A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, January 9, 1962, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Irons
Mr. King
Mr. Mills
Mr. Mitchell
Mr. Robertson
Mr. Shepardson
Mr. Swan
Mr. Wayne
Mr. Fulton, Alternate
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Ellis 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, Einzig, Garvy, and Noyes, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Messrs. Holland and Koch, Advisers, Division of Research and Statistics, Board of Governors
Mr. Furth, Adviser, Division of International Finance, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors
Mr. Yager, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors

Mr. Broida, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Mr. Francis, First Vice President, Federal Reserve Bank of St. Louis
Mr. Hickman, Senior Vice President, Federal Reserve Bank of Cleveland
Messrs. Eastburn, Jones, and Tow, Vice Presidents of the Federal Reserve Banks of Philadelphia, St. Louis, and Kansas City, respectively
Messrs. Stone, Black, and Brandt, Assistant Vice Presidents of the Federal Reserve Banks of New York, Richmond, and Atlanta, respectively
Mr. Willis, Economic Adviser, Federal Reserve Bank of Boston
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Hellweg, Economist, Federal Reserve Bank of Minneapolis

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period December 19, 1961, through January 3, 1962, and a supplementary report covering the period January 4 through January 8, 1962. 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:

> In our operations since the last meeting of the Committee, we have tried to maintain reasonable continuity and stability in the money market in a period beset by unusual holiday and year-end gyrations. Under the circumstances, we were necessarily guided mainly by the feel of the market. The three-month bill rate worked to the upper part of the 2-1/2 - 2-3/4 per cent range until yesterday, when it moved up further to 2.82 per cent in reflection of the Treasury bill auctions yesterday and today. The Federal funds rate was quite firm through the first half of the period, holding at the 3 per cent "ceiling" for several consecutive days between Christmas and New Year, but it has

since receded to a 2 - 2-3/4 per cent range. At the same time, the weekly figures published on free reserves have been such as to give no overt indication to the public of a significant shift in policy. Estimated total reserves substantially exceeded the hypothetical projections that have been developed by the Board staff, largely because of special--and apparently temporary--year-end factors. In view of the pressures already apparent in the money market, it would have been impracticable to attempt to hold total reserves down to the hypothetical projected levels.

The Treasury's announcement on January 3 of its cash financing plans also resulted in upward pressure on bill rates, since the market has been concerned that more bills might be issued in its second cash offering, expected to be announced next Thursday. The Treasury has been unwilling to confine its range of choice by indicating to the market that it would do its second job outside the bill area.

Another unsettling influence on short rates has been the situation in negotiable time certificates of deposit. So far the largest banks, whose certificates trade freely and command the lowest rates, have not, with one exception that we know of, gone beyond 3-1/8 per cent for six months and 3-1/4 per cent for one year. Very few new certificates have been issued at these rates in New York. The First National Bank of Chicago has been aggressive in offering certificates at 3-1/4 per cent for six months and 3-1/2 per cent for one year, but has not issued many so far. The only other banks now offering comparable rates are those whose certificates are not competitive with the best names. The outcome of the Treasury's auction today, and of the second cash offering, for which the books will probably open next Monday, will have a further bearing on the time certificate situation. Rate competition from Treasury bills and other instruments, as well as between the large banks, may eventually result in an upward revision in the rates.

As to the market for longer-term issues, the atmosphere continues to reflect basic caution despite a somewhat better feeling which has resulted from an improvement in the corporate and municipal markets and a related belief that rates will not necessarily move sharply higher in the near future. The calendar of forthcoming new corporate issues is moderate until the $300 million A.T. & T. issue in the middle of February; the municipal calendar is more substantial.

The Treasury seems inclined to offer a coupon issue in its new cash financing to be announced Thursday, possibly a reopening of an outstanding issue of notes or intermediate bonds. Payment for the issue will be on January 23, after which there will be a gap of a week before a decision will be made on the $11 billion February refunding.

Thereupon, upon motion duly made and seconded, the open market transactions during the period December 19, 1961, through January 8, 1962, were approved, ratified, and confirmed.

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

The professional pessimist can still ply his trade by speculating as to whether the world will end in the bang of a fireball or the whimper of fallout, but there can be little question that 1961 ended on a stentorian note. While this was evident in almost every sector, the most spectacular improvements around the year end were in retail trade and unemployment. Retail sales, which had fluctuated in a narrow range earlier in the recovery, moved up vigorously in October and November. Department store sales were at a record 157 per cent of the 1947-49 average, and trade reports suggest further improvement in the nonautomotive group in December--but perhaps not enough to carry the total up further in the face of the drop in auto sales from the advanced 7 million annual rate in November to a 6.1 million rate in December.

Unemployment in December held at the 6.1 per cent level reported for November--a favorable sign when one considers the size of the drop from October to November and the persistence of near 7 per cent rates earlier in the year.

We are still uncertain as to whether industrial production in December will be up 1 or 2 points, but an increase to 115 or 116 seems assured.

Like auto sales, total construction activity receded from the advanced November rate, but it was still at a high level and within the total private residential construction continued to advance.

We are estimating GNP for the fourth quarter at $542 billion--a gain of $16 billion, or 3 per cent, from the third quarter. As indicated by the rise in retail sales, the striking feature of the improvement in this quarter was the fact that it involved a sizeable increase in final takings, as well as a somewhat higher rate of inventory accumulation.

Consumer credit extensions picked up sharply in October and November, primarily as a result of improved auto sales. The net addition to outstandings in December is not likely to be so large, but there will probably be some further increase, placing the fourth quarter in sharp contrast to the first nine months of little change.

Generally, prices have remained stable. The consumer price index declined by an insignificant amount in November and there is a possibility that December may show another small decline. If anything, sensitive commodity prices appear to have edged up a little since I reported to the Committee three weeks ago, but they are still below their level at the end of November.

Common stock prices have declined rather sharply since the turn of the year, despite the more optimistic appraisal of the over-all outlook and the prospects for corporate profits. However, the rally late yesterday afternoon may mark the end of this decline.

The widespread expectation is that the President will propose a balanced budget in his message to the Congress later this month--a not inconsiderable increase in expenditures being offset, along with the deficit in the current fiscal year, by a sizeable increase in revenues stemming from expanded economic activity. Meanwhile, improved sales and profits in the fourth quarter have probably already moved Government expenditures and receipts on an income and product account basis close to balance.

No commentary on the economic situation at the turn of the year would be complete without some mention of the record expansion of bank credit--and especially of bank loans in December. The $775 million increase in business loans at city banks, which substantially exceeded the gain in any corresponding period, was taken by many observers as the strongest evidence to date that we have moved out of the period of recovery into the expansionary phase of the cycle. Certainly, the increased willingness and capacity of borrowers is further evidence of the strength of the upward thrust.

There seems to be universal agreement that the most important single threat to continued orderly economic expansion at the present time is the situation surrounding the expiration of the steelworkers' contract at mid-year. Not only the possibility of a prolonged strike but inventory accumulation in anticipation of either a strike or a substantial upward price adjustment could have a damaging effect on the unusually good balance which has marked the recovery to date. So far, there has been quite a bit of talk about inventory build-up, but little evidence that physical inventory is actually being taken on in large amounts relative to current consumption. Recent reports that steel orders have leveled out at fairly high rates suggest more of a "wait and see" attitude for the moment than a scramble to build up stocks.

In summary, one might say on the one hand that neither market conditions nor current rates of material and human resource utilization suggest an imminent inflationary situation. On the other hand, the rate of expansion in the fourth quarter does not seem to call for further autonomous stimulation of the economy in the form of rapid credit expansion.

In these circumstances, it is difficult to say what sort of a policy with respect to credit and monetary expansion would be conducive to orderly and sustainable growth. Even if one does not agree with those who argue that it is always a wise policy to let market forces reflect themselves against the background of a steady moderate rate of growth in bank reserves, such a policy would seem to have much to recommend it in the present situation.

Mr. Mitchell inquired whether the ratio of retail sales, seasonally adjusted, to disposable personal income was high or low in November and December relative to previous standards, to which Mr. Noyes replied that in the first nine months of the year retail sales were low by historical standards in relation to disposable personal income. In October and November the ratio moved up, although not to anything approaching the levels that prevailed in the early 1950's.

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

In recent weeks credit markets have been dominated by holiday and year-end credit demands, which were even larger than usual. Bank credit increased sharply and, although the volume of available reserves increased substantially as a result of market factors, the supply was not enough to meet demands. Member banks increased their borrowings at the Reserve Banks and in the Federal funds market, and short-term money rates rose somewhat to the highest levels since mid-1960. Long-term bond yields, after rising in November or early December, were faily steady during the past three weeks.

Publicly-offered new capital issues have been in relatively small volume, but there was a substantial volume of private placements of corporate securities during December. Prospects are that offerings both of corporate and of State and local government issues will continue seasonally light in January. Capital markets have been influenced, however, by the announcement that the A.T. & T. Corporation will offer $300 million of new securities for cash in February. Common stock prices, after reaching new high levels early in December, have declined markedly during the past two weeks for reasons not yet evident, unless it is that they had risen too much in terms of prospects for profits.

The most striking recent credit development was the large increase in bank credit during December. The expansion in bank loans was close to or above the record increase in December 1960. The increase seems to have been concentrated at city banks to an even larger extent than is usual for December. Loans to businesses and to finance companies for tax and other year-end needs increased somewhat more than usual, and loans on securities showed large increases, as is customary in December. There have also been some fairly large loans by U.S. banks to foreign borrowers. In addition, banks added rather large amounts to their holdings of securities, other than Governments. Although city bank holdings of Treasury bills increased substantially, these increases were largely offset by declines in holdings of other Government securities.

Dealers, after reducing their positions from the high levels reached in October, showed usual seasonal increases in December. They increased their borrowings--largely at banks--to finance their enlarged positions.

Partial figures for the week ending January 3 indicate that the December expansion in bank loans and investments has been followed by a rather large decline at city banks, which may have been concentrated principally in New York and Chicago city banks. Notwithstanding this decline, the figures for the past five weeks as a whole generally equal or exceed those for the same period last year, which was very high. It will be necessary to observe further developments in January before determining whether the sharp expansion in December was a transitory development or is indicative of a trend.

As a consequence of the bank credit expansion, the money supply increased much more than seasonally in December and ended the year more than 3 per cent larger than a year ago, with an annual rate of increase of over 6 per cent since last August. These figures should be appraised, however, in the light of the 7 per cent or more increase in G.N.P. in the past year and of the fact that since mid-1959 the money supply has increased by little over 1 per cent, while G.N.P. grew by more than 10 per cent. At the same time consideration must be given to increases in the public's holdings of other liquid assets, which have been substantially greater than the money supply growth.

U.S. Government deposits at banks also increased in December. The increase in time deposits at commercial banks, however, slackened considerably from the rapid pace of the past year. New York City banks showed a decline in time deposits, other than savings accounts, during December. The effect of higher rates on such deposits, which have just become effective at a considerable number of banks, remains to be seen.

It may reasonably be concluded that further expansion in economic activity toward capacity potentials, which are also growing, will require some further expansion in the money supply and in general liquidity.

