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, February 13, 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, Scanlon, and Clay, Presidents of the Federal Reserve Banks of Philadelphia, Atlanta, Chicago, 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, Noyes, and Ratchford, 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
Messrs. Coombs, Eastburn, Hostetler, Jones, Parsons, and Tow, Vice Presidents of the Federal Reserve Banks of New York, Philadelphia, Cleveland, St. Louis, Minneapolis, and Kansas City, respectively
Mr. Brandt, Assistant Vice President, Federal Reserve Bank of Atlanta
Mr. Eisenmenger, Acting Director of Research, Federal Reserve Bank of Boston
Mr. Sternlight, Manager, Securities Department, Federal Reserve Bank of New York

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on January 9 and January 23, 1962, were approved.

Upon motion duly made and seconded, the action of the members of the Committee on February 5, 1962, approving the recommendation of the Manager of the System Open Market Account that Account holdings of Treasury notes maturing February 15, 1962, and April 1, 1962, be exchanged in entirety through subscription for approximately $3,305,000,000 3-1/2 per cent certificates maturing February 15, 1963, and approximately $1,500,000,000 4 per cent notes maturing August 15, 1966, was ratified.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period January 23 through February 9, 1962. A copy of this report has been placed in the files of the Committee.

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

Open market operations since the last meeting of the Committee have been directed mainly toward maintaining an even keel while the market focused on the Treasury's February refunding operations. The over-easy reserve situation which had prevailed as a result of a high level of float was rapidly unwound and money market conditions became more normal with a drop of average free reserves to somewhat over $400 million. At these lower levels of reserve availability, Federal funds fluctuated between 2 and 2-3/4 per cent and Treasury bill rates have held around 2.70 per cent for 91-day bills. Although there has been less downward pressure on bill rates from banks trying to put their surplus reserves to work, there has been a continuous nonbank demand from a variety of sources, notably from corporations. Dealers, however, are still wary of current bill rates and have reduced their bill holdings substantially, evidently expecting a sharp rise in short-term rates after the completion of the Treasury's refunding operation. This caution was reinforced by the comments of Secretary Dillon in his testimony before the Joint Economic Committee, which suggested that a further rise in short rates, including the Federal Reserve discount rate, might be in order if the balance-of-payments situation demands it. An additional factor has been injected in each of the past two weeks by rumors in the market of an imminent reduction in the British bank rate.

Attitudes toward the long-term bond market have been progressively more optimistic with the feeling growing that long-term interest rates may not move much higher in the present economic environment, a view which was strengthened by Secretary Dillon's remarks indicating that the Administration would not look with favor on a significant rise in longer-term rates.

The Treasury's February refunding has been an outstanding success, with attrition at a minimum. A significantly large exchange was made into the 4 per cent 4-1/2 year notes, confirming that many banks because of their heavy position in very short maturities are moving into a longer position, particularly because of the higher interest rates that they are paying as a result of the greater latitude now permitted under Regulation Q. In this exchange the larger banks were heavier subscribers for the intermediate issue than was the case with the recent cash offering of 4s of 1969. The exchange operation will be completed with the final settlement on Thursday, February 15.

Indications are that the Treasury will try an advance refunding shortly to take advantage of the present improving market conditions. The market, too, is expecting something of this kind. Presumably, an offering would be made as soon as possible after the completion of the current exchange.

Thereupon, upon motion duly made and seconded, the open market transactions during the period January 23 through February 9, 1962, were approved, ratified, and confirmed.

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

Since mid-summer, economic expansion has been less vigorous. You will recall that the rate of expansion slackened in late August and September, and that industrial production, in fact, declined two points.

This was followed by an upsurge in October and November, especially in retail sales, but it also carried with it an important and long-awaited drop in the rate of unemployment.

Since November there has been another period of slower expansion. Retail trade declined a little from the advanced November level in December, and again in January. Industrial production gained only a point in December and is not expected to advance further in January. It might even decline.

While the over-all unemployment percentage improved a little from December to January, a more detailed analysis of the underlying data suggests that there has been very little change in the basic employment picture in the last two months. If anything, factory employment is off a little.

Construction activity has been substantially unchanged in December and January at the advanced level reached in November. At the same time, surveys of consumer buying intentions show very little real strength in housing or durable goods markets in the period ahead. Auto demand appears to be stronger than a year ago, but this is counterbalanced by weakness in household durables. House purchase intentions are close to year-ago levels.

One bright spot is the relatively good showing of corporate profits in the fourth quarter, which perhaps provides, in turn, an explanation for the improvement in the stock market in the last several weeks.

Prices have continued stable, both in terms of the latest available comprehensive indexes and the recent behavior of the commodity markets.

At best, industrial production in January was less than two per cent above the August level. After a fast run-up last spring, nonfarm employment has increased by only about 100,000 since July. Housing starts in December, at 1.3 million annual rate, were well below the high reached in the fall.

