potential problem as being so grave as to prevent moving in the direction suggested by the staff documents.

Chairman Martin noted that an important subject was under discussion. Accordingly, he inquired whether it was felt that it would be desirable to set up a special meeting in connection with the next regular Committee meeting on December 5 in order that full attention might be devoted to this question and the Committee could try to reach some conclusions. An alternative would be just to include the item on the agenda for the December 5 meeting. In this connection, Chairman Martin noted that he would have in mind that succeeding meetings of the Committee would be held on December 19 and on January 9, 1962.

After some discussion of various possibilities, Chairman Martin suggested that the subject be placed on the agenda for the December 5 meeting to see how much could be accomplished at that time. He noted that Mr. Young expected to be out of the country on that date.

There was general agreement with the procedure suggested by the Chairman. In this connection, Mr. Hayes raised the question whether it might not be desirable for Vice President Coombs of the New York Bank to be present when the subject was discussed further, and Chairman Martin replied that he thought this would be desirable.

The Chairman next called for a report by the Secretary on suggestions received thus far, in light of the procedure agreed upon at the meeting on September 12, 1961, with respect to the Committee's operating procedures.

Mr. Young commented that a number of letters had been received, some only recently. In consideration of the range of views and suggestions, he felt that the Committee might want to request the secretariat to prepare a paper that would pull together those views and suggestions in some systematic way.

Chairman Martin then made the comment that perhaps the Committee would have to schedule a special meeting on this subject at some point. He noted that the matter should be resolved not later than early in the new year.

Asked for his thinking on the scheduling of meetings, the Chairman said it was his view that the Committee should meet on December 19, or two weeks from the December 5 meeting. In his opinion, the present situation called for keeping in close touch with developments. If a meeting were held on December 19, the ensuing meeting would be held on January 9. A suggestion had been made to him that Committee meetings might be held at monthly intervals, but at this particular time he felt that it would be better for the Committee to tighten its schedule somewhat rather than the reverse.

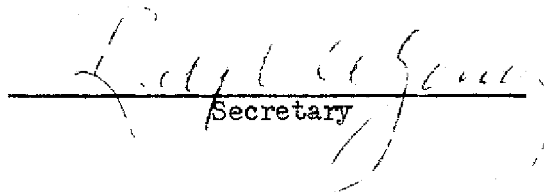
In reply to a question concerning the prospective meeting schedule after January 9, the Chairman said he had in mind that the annual organization meeting would be held on March 6, 1962. This would mean that at some point prior to that date the Committee would meet on a two-week basis. In view of the problems currently confronting the Committee, he felt that the Committee probably should follow such a schedule.

Mr. Hayes indicated that although he did not disagree, he would be inclined to favor, at some point further in the future, meetings at four-week intervals under certain conditions.

It was then understood that further staff work in connection with the study of the Committee's operating procedures would proceed in the manner that had been suggested by Mr. Young.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, December 5, 1961.

The meeting then adjourned.



Secretary