Growth in deposits has resulted in a greater than seasonal expansion in required reserves. As shown in the chart in the staff memorandum, required reserves against private deposits, after adjustment for seasonal variations, reached a very high level in the week ending January 3 and, with excess reserves averaging nearly $750 million, the level of total available reserves was even higher. Reserves were supplied principally by an even greater than seasonal increase in float. The holiday currency demand--net of changes in vault cash of banks--was largely counterbalanced by a return flow of currency to the banks in the latest week. There was some drain of reserves from a gold outflow. Absorption of reserves by System sales in the open market was largely offset by additional member bank borrowings at the Reserve Banks.

These credit developments may be appraised in light of the Committee's current economic policy directive, which in brief calls for providing reserves for monetary expansion at a somewhat slower rate than in the immediate past, while placing emphasis on continuance of bill rates at close to the top of the recent range. It might be said that credit and monetary expansion, after adjustment for usual seasonal variations, has been at a faster pace than that indicated in the directive, but this expansion has been based on borrowed reserves, not on reserves supplied by open market operations. Bill rates, as a consequence of the pressure of credit demands upon reserve availability, have remained at close to the level indicated. No overt action was taken by the Management to reduce the supply of reserves below the seasonal pattern or to raise interest rates. Thus, in the light of circumstances, the Management may be said to have conformed to the directive.

During the current week, it appears that required reserves are declining considerably more than seasonally and total reserves are also being reduced by a combination of market factors, System open market operations, and a sharp reduction in member bank borrowings.

The reductions in required and total reserves this week, however, will not offset all of the excess expansion in required reserves in December but may bring total reserves down close to the projected level based upon a 4 per cent expansion since the end of November.

Further seasonal declines in required reserves--aggregating over $500 million--are to be expected during the next five weeks, as well as a substantial return flow of currency during January. The effects of these additions to reserve availability are likely to be to a large extent offset by a decrease in float from the recent abnormally high level. Because of sales of securities already effected for System Account, free reserves might amount to around $400 million this week and next, unless float continues abnormally high.

In the last two weeks of January, in the absence of System sales or of less than seasonal credit contraction, reserve availability would increase substantially as a result of market factors. In February, March, and April, only moderate week-to-week fluctuations in System operations will be necessary in order to maintain an adequate supply of reserves for further growth in the economy.

In view of the rapid credit and monetary expansion that occurred in the past month, the generally more optimistic views as to economic prospects, and the continued threat of international drains of dollars, some restraint in supplying additional reserves seems appropriate at this time, particularly if credit demands should remain strong. But further credit and monetary expansion at a moderate pace is certainly desirable. If contraction should exceed usual seasonal amounts in the next few weeks, then restraints would not be proper, unless needed to prevent a decline in interest rates that would lead to an outflow of funds abroad and a loss of gold.

It is suggested that, in view of the continued potential for expansion in the domestic economy and in the absence of evidence of speculative excesses, a policy of supplying reserves through open market operations in amounts adequate to support a 3 per cent per annum rate of expansion in the money supply, plus a somewhat faster rate of increase in time deposits at member banks, if that should occur, would probably not be excessive. In fact, a somewhat more rapid rate of expansion might be desirable, but if forces in the economy are strong enough to call for such an increase, the additional reserves needed could be obtained through member-bank borrowing. If, on the other hand, speculative or unsustainable credit demands develop, then interest rates can be permitted to rise and the discount rate should be increased. But, as yet, the evidence does not point to the need for any such overt restrictive action.

Mr. Furth presented the following statement with regard to the balance of payments:

Once more, there has been no significant change in the international position of the United States. Preliminary and fragmentary figures for December confirm our pessimistic forecast: net transfers of gold, foreign convertible currencies, and liquid dollar assets to foreigners have remained in the neighborhood of $500 million, as in the two preceding months, although December usually brings a substantial seasonal improvement in view of year-end debt payments of foreign countries to the U. S. Treasury of about $200 million.

As a result, the net transfers for the fourth quarter probably were around $1.5 billion, as against $0.9 billion in the third quarter and $1.2 billion in the fourth quarter of 1960. The deterioration remains if we consider only those payments that are considered part of the so-called basic balance, i.e., payments on current account and on long-term capital account, and if we eliminate extraordinary transactions, such as U. S. subscriptions to international agencies.

The most disappointing aspect of the picture is the steadiness of the deterioration since last summer. The gloom is relieved by only three mildly encouraging features.

First, in sharp contrast to 1960, most if not all recent net dollar transfers accrued to foreign private rather than official accounts; the year-end figures are affected by the usual window-dressing of European commercial banks and may give a different impression, but the rapid outflow of foreign funds from the Fed into the market during the first week of January indicates a continuation of the trend to private rather than official accrual.

Second, in consequence of that trend most major foreign countries have abstained from converting their dollar gains into gold. The net decline in our gold stock was kept to $500 million, about half of the corresponding amount in the fourth quarter of last year, although more than the total in the first three quarters of 1961.

Third, it seems that the recent deterioration did not originate on trade account. Our figures are still too fragmentary to permit reliable analysis; but--unless figures for December spring an unpleasant surprise--the trade surplus was probably higher in the fourth than in the third quarter.

> While an increase in capital outflow or in Government expenditures abroad affects the liquidity position of the United States as seriously as would a deficit on trade account, the difference is important for two reasons. First, insofar as the deficit is due to a rise in U. S. investment abroad, it does not diminish the real wealth of the U. S. economy; and second, policy measures aimed at reducing an excessive outflow of private capital or of public funds are not as likely to hurt recovery and growth in the U. S. economy as might the measures designed to reduce, drastically and immediately, a deficit on trade account.
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> However, the longer the deficit persists, the harsher will be the measures needed to correct it.

Chairman Martin commented that he had in mind that the Committee would meet again in two weeks. He noted that the Treasury was expected to announce its second cash offering this Thursday and that the problem of the Treasury during the period immediately ahead would have to be borne in mind as comments were made during today's discussion.

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

> The contrast between the favorable domestic outlook and the increasingly serious balance-of-payments position has become even more striking since the last meeting. The December balance-of-payments deficit now shows no real improvement over the huge November figure. For the fourth quarter we are likely to see a near-record deficit of over $6 billion at a seasonally adjusted annual rate. This would imply a 1961 balance-of-payments deficit of over $3 billion (exclusive of special debt repayments), only a minor improvement over 1960.
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> The domestic economy continues to be moving ahead at a reasonably good pace. Over-all prices continue to be relatively stable. Unemployment, despite the recent improvement, continues to be a serious problem.
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> The bank credit expansion in December appears to have been even stronger than in November. Total bank credit rose substantially in December, as business loans and consumer loans expanded vigorously. Bank liquidity remains high. The money supply has risen about 3 per cent in the last year.

During 1961 the Federal Reserve provided the banking system with ample reserves. With the expansion of the domestic economy and bank credit, the Federal Reserve should slow down in the provision of reserves. However, with little sign of imminent inflationary pressures from the demand side and with considerable unused resources, there is nothing in our domestic situation calling for a substantial change in credit policy at this time.

But what about the international factors? Our adverse balance of payments is due to a combination of factors including large payments abroad for military purposes, economic aid to underdeveloped countries, and movements of capital funds, especially large amounts of short-term funds. Our good trade surplus is not good enough to offset these other large items. The solution of the problem involves not only monetary and fiscal policy; it involves the whole gamut of policies, both Governmental and private, that affect our economic and financial life. Monetary policy can help, but it cannot do the whole job. Monetary policy should not try to do the whole job, and we should not get into a position in which the public thinks it can. Monetary policy has its most discernible short-run influence on the movement of funds.

U. S. policy should, of course, be aimed not merely at stopping an outflow of short-term funds, but also at bringing about a return flow. An increase in short-term interest rates in the United States, even though the increase be modest, could help to buttress our balance-of-payments position and protect our gold stock.

The substantial differential between U. S. interest rates and the higher rates abroad, particularly in Britain, provides a clear incentive to move or divert funds to Europe or to Canada on an uncovered basis for those who have no fear that the foreign currency will soon be devalued. It is not possible to tell the extent to which uncovered funds have moved or have been diverted abroad. Some of the shifts have not necessarily been just for short-term investment but have involved the so-called leads and lags, i.e., movements by those needing a foreign currency sometime in the future, either for direct investment or for the settlement of commercial and other payments.

Another factor contributing to the outward flow has been the borrowing of funds in the United States at relatively low interest rates for use abroad.

Every day investors and traders decide whether to hold or borrow more or less dollars. A modest further increase in short-term interest rates in the United States would be unlikely to stop completely the outflow of funds or to stimulate an inflow. But investment decisions result from a balancing of profits and risks; and at the margin a small increase in our rates might, for some investors, tip the balance of advantages in favor of the United States. The psychological impact of even a small increase on the decisions of both private investors and traders and foreign central banks is even more difficult to estimate, but it would probably be substantial. A small additional increase in the Treasury bill rate could help strengthen confidence in the dollar.

Our difficult international situation counsels some further increase in short-term interest rates in the U. S. On balance, our international financial problem is so severe and our domestic economy is so good that some further upward movement in rates is justified.

At the moment, of course, the Treasury is in the midst of both refunding and cash financing operations. These operations call for an even keel in the money market for the time being.

But what about the period following such operations? Early in the year it is customary for the banks to gain reserves and for the Federal Reserve to absorb reserves. If credit demands continue to be strong, they should be permitted to have their influence in tightening the money market. As market rates rise, an increase in the discount rate should be considered.

An increase in the discount rate would signal to those abroad the determination of the U. S. to defend the dollar. We would reap a two fold benefit: first, the advantage of the influence of higher rates here on the international flow of funds, and, second, an excellent psychological lift derived from a signal that is well understood by persons abroad. On the other hand, too early an increase in the rate is likely to be interpreted by many in the United States as evidence of the desire of the Federal Reserve to apply restraint prematurely.

We do not think that there should be a change in the discount rate within the next couple of weeks, but we do think that the System must consider carefully the role that the discount rate may play in the coming months in our effort to help to defend the dollar abroad. For the coming weeks we would like to see a trending toward a slightly less easy monetary condition, with the rate on three-month Treasury bills at about 2-3/4 per cent or somewhat higher.

I was glad to hear the Chairman suggest that the next meeting of the Committee be held January 23. That will enable the Committee to view the situation after the conclusion of the Treasury financing now under way and before the Treasury establishes the terms of its refunding scheduled for the middle of February.

Pursuant to the action of the Committee at its last meeting there are now two directives to the Federal Reserve Bank of New York, namely, (1) a continuing authority directive and (2) a current economic policy directive. The continuing authority directive appears appropriate. I see no reason to change it.

The current economic policy directive presumably will be prepared after the Committee has developed a consensus as to appropriate policy and its implementation. As I stated earlier, I think that in view of the improved domestic business situation and the concurrent worsening of our balance of payments, our policy should be one of trending toward a less easy monetary condition, without overt action, with the three-month Treasury bill rate at or above 2-3/4 per cent.

Presumably, following the discussion this morning, the Secretary, the Manager, and the Economist will prepare for the consideration of the Committee a draft of current economic policy directive on which the Committee will act after lunch.