It would certainly be a mistake to place undue emphasis on the relatively sluggish performance of the economy in two winter months. On the other hand, the reduced rate of advance in key economic indicators over a period of six months is a fact that cannot be gainsaid, and should not be discounted.

In the fourth quarter the advance in gross national product was well maintained, but it now appears unlikely that the first quarter will show as much further gain as would be consistent with the goals for 1962 set forth in the President's Economic Report.

At this point, the question certainly does not appear to be one of imminent downturn, nor indeed of excessive demand pressures on scarce resources--but rather of maintaining a rate of advance that will enable us to discharge the domestic and international commitments we have undertaken. We can certainly expect to be reminded often in the period ahead that our position of leadership in the free world does not depend solely on our ability to stem the drain on our gold reserves arising out of short- and long-term capital outflows, but also on our capacity to make our economic system perform at a sustained high rate. Whether it was wise or not, the United States took strong leadership in rallying the OECD countries to pledge themselves to a high and sustained growth rate for the decade ahead. We took much the same position in promoting the Alliance for Progress. To allow our own still moderate economic recovery to falter within less than a year after these events would be embarrassing.

As things now stand, much will depend on the rate of expenditure for new plant and equipment that emerges as the year progresses. Plans reported in the last survey--which indicated a 4 per cent increase over 1961--would not be sufficient to carry the economy forward to levels of activity which have been widely accepted as within its potential. It is generally assumed that these plans will be revised upward, but we will not know for about a month.

In summary, the business situation does not yet show signs of need for restraint, currently or in the foreseeable future. Nor, on the other hand, is there any evidence that limited credit availability has inhibited the advances thus far. If the situation can be characterized in a few words, they would seem to be that the disposition of the public to hold liquid balances rather than to make expenditures is still high. This disposition may change, but until it does, restriction on the availability of liquid balances could result in an unnecessary and undesirable curtailment of the demand for goods and services--and would have to share the blame for any short-fall in the economy's performance in 1962.

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

When allowance is made for the wide--and often variable--seasonal movements that occur around the turn of the year, it appears that on balance during the past two or three months bank credit has continued to show a moderate expansion. Total demands on capital markets have been fairly large. The money supply, seasonally adjusted, lost in January most or all of its very large December gain, but at the same time there has been a striking increase in time deposits at commercial banks.

Interest rates generally have remained relatively firm, after rising in the last few weeks of the year. Rates on Treasury bills, which rose much more than seasonally in December, have subsequently declined much less than seasonally. Yields on medium- and long-term U. S. securities have generally maintained the higher levels reached in December or early January. Yields on the high-grade corporate bonds have continued to show little change.

In contrast, yields on State and local government issues have declined sharply, and the spread between the average yield on high-grade municipals and that on long-term U. S. bonds is the largest on record. This contrast is attributed to bank buying of longer-term tax-exempt issues as a medium for investment of their growing time deposits. Evidence of any large-scale buying, however, has not yet appeared in the banking figures. To the extent that the buying has been of currently offered new issues, some lag in actual settlement is to be expected. The volume of new State and local government issues has been exceptionally large. Yield declines, however, have occurred in outstanding issues.

The calendar of new securities offerings for February indicates a continued large volume of offerings in the corporate, municipal, and Government agency sectors of the market. The corporate calendar is swelled by the $300 million A.T.&T. issue scheduled for this week. The total of all new corporate issues is expected to equal about $950 million and the total for State and local government securities is almost as large.

The Treasury has raised $1.8 billion of new cash in January and February, in addition to refunding maturing obligations with little attrition and some debt lengthening. It will need to raise cash again in March and April--between $4.5 and $5 billion--but will retire $3.5 billion of maturing tax bills. After April, further cash borrowing will probably not be needed until July. The net increase in the debt for fiscal 1962 will be about $8 billion.

The Treasury may need to borrow as much as $7.5 billion to raise cash during the last half of 1962, but the net increase in the debt for this calendar year as a whole, after allowing for redemption of maturing issues, may be less than $5.5 billion. For fiscal 1963, current budget estimates indicate the possibility of a small net reduction in the public debt.

On a seasonally adjusted basis, the cash budget continues to show deficits during the first two quarters of calendar 1962, but will be approximately in balance during the latter half of 1962. A surplus is projected for the first half of 1963. The national accounts budget, which allows for the effect of tax accruals, is estimated to show a small but growing surplus throughout 1962, aggregating about $2.5 billion for the year. These accounts, however, do not include some $4 or $5 billion of credit operations by Government agencies, the funds for which must be provided by the Treasury. On balance, therefore, it may be said that the Federal Government's fiscal operations are likely to be a stimulating factor in the economy through most or all of 1962, but that the degree of stimulation will be diminishing.