I would like to comment on the current economic policy directive approved by majority vote following the last meeting of the Committee, with the thought that experience in that connection may be helpful in preparing the policy directive today. A current economic policy directive is a new venture; we are feeling our way with respect to its content and use and the method of its preparation. We understood that the directive would in effect state the conclusions embodied in the consensus of the meeting. The consensus of the last meeting, as stated by the Chairman, and approved by a majority of the Committee in the meeting, "was along the lines of concentrating on a bill rate in the upper part of the range of 2-1/2 - 2-3/4 per cent and trending toward a slightly less easy monetary condition, without overt action." No mention was made in the statement of the consensus of a goal of providing reserves with a somewhat slower rate of increase in total reserves than during recent months. While I have no doubt that the draftsmen were seeking to clarify the consensus and its implications, it seems to me that the inclusion of the total reserves concept in the draft of directive sent to Committee members following the meeting could be construed, in effect, as a statement of a new consensus rather than merely a clarification of a previously expressed consensus. It seems to us that the current economic policy directive should set forth as closely as possible the consensus as stated by the Chairman and approved by the Committee--perhaps with some rephrasing to add clarity, but without injecting new tests or new interpretations.

We question the advisability of placing primary emphasis on total reserves. We agree that total reserves are an important consideration, but among other things they do not reflect the intensity of the use of reserves.

Figures on total reserves are unsuitable as day-to-day guides. While member bank balances at the Reserve Banks are known each day, the amount of vault cash serving as reserves is known only after some delay. Even if accurate figures on total reserves were available immediately, the figures would be helpful over a short period only when adjusted for so-called seasonal influences. The seasonal adjustments are far from perfect. The statement week is the basic period for which member banks calculate their reserves and take steps to comply with reserve requirements; it is the period used by the Federal Reserve in its calculations as to whether to supply or absorb reserves. The statement week, therefore, must be the period to which seasonal adjustments are applied to total reserves. But the composition of each week shifts slightly from year to year in terms of the days of the month involved, and this can make an enormous difference in the light of special dates such as holidays, tax dates, and so forth. Even where the general outline of a seasonal movement is fairly reliable, just a small difference in timing can make a large difference in the factor appropriate for a particular week. And the condition of the market over a period as short as a week, or even part of a week, can be quite important to marginal decisions in the capital markets. In addition to erratic seasonals, the total reserve measures also suffer from the same short-term volatility that besets total bank credit and deposits. The cause might be an abnormal upsurge in Government securities dealers' borrowings around a tax date, or a spate of corporate borrowing to make up for a slowdown in Defense Department progress payments, or any of numerous other causes that would perhaps be identifiable much later, if at all.

In the light of all these factors it is impossible to make adequate seasonal adjustments that will produce, over a period as short as a statement week, the correct target level of reserves that the banking system should have. An effort to offset the various factors that appear to prevent the attainment of the theoretical figure could produce such sharp changes in the money market atmosphere as to impede seriously the smooth flow of credit which is among the primary responsibilities of the Federal Reserve System.

We have looked back over our experience during the last year and have found a number of occasions on which concentration on total reserves would probably have had perverse effects.

At times the close pursuit of a total reserves target could have led us to withdraw reserves when market conditions were already quite firm, and to supply reserves when market conditions were already quite easy.

I mention these occasions not to discredit the use of total reserves as a factor to be considered but to caution against giving them too much weight. They are an appropriate intermediate reference point for the Committee--intermediate between a measure such as free reserves, with its close tie to the immediate money market atmosphere, and a broader measure such as total deposits or total bank credit.

However useful total reserves may be as a benchmark for the Committee, such a measure, for reasons mentioned earlier, is not a satisfactory working guide for the Desk in conducting operations from day to day. I submit that the most satisfactory and workable guide between meetings is an indication as to whether it is desirable that money market conditions and short-term interest rates continue about the same, or that they trend toward an easier or less easy condition. Success in pursuing such an objective can be tested by the feel of the market as reflected in such factors as the rate on Federal funds, the rates on three-month Treasury bills and other securities, the availability and cost of dealer financing, the amount of member bank borrowing, and other related factors. The effect of operations conducted in the light of such guidelines, on total reserves and other broad measures, can be observed by the Committee at each meeting, and the Committee's instructions can be adjusted accordingly.

Mr. Treiber also said that he was prepared to comment on two other matters if comments thereon were desired at this point. The first matter had to do with the continuing operating authorities usually reaffirmed at the March organization meeting each year, reference to which had been made at the December 19, 1961, meeting of the Committee. The second matter had to do with the draft of article prepared for inclusion in the Federal Reserve Bulletin concerning the Committee's action at the December 19 meeting in terminating its three continuing statements of operating policies. This draft had been distributed to the Committee with a memorandum from the Secretary dated January 5, 1962.

Chairman Martin indicated that he felt it would be preferable to defer comments on those matters. For the moment he thought it desirable to consider, in light of the comments made by Mr. Treiber, the current economic policy directive that had been issued following the meeting on December 19. He stated that he would like to have Mr. Young explain the procedure followed in drafting the directive since, if he understood correctly, Mr. Treiber did not feel that the second paragraph of the directive reflected the consensus reached at the meeting. The Chairman said he considered it important that the Committee be advised as to how the difference of opinion arose.

Mr. Young pointed out that the December 19 meeting was the first occasion for the staff group consisting of Mr. Rouse, Mr. Thomas, and himself to experiment with the preparation of a current economic policy directive pursuant to the new procedure that the Committee had agreed upon at that meeting. He noted that various phrases had been used by individuals around the table in describing the kind of operations that they would like to see conducted during the period that was then immediately ahead. Some had used phrases such as "a tendency toward less ease"; the New York Bank in particular had stressed this. Other members of the Committee had talked in terms of a lesser rate of growth in total reserves. At the point during the meeting when the consensus was being formulated the question of total reserves was raised and remarks were made by Mr. Thomas, among others. The consensus was stated generally in terms of tending toward less ease, and Mr. Shepardson had inquired whether the consensus included the objective of a slower rate of growth in total reserves, indicating that he would interpret it as such. In attempting to draft the current policy directive, at which time the minutes of the meeting were not yet available, there was discussion of the sense of the meeting on the basis of recollections. There was discussion by telephone with Mr. Rouse in New York as to the meaning of the words that had been used--the semantics of the problem--and it was argued by Mr. Thomas (and Mr. Young stated that he had concurred) that the expression "less ease" was ambiguous. The point was made that less ease would be brought about by tending toward a somewhat slower rate of growth of bank reserves than the Federal Reserve System had theretofore been encouraging. In the light of that thought, the question was put to Mr. Rouse whether it would not be a good idea to include both thoughts in the draft of directive as alternatives, and Mr. Rouse agreed with this suggestion. Therefore, this was done in the draft of directive that was sent to the members of the Committee. Question then was raised by Mr. Hayes, who called Mr. Young by telephone and said he thought that the Secretariat had, so to speak, taken advantage of the situation by putting in the telegram first the alternative language that referred to trending toward a somewhat slower rate of increase in total reserves. The other alternative had been placed second in the wire. Mr. Hayes thought the consensus as expressed at the meeting provided for the latter alternative only, and Mr. Young had replied that views on the interpretation of the consensus could differ, but that the Secretariat could be legitimately criticized for the order of the options in the outgoing wire. It was the opinion of Mr. Thomas, and also his opinion (Mr. Young's), as against that of Mr. Rouse that the real meaning of the consensus was to work toward a slower rate of growth in total reserves.

Mr. Young went on to say that when the views of the Committee members were received concerning the language of the draft directive, the majority of the eight members who had agreed at the meeting with the implementation of policy according to the consensus favored the alternative language providing for a somewhat slower rate of increase in total reserves than during recent months. The two who favored the second alternative choice of language were Mr. Hayes and Mr. Swan. This was reported by Mr. Young to Mr. Hayes, including the fact that most of the replies had taken explicit note of the two alternatives presented, and the latter agreed that in the circumstances the Secretary had no option but to send the directive to the New York Bank in the form in which it was now recorded in the minutes of the meeting on December 19, 1961.

Mr. Treiber commented that he had not been trying to be critical of the way in which the situation had developed. A new procedure was involved, and everyone concerned was feeling his way. Instead, his statement was intended to bring out the view that for a day-to-day guide to the Desk it was preferable to say "stay about where we are" or "less ease" because such expressions were more helpful than to refer to a factor such as the rate of growth of total reserves. As Mr. Thomas had pointed out in his statement today, total reserves had varied several hundred million dollars from the projections because of special factors.

Mr. Thomas commented that every objection Mr. Treiber had raised to total reserves would apply to net free reserves and also to the feel of the market. As Mr. Bryan had pointed out at the December 19 meeting, the objectives of the Committee should be stated in terms of what the System could control, rather than what it could not control. It could not control other factors supplying reserves in the market or the demand for credit, which would determine whether there was less or more ease or lower or higher interest rates.

Mr. Mitchell commented that the directive must be expressed in terms of what the Manager thought he could do. If he understood correctly, Mr. Treiber had said that the Manager could not operate under the formula contained in the current economic policy directive issued following the December 19 meeting.

Mr. Rouse commented that the past three weeks had provided a rather clear-cut example of a situation where total reserves could not be used as a guide. If they had been used as a guide, this would have resulted in overt action in the market. There would have been such a tight situation as to have had an adverse effect on the price of Government securities, with the public thinking that there had been a clear-cut shift in System credit policy. It would have been necessary to take $300 or $400 million of reserves out of the market to conform to the terms of the directive as far as total reserves were concerned. An extreme situation had developed as the result of special factors. Had the Desk gone along with the total reserve objective, as stated in the directive, that would have accentuated the situation. If the Desk had taken out of the market the amouht of reserves that the total reserve concept suggested, this would have had a drastic effect on market prices.

Mr. Thomas noted that the Desk did take $300 million of reserves out of the market by open market operations in the past period, and that those were replaced by member bank borrowing. If the Manager had tried in this period to maintain free reserves at something like the level indicated, he would have followed a mistaken policy of feeding the economy. Instead, the Manager let free reserves decline and let the banks obtain any additional reserves they wanted to obtain by borrowing. The Desk did the job of following the directive, even though this put free reserves below the level implied by some of the comments at the December 19 Committee meeting.

Chairman Martin then commented that it would be well for everyone to have a chance to study Mr. Treiber's statement. There were bound to be difficulties as the Committee got into the new procedure adopted at the December 19 meeting. Words had different meanings to different people around the table. However, it should be emphasized, in regard to the new procedure, that the Committee ought to try to do its best to get a consensus. The New York Bank had rendered a service by making available the paper presented by Mr. Treiber. At the same time, the Committee should not get too sticky about words unless it knew precisely what it was doing. It would hardly be possible to have anything written exactly in the way that would suit each individual best.

Mr. King said that the experience cited by Messrs. Treiber and Young illustrated the advisability of formulating the current economic policy directive and voting on it before each meeting adjourned.

Chairman Martin replied that the procedure beginning with this meeting, as agreed to by the Committee at the December 19 meeting, contemplated voting on the current economic policy directive when the Committee reconvened following a luncheon recess.

The Chairman then called for a continuation of the usual go-around of views on the economic situation and monetary policy beginning with Mr. Ellis.

Mr. Ellis said that the terminology used by Mr. Noyes in describing the over-all economic situation at the end of 1961 could well be applied to the situation in New England. The record of department store sales was excellent, not only for the Boston area but New England as a whole. Sales for the year, on a cumulative basis, were about 5 per cent over 1960, one of the best records of any District. Automobile sales continued brisk in December, and this briskness carried over into the manufacturing field. Manufacturers were experiencing order increases and were responding by slow expansion in their production, after seasonal adjustment. There was evidence of the increased activity in electric power consumption and the number of man-hours worked in manufacturing. However, even though 1960 was a year of relatively low manufacturing employment, there was still only a gain of 0.3 per cent in 1961. Statistics on other employment were stronger, but on a year-to-year basis the increase in total employment was only about 1 per cent. On the other hand, insured unemployment was some 25 per cent below year-ago levels.

Continuing, Mr. Ellis said that during the past few months construction activity in New England had been rising more rapidly than in the nation as a whole. On a cumulative basis, it had recovered to such an extent as to match the national pattern. Banking statistics reflected the steady expansion in economic activity. Debits and demand deposits were up materially, and in December check volume at the Federal Reserve Bank was 12 per cent ahead of 1960 on a year-to-year basis. Very few banks had as yet announced increases in interest rates on time and savings deposits. Business loans rose further in December, and loan-deposit ratios matched year-ago levels. The banks continued to shorten their portfolios of Government securities. Except for one two-week interval, District banks had been heavy sellers of Federal funds since late September.

Turning to the national economy and monetary policy, Mr. Ellis said he was attracted to an analysis that started with recognition that throughout 1961 the Federal Reserve System had supplied about as many reserves as the banking system could absorb without pushing short-term rates down to such a degree as to stimulate short-term capital movements. He agreed that there should be some further bank credit and monetary expansion. However, if the System continued to supply reserves to the same extent as in the past, speculative tendencies and credit excesses could be expected to develop. Therefore, the System should provide only for some steady reserve growth. Then, if market demands should become more intense, the banks would borrow and the market would tighten itself. Only after such tightening should there be a confirming discount rate action on the part of the Federal Reserve System. At the December 19 meeting the Committee had adopted a policy of providing additional reserves at a somewhat slower rate, with a shading of policy toward somewhat less ease. Since the Treasury would be conducting financing operations in the next few weeks, it would seem appropriate to make no change at this time in the basic policy adopted at the December 19 meeting.

Mr. Ellis also said that in view of the traditional year-end difficulties, he had been quite satisfied with conditions in the money market and with the actions of the Account Management during recent weeks. He would expect the Desk to vary from strict adherence to the language of any directive if market conditions developed that were at variance with expectations at the time the directive was issued. For the period ahead, he would favor a current economic policy directive much along the lines of the existing directive.

Mr. Ellis said he had viewed the new format of the directive as an opportunity to experiment with the use of factors that the Committee might consider most important at any particular time. On occasion he believed the directive should refer to total reserves, and on occasion to other factors. Given the present situation, he would expect that the policy would be to refer to some expansion of the volume of reserves. He would anticipate net free reserves in the $400 million area and expect a rate on short-term bills of around 2-3/4 per cent, with Federal funds occasionally at 3 per cent but mostly just below.

As to the continuing directive, Mr. Ellis said he would like to see the Committee arrive at an understanding whereby that directive would be renewed each time without having an official motion made and acted upon at each meeting. As to the current directive, he would drop out the sentence: "No overt action shall be taken to reduce unduly the supply of reserves or to bring about a rise in interest rates." In saying this, he did not mean to suggest that the Desk should proceed to take overt action. However, while this sentence may have seemed appropriate the first time the Committee adopted its current procedure, he questioned whether it was wise for the Committee constantly to refer to what it proposed not to do. As to operations in the longer-term area of the market, he hoped that implementation of the current directive would not lead to the purchasing of longer-term securities in such degree as to suggest that the Federal Reserve was dominating the market. On the other hand, he would favor maintaining contact with the market over the entire range of maturities.

Mr. Irons said that during the closing weeks of 1961, expansion moved ahead rather substantially in the Eleventh District. The year had ended on a strong note. Department store sales in December were up substantially from the preceding month. The industrial production index rose to a new record high, with advances spread rather widely throughout the manufacturing and mining areas. There had been a seasonal advance in crude oil production, and refinery activity also improved. Construction activity moved ahead sharply; it looked as though 1961 would be up about 7 per cent from the preceding year. There had been little change in employment figures, except for the seasonal movement, while unemployment in the area was about 4.9 per cent of the labor force. Agricultural activity was very good, with about a 7 per cent improvement in cash farm income indicated for the year 1961 as a whole.

Turning to banking, Mr. Irons said there was strength at year-end, with loans up sharply. For the year, loans and investments each were up about 10 per cent. At the end of the year, demand deposits also showed a strong advance, especially deposits of individuals, partnerships, and corporations. The banks appeared to be in a reasonably liquid position. Except for some temporary borrowing incident to year-end adjustments, borrowing from the Federal Reserve Bank had been quite nominal. There had been a spreading tendency throughout the District to raise interest rates on time and savings deposits, with considerable advertising, but personal comments by bankers indicated that the increases were made with reluctance.

Turning to policy, Mr. Irons commented that the dominant factor in the period ahead would be the Treasury's intervention in the market, which suggested maintaining the status quo as nearly as possible during the next two-week period. By this he meant that policy should continue to be implemented in about the same manner as during the past three weeks. Considering all of the year-end disturbances, he felt that the New York Bank had done a good job in operating in a way that carried out the consensus. Further, it had seemed to him that the draft of directive, as distributed, was a good statement of the consensus. The directive could have been written in various ways, but he was agreeable to it as written. For the next two weeks, he would envisage a bill rate around 2-3/4 per cent and a Federal funds rate between 2-3/4 and 3 per cent, with reasonable fluctuations. While he would provide some reserves if such were needed, he would not object if the market firmed against itself somewhat; however, there should be no direct action on the part of the Desk to bring about such a firming development.

The domination of the Treasury in the picture may have caused some disturbance in the market, Mr. Irons noted. In his view the Desk should work largely according to the feel of the market, at the same time watching interest rate movements and reserve availability. Two weeks from now the Committee would have an opportunity to look at what had happened and see what action it might want to take. Perhaps that action would be a little more affirmative than seemed warranted today. Developments were moving in the direction where, from the standpoint of both domestic and international factors, monetary policy action might be more clearly indicated. The strengthening of the economy might cause domestic considerations to fit into the same kind of policy that the Committee would want to follow from the point of view of international considerations.

Mr. Swan reported that the business situation in the Twelfth District continued to improve. While employment data for December were not yet available, construction and manufacturing led a general advance in November and reports of employer hiring intentions for the next few months suggested a further improvement in most of the major labor markets in the District. Steel production rose in December, and demand strengthened for copper and zinc. As elsewhere, department store sales were strong in December and new car sales, on the basis of early registrations in California, were quite good. In the three weeks ended December 27, weekly reporting banks showed substantial increases in business, real estate, and consumer loans. They also increased their holdings of Government and other securities. Virtually every major bank in the District had gone to a 3-1/2 per cent interest rate on savings accounts and many of them had also announced a 4 per cent rate on one-year certificates or some kind of special savings accounts. The 4 per cent rate loomed very large in the advertisements and the 3-1/2 per cent rate very small, but this did not reflect exactly the situation that the banks would like to see develop. One bank had made an estimate that the 4 per cent money represented by special certificates was coming from the bank's own savings depositors, as against funds from other sources, in a ratio of about 3 to 1. In view of the substantial volume of savings deposits held by District banks, many banks were concerned at the moment about earnings and were looking around for higher yields, including the possibility of shifting into municipals from U. S. Government securities.

In terms of policy, Mr. Swan pointed out that it had already been noted several times at this meeting that Treasury financing operations rather obviously dictated an even keel, that is, no change in policy for the immediate future. He would include in that picture no change in the discount rate. As also had been mentioned, the past three weeks provided an illustration of market forces tightening the situation. It did not seem to him that in the weeks immediately ahead the Committee would want to do anything to promote this tightening. However, it probably would continue to some extent due to market forces, which posed some problem relative to maintaining an even keel.

The behavior of the bill rate in the past three weeks had been in line with what the Committee had indicated in its directive, Mr. Swan pointed out. While he was not sure that this result could be achieved, he would hope that some margin could be maintained between the bill rate and 3 per cent. He would favor a bill rate around 2.75 or 2.8 per cent, yet it seemed to him that if the rise should continue and the rate should approach 3 per cent, that would tend to add, in a self-reinforcing sense, to the upward pressure on rates. If it should begin to create expectations that a discount rate increase might be imminent, that would tend to reinforce upward pressures in the market, and there were enough such pressures from other market expectations at the moment. Since it did seem that some selling might be ahead in terms of seasonal factors, this might imply a possibility of absorbing reserves by selling some securities other than bills, unless that would in turn conflict with Treasury financing plans, depending on the securities offered by the Treasury in its cash financing. Some problem might develop in that area, but of course this could not be known at the moment.

Regarding the inclusion of the total reserve concept in the directive, Mr. Swan said that although he was one of those who had preferred the other phrasing of the draft directive, he thought the directive did reflect the attitude at the December 19 meeting. On the broader question of the general use of a reference to total reserves in the directive, he had some sympathy with Mr. Treiber's remarks. It seemed to him that total reserves were valuable as a general indicator of where the Committee had been and where in the longer run it might want to go. On the other hand, he had some question about the use of total reserves as a short-run guide. He appreciated the fact that the question of the availability of reserves was important, that a reduction in net free reserves because required reserves had increased was different from a reduction because total reserves went down. However, he still had a question about the source of the additional available reserves. This might be a problem, partly, of what was meant by providing reserves. In the week ended January 3, there was an average daily excess of $481 million of reserves over the total reserve target. He would agree that the Desk could not appropriately have offset this, yet as Mr. Thomas indicated, this excess had resulted from member bank borrowing rather than positive action on the part of the Desk. Nevertheless, this illustrated the fact that the increase of over $300 million in total reserves, as supplied by borrowing, was quite different from an increase as supplied by Federal Reserve initiative through open market operations. At the December 19 meeting, Mr. Thomas had suggested in his statement that the specific guide to operations should be total reserves--or non-borrowed reserves--rather than free reserves or interest rates. But the phrase inside the dashes did not receive any further attention. Therefore, he wondered whether, for shorter or longer-run reserve guidance, the Committee should not look more specifically at nonborrowed reserves. By subtraction, one could get that out of the staff memorandum, but he would like to have the figure actually shown. This had not made much difference when there was little or no borrowing, but when borrowing rose substantially the Committee might want to consider nonborrowed reserves as well as total or free reserves.

Mr. Swan also said that he was not sure that the Committee should discard free reserves as a guide even if it wanted to deemphasize that statistic. Whether rightly or not, the market attached considerable weight to free reserves. From that standpoint, it seemed quite fortunate that the average of free reserves ($341 million) for the week ended December 27 was the revised figure, issued a week later, rather than the estimate. For the next two weeks, and thinking in terms of an even keel, he felt that the Committee might have in mind free reserves of $400-$450 million rather than $400 million and below.

As to the directive, Mr. Swan said he would agree with Mr. Ellis that the last sentence in the directive issued after the December 19 meeting was not only unnecessary but could be harmful. It stated what should not be done rather than what should be done.

In a final comment, Mr. Swan referred to the provision in the procedure for reallocation of securities in the System Open Market Account whereby when a Reserve Bank's reserve ratio falls below 30 per cent on the next to the last business day of a statement week or month, an adjustment is made in Account participations to bring that Bank's ratio back to 35 per cent. However, the result of the procedure was to bring the Bank's ratio to above the System reserve ratio at the present time. If the Committee so desired, the procedure could, of course, be changed at the March organization meeting. He simply mentioned the matter for what it was worth.

Mr. Deming commented that the procedure of reporting at Committee meetings every two or three weeks perhaps tended to cause some loss of perspective. Looking at personal income, the Ninth District did not gain as rapidly as the nation in the last half of 1961. However, it had been gaining more rapidly through the middle of 1961. When one looked at the last half of the year relative to the beginning of 1960, the District had shown a better gain than the nation. Perhaps, therefore, the situation in the District was not as bad, in a relative sense, as he might have seemed to imply from time to time.

Department store sales in November and December set a new record for the Ninth District, Mr. Deming said, and last year the District did somewhat better than the country as a whole in comparison with 1959. It was probably fair to say that the District was still suffering somewhat, relatively speaking, from the effects of the drought last summer, but it was moving back in line with the rest of the country. Even in the banking area, where loan demand in the District had lagged the nation, the demand in November was up. This trend seemed to have continued in December, with the demand again focusing on the city rather than the country banks.

With reference to the results of the recent "Minnesota Poll" on personal finances and general business conditions in 1962, which were published in the Minneapolis Tribune last Sunday, Mr. Deming noted that more than 4 out of every 10 State residents (42 per cent) expected business conditions in the United States to be better in 1962. This compared with 29 per cent in December 1960 and 36 per cent in December 1959. One out of three respondents thought he was going to be better off financially a year from now, as compared with one out of five in December 1960 and one out of four in December 1959.

Turning to the national economy and monetary policy, Mr. Deming said he was one of those who had believed that total reserves would be a good guide for the Desk. He had so stated at the December 19 meeting, at which time he also stated that he thought the movement should be toward less ease. He had some sympathy with what Messrs. Treiber and Rouse had said about total reserves as a guide to the Desk, but he also had some sympathy with what Mr. Thomas had said, namely, that the same criticism would apply to free reserves. Probably, it would likewise apply to nonborrowed reserves, although he had not looked closely. Reviewing the past three weeks, there was no question but that there had been less ease in the market, which was what the Committee said should happen. The bill rate was in the upper part of the 2-1/2 - 2-3/4 per cent range, as also specifically mentioned by the Committee. With all the year-end churning and other developments, he felt that the Desk had done a good job. It did not hew to the 4 per cent total reserve growth rate target, and would have fared badly had it done so. However, this did not mean necessarily that total reserves would not be a reasonably good guide in the future. The past period was probably as bad from that standpoint as could have been encountered, and total reserves could be a better operational guide at some time in the future.

With regard to the forthcoming two weeks, and probably the period beyond that, Mr. Deming felt that the directive ought to be written in terms of maintaining an even keel. If there was less ease at the moment, that condition probably should be maintained for the next five weeks. In other words, the present policy should be continued. He would think that the Committee would not want to recover the reserve surplus--if that was what one wanted to call it--that had accumulated in the past three weeks, at least not to such an extent as to change the feeling in the market. He would emphasize maintaining the bill rate at around 2-3/4 per cent during the next two weeks. There seemed to be no reason for, and positive reasons against, changing the discount rate at this time. He would renew the continuing directive.

Mr. Baughman said it appeared that business conditions in the Seventh District had continued to improve somewhat, with the steel and automobile industries continuing to be the outstanding factors in the picture. The steel industry saw nothing immediately ahead except a continued rise in activity, due in part to the uncertainty regarding continuation of production but also due in part to a rebuilding of inventories from what the industry believed was a very low level, so far as most users were concerned, at the end of 1961. Contacts in the automobile industry continued to hold a very optimistic view, notwithstanding the decline in the daily average sales rate in December and notwithstanding a gradual cutback by one producer and a continued strike at another producer. There was evidence of some further pickup in employment, mostly in areas primarily concerned with motor vehicles and electrical goods, which were benefiting from an increased flow of defense orders. Recently there had been some recruitment of skilled machine-shop workers in the District by West Coast aircraft firms. Retail sales of general merchandise in December appeared to have moved somewhat closer to the national pattern after a considerable period during which they lagged.

The loan picture at District weekly reporting banks had been following about the same trend as in the nation recently, Mr. Baughman said, although there was a little less pickup in security holdings than for weekly reporting banks generally. Even aside from the fact that there was no tax bill maturing in December, and some similar factors, evidence was seen of a pickup in basic loan demand at District banks currently. However, no pickup had been seen in consumer loans, and real estate lending remained slow. Chicago banks were holding rather large portfolios of bills. Unless there was some change between now and the April 1 personal property tax assessment date, they would seem to be in a better position than usual to meet the demands with which they are always confronted at that time.

Early reports from the Reserve Bank's monthly survey of rates paid on time deposits indicated that about 12 per cent of the District banks in metropolitan areas had announced rates of 3-1/2 per cent or more. Most of them had announced a rate of 4 per cent on time certificates of one-year maturity, but there was some variation in respect to paying 4 per cent on savings deposits over one year. A small number of reports available from banks in rural areas gave some evidence of a tendency to stick to 3 per cent on savings accounts while offering 4 per cent on 12-month certificates of deposit. As compared with the experience when the maximum permissible rates were last raised, effective January 1, 1957, banks were moving much more rapidly to the new maximum rates. In January 1957, only about 5 per cent of the banks in metropolitan areas had moved to the 3 per cent ceiling. However, a much larger proportion were at the ceiling rate this time before the ceiling was raised. The large Chicago banks had announced their changes in rates only last week-end, so they had had little experience with the new rates as of yesterday afternoon. However, they indicated that they were getting a large response, with some evidence that the money was coming in part from the transfer of funds from other kinds of financial institutions.

Mr. Baughman said, in summary, that evidence was seen of increased activity in the Seventh District. However, there was still a very substantial amount of unused capacity in most industries.

Mr. Clay said that for the period immediately ahead it appeared that Treasury financing was the dominant consideration in the formulation of monetary policy--calling for the maintenance of the so-called "even keel." Continuation of essentially the current posture without further tightening would be appropriate for other considerations as well. The Treasury bill rate had reached the level of approximately 2-3/4 per cent that the Committee set as its goal at the last meeting in view of the international balance-of-payments problem, and the maintenance of approximately that rate level would seem to be in order. In terms of the domestic economy, the objective of monetary policy should continue to be that of encouraging economic expansion and the fuller utilization of manpower and other resources. Recent economic developments had been distinctly favorable, but there was still a long distance to go in order to attain the satisfactory level of activity that was essential in the interest of both our domestic and our international problems.

Mr. Clay observed that the nature of open market operations would be strongly conditioned by seasonal factors in the weeks immediately ahead. It might not be necessary to operate in longer-term maturities, but the Manager should have the authority to do so if it became necessary to offset some of the sales of Treasury bills. The Reserve Banks' discount rate should not be changed.

Mr. Wayne reported that Fifth District business continued to move ahead at a good rate toward the end of 1961. Strength was evident particularly in sustained record levels of employment and increased consumer buying. Christmas business apparently rose to record volume and was expected to provide additional impetus in some industrial lines. Textile and apparel manufacturers, for instance, viewed the resulting reduction of soft goods inventories as a prelude to a good volume of orders for spring and summer. The construction industry, one of 1961's most consistent sources of strength, gained new support from a strong November increase in contract awards. Furthermore, the November rise included the second largest seasonally adjusted volume of residential awards in the past five years, an encouraging sign for the lumber business, which had thus far failed to respond to the business upswing. Fourth quarter coal production was up considerably from the previous year's level, and producers continued to take a bright view of the future. The tobacco business had a record year all along the line, and the experts foresaw further gains in consumption in 1962.

Mr. Wayne said that after nearly a year of experimentation it had become the regular practice of the Richmond Bank to contact a representative group of 65 businessmen every three weeks. Forty-five manufacturers were among those responding to the most recent request. On balance, they reported a rising trend in new orders, shipments, and employment, but the proportion of favorable reports was somewhat smaller than previously.

Hours of work, formerly rising, were reportedly fairly stable. Respondents' views of the outlook for profits were somewhat less salutary than they were a few weeks earlier.

The recent strength in bank loan demand across the nation was even more pronounced in the Fifth District, Mr. Wayne said. Business and all other loans had been particularly strong.

Mr. Wayne expressed the view that the results of policy since the December 19 meeting had been desirable. He would like to see bill rates edge somewhat further upward, but he would not favor any overt actions to nudge the market--particularly in view of the forthcoming Treasury financing. He believed that every encouragement should be given to any natural tightening forces. Over the past five weeks there had been a definite and fairly strong upward movement in primary spot market prices. It was too early to know whether this would be reflected in the broader price indexes, but in any event it should be remembered that price increases by this phase of earlier recoveries were quite small in comparison to those that occurred later in the upswing. In short, the recent stability of prices might present a somewhat misleading picture of the pressures that would be felt as business activity expanded. Moreover, as Mr. Noyes had pointed out, the strength of the expansion movement was such that it no longer seemed to need further stimulus.

Mr. Wayne said he wished to emphasize again that he did not have in mind sufficient tightening to interfere with the Treasury financing.

However, he would encourage any factors moving the System on the way it might have to travel in the months ahead. He would leave the discount rate at 3 per cent at this time. The policy direction or trend contemplated in the current directive should be continued (though he agreed with Messrs. Ellis and Swan that the admonition against overt action should not be allowed to remain in the directive indefinitely). The continuing directive should be renewed.

Mr. Mills said he shared completely Mr. Treiber's reservations about attempting to use total reserves as an infallible guide to the formulation of monetary and credit policy. His own belief was that there were other satisfactory guides that could be used in combination and had dollar values, including particularly net free reserves. He did not believe that the Committee could legally, or should, abdicate its responsibility by leaving the Desk to be guided completely by its feel and judgment of the market.

As to current and prospective developments having a bearing on policy, Mr. Mills presented the following statement:

> Since the December 19th meeting of the Open Market Committee, natural factors working through market processes have produced the kind of monetary and credit policy climate that preferably should have been developed over many weeks past by conscious Federal Reserve System actions. An abrupt rise in required reserves, actuated by higher demands for bank loans, has been reflected in a tighter money market and a firmer interest rate structure, but has in no wise constricted the basic availability of bank credit.
>
> The present situation should now be capitalized upon policy-wise and not thwarted or negated by an impulsive effort to loosen

the money market and bring down interest rates; in fact, to attempt to do so would only confuse market operators, who long ago justified in their own reasoning the kind of money market conditions that have eventuated. (To interpolate, there is now a projected level of free reserves in the area of $550 million for the current statement week, and as of yesterday the rate for Federal funds dropped below 2 per cent. I would feel that this is a negation of the policy that should appropriately be carried out.) As far as the Treasury's prospective financing program is concerned, the adequate credit base presently serving the private borrowing needs of the economy is also broad enough to support the Treasury's approaching cash financing, given a temporary reserve assist if a tax and loan account financing procedure is followed at that time.

A monetary and credit policy appropriate to existing financial and economic circumstances would (in the family sense of the word) "adopt" the kind of policy that has recently developed out of the interplay of natural market factors. The results of such a policy would be to tacitly recognize the appearance of firmer interest rates and their restraining influence both on an overgrowth of credit and on the outflow of gold and dollars from the United States. A wholesome public reaction could be expected to this Federal Reserve System policy stance which would at long last face up to the national and international financial exigencies that dominate the attitudes of many economic observers.

Inasmuch as any early demand for commercial bank loans can be satisfied readily through a rearrangement of bank assets (replacing securities with loans), excessive upward pressure on interest rates arising from this source, and money market disturbances, are unlikely. The economic policy directive issued at the last meeting of the Committee conceives a more liberal monetary and credit policy than is called for. It should, therefore, be modified.

Mr. Robertson said he saw nothing in the economic picture today that would justify any deviation from the long-continued policy of even keel during periods of Treasury financing. He would hope, however, that the even keel would be related to the past five-week period rather than the most recent week.

Mr. Shepardson said it seemed to him that the situation portrayed in the current reports, namely, rising activity in the domestic economy and an adverse international payments position, justified a lessened rate of monetary expansion. He was not disposed to argue how this should be measured, but in his opinion the situation had reached the point where the rate of monetary expansion that had prevailed for some time past could be lessened, recognizing of course the necessity of taking into account the Treasury operations over the next few weeks. While these operations should not be upset, he continued to hope that by whatever guideline was appropriate, whether it be free reserves or total reserves or some other guide, the System could slow down a little the rate of expansion of reserves and the money supply. A Treasury bill rate of 2-3/4 per cent or upward seemed to him appropriate. Likewise, he thought it would be appropriate if free reserves were in the area of $400-$450 million rather than $500-$550 million. It would not seem appropriate to consider a discount rate change at the moment, although that might be in the offing.

Mr. King said that although business activity clearly was improving throughout the country, he thought it was improving rather slowly. The Committee should be careful not to think that Christmas was necessarily going to last all year. The holiday season buying had, of course, removed stock from some shelves and the replacement of that stock would carry into the new year. Treasury operations were now imminent, and it was difficult to oppose an even keel policy. However, as a reference point for maintaining an even keel, he would take the period beginning January 4, as reviewed in the supplemental memorandum on open market operations received from the Federal Reserve Bank of New York. An extension of those conditions would, he thought, be appropriate for this particular month and for this particular type of business cycle, the characteristics of which seemed to differ somewhat from other recent cycles. He would not care to see open market operations conducted in such manner that the current level of free reserves would be reduced too much; the desirability of free reserves as low as $400 million seemed to him doubtful.

Mr. Mitchell commented that one could be thankful that economic activity was continuing to expand at a rather steady pace. He did not think there was anyone present who doubted that there was still considerable room for a good deal of additional noninflationary growth. It should be a major objective of Government economic policy, he suggested, to see that this condition continued as long as possible. However, the problem of monetary policy was one of dealing with expectations in the financial area. Anticipations, and speculation based thereon, were the things about which it was necessary to be apprehensive. There was currently a great deal of speculation about a change in Federal Reserve policy, and this had given rise to a considerable amount of uncertainty in financial markets. In his opinion, therefore, this was no time to drop from the current economic policy directive the statement that no overt action signalling a shift in policy was to be taken. An even keel should be maintained during the next two weeks, first, on account of the Treasury situation, and second, because even apart from that circumstance this would be, at least in his opinion, the right policy.

Mr. Mitchell went on to say that there were some things that appeared likely to cause trouble in the future, and the Committee should start thinking about them. For a long time there had been a highly artificial level of short-term rates, which served as a deterrent to the stretching out of investment portfolios of many institutions, including banks. If they should decide to stretch out their portfolios, that would have an influence on longer-term rates, which had been quite tranquil, even declining a little. One might look forward to a situation where there would be this kind of action, which would be desirable as far as the economy was concerned, and he hoped that the System would not contribute to another abortion of economic activity such as occurred in 1959 by tightening too soon. The current volume of steel orders seemed to reflect largely the objective of temporary inventory accumulation; therefore, the situation was more analogous to a seasonal development than a cyclical swing. For this reason, he would try to evaluate the quantity of credit necessary to finance those orders and accommodate it like a seasonal development instead of attempting to use this temporary phenomenon as a reason for a more restrictive monetary policy. So far as financing steel users' inventory accumulation was concerned, it should not be a signal to set off a sequence of monetary restraint as in 1959.

Further, year-end credit statistics should be appraised with caution. It would seem advisable to wait and see the figures for the next couple of weeks, for they might be toned down quite a bit after a short flare-up around the end of the year.

With regard to instructions to the Desk, Mr. Mitchell commented that they should be consistent and capable of being executed. If the directive should become inconsistent, as he understood it was in the past period, the Committee should be gotten together by telephone and asked what it wanted the Account Management to do. The Committee should be able to communicate to the Manager in terms that the latter could understand and that he considered consistent. If the Manager failed to understand or felt that the instructions were not consistent, it was up to the Committee to make the instructions consistent and understandable. The fact that a difficult problem was involved should not prevent the Committee from attempting to communicate understandably with the Manager, and the Manager should come back to the Committee when he did not get meaningful instructions.

Mr. Fulton reported that a year end economic activity in the Fourth District was moving up briskly. For the year as a whole, department store sales were up 3 per cent from 1960, reflecting strength in December. Automobile sales receded slightly in December, as they did nationally. The seasonal rise in unemployment was partly offset by improved job opportunities. However, in the recession the District dropped further in manufacturing employment than the country as a whole, and it had not yet recovered to the same extent as the nation.

Turning to the steel industry, Mr. Fulton said that a flood of orders had been coming in for certain types of steel. Order books were full for the first quarter, with some items being placed on allocation. Shipments were picking up and were due to increase until mid-year. The automotive and appliance industries were taking large tonnage for current production and for stockpiling, with the auto companies insisting that their suppliers accumulate a 90-day inventory in addition to regular production needs. In summary, the outlook was for a booming first half in the steel industry but for a poor third quarter, with no hope seen of avoiding a let-down after mid-year. Operations were now at between 80 and 90 per cent of capacity, but profits were down from prior years, on the basis of comparable tonnage, despite the fact that the steel companies had spent, and were spending, large sums for modernization of equipment and to increase capacity.

The labor situation in the steel industry, with its pervasive effects on other industries, was a matter of concern, Mr. Fulton said. The kind of package settlement that was worked out in the automobile industry would be substantially more expensive for the steel companies than for the auto companies, and evidently would necessitate a price increase. In fact, although there was concern about a price increase in light of foreign competition, it seemed almost inevitable that any substantial labor settlement would result in a price adjustment. At present, there was every appearance that a strike would occur; its likely duration was more uncertain.

Turning to other industries, Mr. Fulton said he understood that businessmen were appraising the current improvement in activity with caution. They were trying to put their houses in order and to build up adequate but not excessive inventories. While there had been an abrupt increase in bank loans in the District over the year end, some bankers felt that the increase was temporary, that most of it was in loans on securities and loans to finance companies, and it did not reflect inventory borrowing. Their projection was for a rather steady volume of commercial loans, with no real increase for at least the next 90 days.

Turning to policy, Mr. Fulton said he would hope that the bill rate could be maintained at about the 2-3/4 per cent level, with free reserves in the $400-$500 million area if that would contribute to a bill rate around the level mentioned. For the period ahead he would maintain an even keel, with no overt action. He would not change the discount rate at this time.

Mr. Bopp commented substantially as follows:

> There is nothing especially noteworthy to report about the Third District. We, too, have had very brisk department store sales. Except for a recent more-than-seasonal rise in claims in December, the unemployment picture is looking better. In banking, although reserve positions still are essentially easy, there has been a perceptible trend toward less ease. Reserve city banks have been borrowing more frequently, although only small amounts, at the discount window, and they have been more frequent borrowers of Federal funds. We feel that the recent somewhat firmer "tone" of the money market is appropriate and with Treasury operations pending should be continued.
>
> I am concerned with the public relations aspect of our current economic policy directive. An important reason for changing our method was to promote public understanding and to facilitate analysis by professional observers. The directive of December 19, 1961 instructed the Manager of the Account to conduct operations so as to produce "a somewhat slower rate of increase in total reserves than during recent months." Actually, as has been pointed out, total reserves have increased much <u>more</u> rapidly. An historian, looking back on this

period, might be tempted to conclude that the Manager had not followed his instructions. This is the kind of evidence in which some historians and analysts delight.

In striking contrast to such an interpretation is the fact that everyone who has commented on operations since our last meeting has agreed that the Manager did an excellent job. He was guided by the last two sentences of the directive:

> "Operations shall place emphasis on continuance of the three-month Treasury bill rate at close to the top of the range recently prevailing. No overt action shall be taken to reduce unduly the supply of reserves or to bring about a rise in interest rates."

This experience casts additional light on the nature of our problem. I have been impressed with the view developed over a long period by Mr. Bryan and Mr. Johns that the directive to the Manager should be as precise as possible and should be related to the means at his disposal.

Experience in the last three weeks demonstrates that the Manager cannot control the volume of reserves--total, nonborrowed or free; and that they are inadequate guides to policy even if they were subject to precise control by the Manager.

The Manager operates from moment to moment. His only control in the short run is over the size and composition of the portfolio of securities. The portfolio, of course, is related to reserves but not in any invariable or even predictable way. It is beyond the capacity of the Manager to achieve a precise objective couched in terms of reserves.

A directive in terms of yields on Government securities could, of course, be achieved so long as the portfolio of Government securities was appropriate on the one hand and there were excess gold reserves on the other. The Radcliffe Commission, if I understand its report, would favor a directive couched in terms of interest rates. My own view is that this is inadequate. Neither of the two precise criteria that the Manager can in fact achieve--size and composition of the portfolio and yields on Government securities--is adequate for our purpose in our present state of knowledge and foresight.

This leaves us with the alternatives of expressing the directive in some general term such as "tone" or "feel" of the market or in terms of several criteria which would define these words--such as the Federal funds rate, bill rates, volume of various reserve magnitudes, and so on. The discussion would indicate to the Manager the relative importance that he should attach to the several items.

> I wish we could be more precise; but I would not purchase precision at the cost of occasionally forcing the Manager to do what is clearly not intended.

Mr. Bryan said there were no important developments in the Sixth District that differed significantly from national trends. The District had ended the year briskly. However, he was concerned about some longer-run factors in the District. With a heavy percentage of completely unskilled and semi-skilled labor, he was apprehensive that in an age of automation the Sixth District was not prepared to expand as it had in the past decade, and at a rate that was needed.

Mr. Bryan commented that there had been a number of statements made during this meeting with which he would take issue, but that he would not go into them at this particular time. As he saw it, every signal was flying to indicate that the Committee should move gradually toward a more restrictive policy. Abstracting the next two weeks, he would suggest, therefore, that the Desk proceed according to its feel of the market and, based on that feel, trend toward a situation of less ease. In view of the impending Treasury operations, he would suggest that for the next two weeks the Desk strive to maintain an even keel.

Mr. Francis said that in the Eighth District production quickened and unemployment declined somewhat in November. Also, bank credit, both loans and investments, expanded in December. But, relying on the evidence of bank debits, over-all activity improved only moderately during November and, in fact, was still slightly below the May to July average. The

District had not moved up appreciably from the plateau of activity that appeared about mid-year in both the District and the nation. Longer-term measures suggested that the District was not growing in pace with the nation in several significant economic activities. To a large extent this failure to keep in step with the nation reflected developments in the St. Louis metropolitan area. Employment in St. Louis had lagged national growth, even though the unemployment ratio had been cut to about half what it was earlier in 1961. Bank deposit growth at District member banks in the year to November 1961 did not match the percentage increase for all member banks because time deposit growth was relatively less in the District. Construction contract awards for the first eleven months of 1961 were about 6 per cent below year-earlier levels, in contrast to a plus 2 per cent nationally. Retail sales in the District, according to Census data on Group I stores, were below year-ago volumes in October, whereas nationally the totals were slightly above the previous year.

Mr. Balderston commented that although the money supply proper increased only about 3 per cent during the past calendar year, the money supply plus time deposits increased about 6 per cent as did the reserves supporting private deposit expansion. He mentioned that as background for what he was going to say next. This was that since the September-October period the reserves supporting private deposit expansion had increased at an annual rate about double the 6 per cent rate of reserve expansion since March 1, 1961. Therefore, he would favor, as a longer-run policy, the continuation of some additions to bank reserves, but at a rate less than the rate that had prevailed recently. To repeat a phrase that he had used at the December 19 meeting, he would favor a deceleration of the rate of acceleration. However, even though in his opinion that should be the longer-run goal, he would favor approaching that goal gradually. It seemed to him the financial community understood the System's actions best when the System moved from one position to another, or changed from one direction to another, with smoothness and gradualness rather than in a jerky fashion. For the period immediately ahead, of course, precedence must be given to the needs of the Treasury, which would be in the market between now and the middle of February. It was especially important that the large refunding that would take place around the first of February should be a success because $6.2 billion of the maturing securities were held by the public. Consequently, during the period between now and the middle of February he would favor the maintenance of an even keel. After the middle of February, there would be an opportunity for a change of System policy if conditions at that time made such a change seem necessary.

Chairman Martin commented that the only thing with which the Committee was immediately concerned today was the forthcoming two-week period. Like Mr. Robertson, he did not see anything in the present picture that would cause the Committee to deviate from the long-held policy of even keel in a period of Treasury financing, and such a period was immediately ahead.

Nevertheless, the Account Manager might have a difficult time in trying to maintain an even keel. He (Chairman Martin) had come to have more and more sympathy for the position of the Account Manager the longer he worked in this field.

After commenting that he thought Mr. Bopp had made some good points with regard to the formulation of the current policy directive, the Chairman went on to say that he thought it would be unfortunate, on the eve of Treasury financing, if the language of the present directive with regard to avoiding overt action were to be changed. This illustrated the kind of problem with which the Committee was confronted all the time. There was a major public relations problem involved in explaining System actions to the public.

The Chairman then noted that there had been dissents at the December 19 meeting from the implementation of policy according to the consensus, as then stated. Those who had dissented might still feel that the policy expressed in the consensus was not correct. However, they probably would not want to dissent from the maintenance of an even keel during the period of Treasury financing.

Mr. Mills said he understood that the even keel policy would be keyed into the sort of reserve and interest rate climate that had prevailed in the period since the meeting of the Committee on December 19, following which Chairman Martin noted that on December 19 there had been a split decision, by vote of eight to four, on the implementation of policy according to the consensus. It would be his understanding that the even keel now being talked about would be an extension of the policy reflected in the majority position then expressed.

Mr. Mills then said that he would have interpreted the weight of opinion today as accepting the sort of climate that had prevailed in the past three weeks, with an interest rate structure that was relatively in line with the averages of that period.

Chairman Martin commented that the lesser degree of ease indicated by the directive had been achieved by the Desk, although by a somewhat different route than the directive suggested.

Mr. King inquired whether it was fair to say that, if the Desk had followed literally the Committee's directive of December 19, 1961, regarding a slower rate of increase in total reserves that would have resulted in more tightness than actually existed, and Mr. Rouse responded in the affirmative. As the Chairman had stated, the objectives of the Committee had been achieved, but by a different route than indicated by the reference to total reserves in the directive. The Committee's objectives were achieved by following the last part of the directive when it became clear that following the total reserves part would have produced results contrary to those objectives.

Mr. Rouse then said he had regarded the consensus at the December 19 meeting as being in the terms used when the Chairman restated his concept of the consensus. The Chairman had said at that point that the consensus, as he saw it, was along the lines of concentrating on a bill rate in the upper part of the range of 2-1/2 - 2-3/4 per cent and trending toward a slightly less easy monetary condition, without overt action. Mr. Rouse added that his interpretation of what had been said today, bearing in mind the Treasury's position, was that the consensus would be along the lines of concentrating on a bill rate of around 2-3/4 per cent and maintaining the slightly less easy monetary condition that had developed without overt action.

Chairman Martin said that he thought this was about the only way the matter could be put. However, Mr. Mitchell commented that he thought the maintenance of an even keel should mean not moving in any direction during a period of Treasury financing. That was not quite the same as saying "a little less ease all the time." Mr. Wayne said he would interpret the even keel concept as meaning that the Desk would strive to maintain the position of slightly less ease that had developed, and with this Mr. Mitchell agreed. Mr. Rouse indicated that this was in conformity with the thought he had expressed previously.

Chairman Martin commented that if such a course of action for the next two weeks was agreed upon, it would appear relatively easy for the group consisting of the Secretary, the Account Manager, and the Economist to draft a policy directive that the Committee could consider after the luncheon recess.

There was no indication of a view that the drafting should not be along such lines.

At this point Mr. Mills referred to the distribution by the Secretary under date of January 5, 1962, of a draft of statement proposed for inclusion in the Federal Reserve Bulletin explaining the termination by the Open Market Committee, at its meeting on December 19, 1961, of the three statements of operating policies that had been in effect since 1953. This draft had been prepared pursuant to the understanding at the December 19 meeting.

Mr. Mills said that he would like to direct the Committee's attention to what he considered an erroneous tone of the draft, a tone which suggested to him that the termination of the operating policy statements reflected a conclusion that the original reasons for operating in Treasury bills exclusively had disappeared. His own conception, and he thought there were good grounds for it, was that the operating policy statements were adopted following a complete review of System open market operations that gave primary importance to the thought that monetary policy could best be conducted within the framework of a free market. It was felt that the free market should determine, with as few impediments as possible, the trend of interest rates. Therefore, the policy would be to operate in bills, except as determined by proper decisions of the Committee. He did not feel that the proposed Bulletin article, in the manner in which it was drafted, brought out that philosophy, as it existed and as it was accepted. If an article of this sort should appear in the Bulletin, he believed it would do an injustice to Mr. Riefler, the former Secretary of the Committee, and his dedicated study of this problem, including the papers Mr. Riefler wrote explaining the operating policies and the reasons for their adoption. The same thing might be said with regard to the comments in the paper that Messrs. Young and Yager wrote more recently and presented at a Harvard seminar. In his opinion it would be a disservice to permit an article to be published without taking fully into account the different facets of the System's operating principles.

Chairman Martin suggested that the Committee should put down for discussion the question whether or not it wanted to have an article published in the Bulletin. It was not entirely clear, he thought, from the December 19 minutes whether the Committee did or did not. The subject should be taken up at the next meeting of the Committee for discussion in its entirety.

Mr. Treiber noted that the Secretary's memorandum transmitting the draft article had suggested the possibility of publication of such an article in the January or February issues of the Bulletin. It seemed to him that it would be advisable to wait at least until the February issue. This was an important subject and should be studied carefully. He inquired whether another draft would be envisaged in the light of comments received.

Mr. Young replied that the Secretariat was expecting comments and had in mind preparing a redraft in the light of those comments.

In further discussion there was general agreement that publication of an article in the January issue should not be considered, and the Chairman commented that the Committee did not need to decide at this time whether to publish an article in the February issue. In reply to a question, he stated that any comments on the draft should be submitted as promptly as feasible.

The Chairman then referred to the continuing authority directive to the Federal Reserve Bank of New York that had been adopted by the Committee at the meeting on December 19, 1961, and inquired of Mr. Rouse whether the latter saw need for any change at this time, to which Mr. Rouse replied in the negative.

Mr. Treiber said it was his understanding that the directive would continue in effect unless the Committee took action to change it in some respect. If the Committee decided not to make any change, the directive would remain in effect.

Mr. Robertson and Chairman Martin expressed agreement, and there were no comments to the contrary.

> Accordingly, it was understood, without objection, that the continuing authority directive, as adopted at the December 19 meeting of the Committee, would remain in effect.

Mr. Hexter, Assistant General Counsel, entered the room at this point.

Chairman Martin turned next to the subject of Federal Reserve operations in foreign currencies, stating that in accordance with the understanding at the meeting on December 19, 1961, further discussions had now been held with the Treasury. From the minutes of the December 19 meeting, he did not think that the scope of the authorization for further discussion was entirely clear, except for agreement that the matter should be explored with Counsel for the Treasury. He noted that there had now been received and distributed to the Committee a letter from Robert H. Knight, General

Counsel of the Treasury, dated January 8, 1962, transmitting a copy of his opinion to the Secretary of the Treasury with regard to the power under existing legislation of the Federal Reserve System to conduct operations in foreign currencies under the proposed plan being considered by the Open Market Committee. The Chairman then turned to Mr. Hackley and asked that he report to the Committee on his discussions with Mr. Knight.

Mr. Hackley stated that yesterday afternoon, after some previous discussion of the matter, Mr. Knight brought to him a two-page memorandum addressed to the Secretary of the Treasury in which he expressed general concurrence with the legal conclusions set forth in Mr. Hackley's memorandum to the Open Market Committee of November 22, 1961. Further, as indicated in his memorandum, Mr. Knight had asked the Department of Justice whether the Attorney General concurred in his (Mr. Knight's) opinion, and he had been authorized by that Department to state that the Attorney General did concur.

Mr. Hackley commented that it was gratifying to know that the Attorney General concurred. He added that he would like to make it plain that he (Mr. Hackley) was satisfied with the legal conclusions reached in his November 22 memorandum. However, as he had indicated before, he would consider it preferable to have legislation enacted specifically authorizing the proposed operations in foreign currencies. The Attorney General's opinion perhaps supported the legal position of the Federal Reserve System; that opinion might make it less necessary to seek legislation. Furthermore, if legislation was sought but was not enacted, that might politically, if not legally, weaken the System's position under present law. Nevertheless, Mr. Hackley said, he would still prefer to have legislation if there could be some definite assurance that such legislation would be promptly enacted.

Chairman Martin commented at this point that the obtaining of the Attorney General's comments was an outgrowth of a Federal Reserve suggestion, made in the light of points raised by several members during previous discussion of the subject by the Open Market Committee.

The Chairman then called upon Mr. Young, who said that last week Mr. Knight came to his office, at his (Mr. Knight's) initiative, and asked if he could discuss this whole matter informally. Mr. Knight stated that he had arrived at a legal opinion that would concur with Mr. Hackley's opinion. He further indicated, rather vaguely, that he might get the concurring opinion of the Attorney General. He seemed to have had some conversations with the Attorney General's Office about the subject. It was indicated to Mr. Knight that if his own opinion was now firm, it would be helpful to have that opinion available for this meeting of the Open Market Committee. Also, if the Attorney General was disposed to concur, it would seem helpful to have his concurrence reported at the same time, since there had been some indication on the part of Committee members that they would be interested in knowing just what the Attorney General thought about this problem.

Mr. Young went on to say that Mr. Knight then went into the matter of legislation, which he stated he had been discussing with Mr. Hackley.

Mr. Knight indicated that there were some rather strong reservations at the Treasury about seeking legislation at this time and gave three grounds for those reservations. First, the international situation was very tender, particularly with respect to volatile flows of funds. It was not clear just what was happening in international markets, but indications from figures that had been reported to him at the Treasury were not too favorable. In such circumstances, if there were discussions on the Hill, they might be agitating to the markets. Second, to the extent that the problem was one of obtaining clarifying legislation, it was felt that it might be better to seek such legislation after the Open Market Committee had had some experience in order to determine what its problems and limitations were. Presumably and hopefully, its operations in the initial stages would be on a relatively small scale. Third, there was a range of ideas on the Hill with regard to the Federal Reserve System, including varying views with respect to the operations and the organization of the System. Legislation, if sought, might become a vehicle for adding various amendments the nature of which could not be foretold.

Mr. Young said that the balance of his discussion with Mr. Knight related to problems of organization and relations with the Treasury. On the matter of organization, Mr. Knight indicated a Treasury preference for an operation that would be started under the immediate direction of a special subcommittee of the full Open Market Committee. In that respect, Mr. Young explained to him the reasons why the original design of the staff proposal had been changed so that the responsibility from the outset would be in the hands of the full Committee. Mr. Young related to Mr. Knight the feeling that since this was not an undertaking which, if entered into, it would be easy to withdraw from, it would probably be best from the outset to go forward with the full Committee having the responsibility. After this explanation Mr. Knight seemed to concur, or at least to be satisfied. Mr. Knight then went into the matter of how responsibility might be divided between the Federal Reserve and the Treasury. He advanced very tentatively an idea of his for discussion and asked whether or not the Federal Reserve staff proposal with regard to the division of responsibility was intended as more than a starting point for negotiations. Mr. Young explained to him that the proposal, before being presented to the Open Market Committee, had been seen by Under Secretary of the Treasury Roosa, not with the idea, however, of getting any commitment. In fact, Mr. Roosa would have been unable to make any commitment because he was not in a position to consult with his colleagues and with the Secretary of the Treasury. Therefore, the proposal could only be regarded as a beginning point for negotiations and discussions between the Federal Reserve and the Treasury if the Open Market Committee decided to go ahead with the program. Mr. Young said he told Mr. Knight that at the moment the Federal Reserve staff was without any instruction from the Committee to discuss the division of responsibilities in any detail. The staff would have to await an instruction from the Committee.

Chairman Martin said he spent about an hour yesterday with the Secretary of the Treasury and that he thought there had been a fairly good meeting of the minds. The Secretary went over with him the points Mr. Young had just presented regarding the question of seeking legislation. As could be seen, there were real problems involved. Where he and the Secretary came out was that on the basis of the concurring legal opinions, and without crossing the bridge as to what specific legislation, if any, should be sought, the Open Market Committee might want to authorize him (Chairman Martin) to take the matter up with the Chairman of the House and Senate Banking and Currency Committees in order to get their advice. If the Open Market Committee wished to give such authorization, he would then report back to the Committee on January 23. In this manner, the Open Market Committee would be in a position to have the benefit of some further guidance. If the Committee Chairmen, after hearing Chairman Martin's explanation, should feel strongly that the introduction of legislation would cause a great deal of stir, it might be better not to embark on that course. In this, he thought the Secretary of the Treasury concurred. Whatever advantages there might be in System operations in foreign currencies could be completely destroyed by a long Congressional debate on the subject.

The Chairman then commented that apparently there would be some publicity even if the System should decide to move forward without Congressional sanction in the form of specific legislation. If he understood correctly, the Board would have to make an amendment to one of its regulations.

Mr. Hackley responded that the Board would have to make an amendment to Regulation N, Relationships with Foreign Banks and Bankers, and certain instructions would have to be issued by the Federal Open Market Committee. It would seem to be a matter of judgment whether those instructions should be made public.

Chairman Martin noted that a delicate problem was involved, particularly in view of the balance-of-payments information that would be coming out at the middle of the month. He suggested that the opinion of the Treasury's General Counsel be studied in conjunction with the opinion of Mr. Hackley. Also, he would propose, if the Committee was willing, to explore this matter with the Chairman of the Banking and Currency Committees and to report back to the Open Market Committee. Then there could be a full discussion at the next Committee meeting against the background of whatever he (Chairman Martin) could develop from the discussions with the Committee Chairmen.

Mr. Treiber said he considered this a very important matter, on which it was important to move forward. He thought it would be highly desirable for Chairman Martin to talk with the Chairmen of the Banking and Currency Committees.

Mr. Mitchell observed that none of the people being consulted, including the Chairmen of the Banking and Currency Committees, would appear to have anywhere near the same stake in the matter, in terms of prestige and public relations, as the Federal Reserve. If the Federal Reserve got into the proposed operations via the back door and made a mistake, particularly with no precedent for such operations over a period of 30 or 40 years, he felt that the reverberations would be serious. No one else had reason to be nearly as concerned as the System itself. If a mistake should be made, everyone would say that it was the Federal Reserve that did it. Therefore, before making a move of this sort, he felt that the possible public relations reaction should be considered fully.

Chairman Martin responded that the point was well taken. He simply would like to inject the thought that if a crisis should develop in this field and the Federal Reserve was not alert to it, the repercussions could be equally severe.

Mr. Mitchell then inquired about the progress being made in developing draft legislation, to which Mr. Hackley replied that the draft prepared prior to the December 19 meeting had since been re-worked to some extent. It had been discussed with the legal staff of the New York Bank, and the Bank was satisfied. He felt that the Federal Reserve would be prepared to go forward with a request for legislation fairly promptly if such a course should be decided upon.

Chairman Martin agreed, adding that the question came down to whether legislation should or should not be sought.

Mr. King commented that the reservations expressed by the Treasury appeared to be based on apprehension as to what might happen if legislation were requested. He went on to say that he would want to be cooperative with any Treasury or any Administration. However, it appeared to him that because of apprehension as to what might happen if legislation were sought, the Federal Reserve might be asked to take all of the responsibility, and he would have a question about cooperating to that extent. It should be recognized, he thought, that all of the opinions that had been expressed came from more or less a common base and might not necessarily be thoroughly objective. He agreed that the thing to do next was to talk with the Chairmen of the Banking and Currency Committees. However, he was inclined to think that the Federal Reserve was being asked to go a little too far in the name of cooperation. As he understood it, the Treasury was suggesting that it might not favor seeking legislation because of apprehension as to the outcome.

Chairman Martin responded that he wished to make it clear that no one had asked the Federal Reserve for its cooperation. To date, all of the impetus had come from the Federal Reserve. It had approached the Treasury; the Treasury had not approached the System. When the Treasury was approached, however, it was entitled to raise a question. This question was whether it might not be inadvisable to do anything. In that case, the Treasury might want to use the Stabilization Fund entirely.

It should be kept clear, the Chairman continued, that the proposal now before the Committee had been developed within the Board and the New York Bank. It had been discussed over a period of several months. Every effort had been made to give each member of the Open Market Committee an opportunity to express his opinion on the matter, and no final decision of any sort had yet been made. There were certainly questions involved in the proposal. However, he (Chairman Martin) happened to believe that the world had changed, in fact much more than he understood, and he was convinced that this job was going to have to be done by somebody, whether it be the Stabilization Fund or the Federal Reserve. Mr. Thomas, he noted, had submitted a good memorandum on the rationale for such a program being undertaken by the Federal Reserve, but the point had not been resolved as yet. In any event, however, nobody had asked the Federal Reserve for its cooperation or made any request.

In reply to a question by Mr. Mitchell regarding how Under Secretary Roosa had entered into the picture, Mr. Young recalled that last summer he and Mr. Furth prepared a memorandum in which operations in foreign currencies were proposed. It was then suggested that an operational framework for such operations be designed, and additional memoranda, as distributed to the Committee, were prepared for that purpose. It was in connection with that work that at one point he told Mr. Roosa in confidence of the assignment on which he (Mr. Young) was then engaged.

After further discussion, Mr. Mills said that he would like to second the proposal that Chairman Martin be authorized to contact the Chairmen of the House and Senate Banking and Currency Committees to acquaint them with the problem and with the approach that the System might be making to operations in foreign currencies, and to obtain their reaction.

Chairman Martin added that, if so authorized, he would like to report back to the Open Market Committee at its next meeting and to have a full discussion by the Committee of the whole problem.

The Chairman then inquired whether there were any objections to proceeding in this manner. No objection being indicated, it was understood that he would contact the Chairmen of the Banking and Currency Committees for the purpose indicated and that he would then report back to the Open Market Committee at its next meeting.

In this connection, Chairman Martin said it should be made clear that at this point no commitment was being made to anyone.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, January 23, 1962, and that succeeding meetings would be scheduled for Tuesday, February 13, and Tuesday, March 6, the latter to be the annual organization meeting of the Committee.

Mr. Treiber noted that at the December 19 meeting Mr. Thomas had referred to the effect of adoption of the continuing authority directive on certain operating authorities that are customarily reaffirmed each year at the Committee's organization meeting. He said that, if desired, he would be prepared to comment on that subject at this meeting.

Chairman Martin suggested, however, that the subject be deferred until another meeting of the Committee, and there was agreement with this suggestion.

The meeting then recessed and reconvened at 2:15 p.m., with the same attendance as at the beginning of the morning session.

There were distributed copies of a draft of proposed current economic policy directive to the Federal Reserve Bank of New York that had been prepared by the Secretary, Account Manager, and Economist. The draft read as follows:

> It is the current policy of the Committee to permit further bank credit and monetary expansion so as to promote fuller utilization of the economy's resources, together with money market conditions consistent with the needs of an expanding domestic economy, taking into account this country's adverse balance of payments as well as the Treasury financing calendar.
>
> To implement this policy, operations for the System Open Market Account during the next two weeks shall be conducted with a view to maintaining the generally less easy monetary conditions that have prevailed in recent weeks, and to continuing the rate on three-month Treasury bills within the recent range, without overt action to change unduly the supply of reserves or the level of interest rates.

In reply to a question whether the Account Manager felt that he could operate satisfactorily under a directive along the lines drafted, Mr. Rouse stated that he could.

In a discussion that ensued concerning the language of the proposed directive, certain changes were suggested. It developed that a majority favored eliminating the final clause, beginning with the words "without overt action." Those supporting the elimination of this language suggested, in essence, that it was unnecessary or redundant in view of the preceding phraseology, that it might convey unintended implications, and that it might inhibit the Manager if certain actions were deemed necessary to carry out other portions of the directive. A minority view, favoring retention of the language, was based on the thought that the language had been included in the directive issued following the December 19 meeting, that its elimination of this particular time might be misunderstood, and that it pointed up the desire of the Committee that an even keel be maintained during the forthcoming two weeks.

There was general agreement with a suggestion that the words "generally less easy" be stricken from the portion of the directive referring to conditions that had prevailed in recent weeks, and that the Desk should seek to maintain during the ensuing two weeks, inasmuch as those words would seem to convey the impression of a more pronounced shift in money market conditions than the Committee had had in mind at the December 19 meeting, and possibly also the impression that some further shift was contemplated during the next two weeks.

There was likewise general agreement with a suggestion that the term "money market conditions," as used in the first paragraph of the draft, be changed to "monetary conditions," and that, conversely, the term "monetary conditions," as used in the second paragraph, be changed to "money market conditions."

In the course of the comments on the directive, Mr. Mills recalled that at the December 19 meeting he had dissented from the adoption of a procedure whereby the policy directive, in its then-existing form, would be separated into a continuing authority directive and a current policy directive, with the latter to be drafted and acted upon before the adjournment of each meeting. He felt that his grounds for dissent were validated by the difficulty being experienced in issuing a current policy directive, as exemplified by the discussion that had occurred today regarding that it pointed up the desire of the Committee that an even keel be maintained during the forthcoming two weeks.

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