Bank credit data for January, together with partial figures for banks in leading cities for the first week of February, indicate a decrease in total loans and investments of at least customary seasonal amounts. Because of the very large December increase, however, there appears to be a net increase since November, which may be considered contraseasonal.

For the past ten weeks as a whole, the net decline in business loans at city banks was apparently somewhat smaller than usual. The figures show no indication of borrowing by fabricators of metal products to build up steel inventories. Loans to finance companies showed about the usual seasonal increase and decrease over the period. Loans on securities, mostly to brokers and dealers, also declined sharply following a large seasonal increase in December. Banks added moderately to their holdings of U. S. securities in both months and also increased holdings of other securities--substantially in December and only slightly in January.

The most striking development in banking since the turn of the year has been the sharp increase in time deposits, accompanied by a smaller but substantial decline in demand deposits after adjustment for seasonal variation. The increase in time deposits at all commercial banks during the five weeks ending January 31 amounted to about $2.5 billion--distributed among all classes of banks. At weekly reporting member banks in leading cities, about a third of the increase was in savings deposits; practically none was in the reported categories of foreign deposits.

At the same time, private demand deposits adjusted for usual seasonal variations declined by $1.9 billion. U. S. Government deposits declined by about $1.5 billion--close to the usual seasonal decrease. There was a less than seasonal decline in currency in circulation. On a seasonally adjusted daily average basis, the private money supply in the last half of January was over $1 billion less than in the last half of December, and later data would indicate some further decline to below the November level of about $144 billion. This would mean an increase of less than 2 per cent from the average level generally maintained from late March until early September.

The total of money supply and time deposits at commercial banks, however, is about $15 billion, or 7 per cent, larger than a year ago. In addition, it appears that nonbank holdings of U. S. Government securities have increased somewhat during the past two months. Hence, liquidity in general has continued to increase, though it cannot be viewed as excessive in relation to expanding economic activity.

Reflecting the combined effect of the time deposit increase and the decreases in private and Government demand deposits, required reserves declined by more than the usual seasonal amount in the first three weeks of January, following the much greater than seasonal increase in December. During the past three weeks, changes in required reserves have conformed closely to the seasonal pattern. The seasonally-adjusted figure for required reserves against private deposits is now close to the 4 per cent per annum growth line projected from November, and not much below the 5 per cent line projected from last February or from mid-1960.

Total reserves available to be held against private deposits have declined somewhat more than required reserves since early January and have decreased somewhat since late November, while required reserves increased. These differences are reflected in the lower level of excess reserves that has prevailed during the past two weeks. Reserves have been absorbed since the beginning of the year by a decline in float, which exceeded the post-holiday return flow of currency, and by a moderate reduction in Federal Reserve holdings of Government securities.

Customary variations in required reserves and in factors affecting the supply of reserves would indicate little need for other than temporary Federal Reserve open market operations during the next ten or twelve weeks. The projections presented include an expansion allowance of about $60 million a month--or 4 per cent a year--in required reserves. A variation of one per cent a year in this increment would make a difference of about $15 million a month, or less than $4 million a week.

Turning to broader questions of Federal Reserve policy in the immediate period ahead, it would appear from the report and analysis of the current economic situation in this country that there has been some slackening or lag in economic expansion relative to the rate that may be viewed as desirable. Under the circumstances, there would seem to be little need for imposing any particular restrictions on the availability of bank credit. If attention is paid only to events, without an assessment of underlying causes, one might even conclude that some stimulants were desirable. This conclusion, however, is of doubtful validity, when consideration is given to our balance-of-payments situation and to the likelihood that that situation and also the slackening in the rate of domestic economic expansion are probably due in large part to structural difficulties that could not be remedied by fiscal deficits or easy credit. They might even be worsened by such palliatives.

Such an analysis leads to a conclusion that credit should continue to be available to meet any further expansion in demands of a moderate nature, but that additional reserves need not and should not be supplied in amounts that would result in a decline in interest rates or encourage speculative commitments. If demands should develop at a pace that seems excessive, then some restraint would need to be exercised in supplying reserves to banks. In that event interest rates may be permitted to rise.

Mr. Furth presented the following statement with respect to the United States balance of payments and related matters:

According to incomplete data for January, net transfers of gold and dollars to foreigners declined sharply from the monthly average for the last quarter of 1961. The improvement may be exaggerated by statistical quirks, which probably made the December figure appear a little worse than it was. Still, the December-January average, corrected for extraordinary receipts from foreign year-end payments to the U. S. Treasury, was much smaller than the October-November average, though far too high for comfort. Preliminary and fragmentary data for the first week of February suggest further improvement.

Another encouraging sign is the fact that the December deficit was accounted for by extraordinarily large increases in claims on foreigners as reported by U.S. banks. As stated before, a deficit is a deficit, whether caused by an unfavorable trade balance or by an outflow of capital. However, an outflow that leads to increases in liquid claims on foreigners, such as bankers' acceptances or deposits with foreign banks, hardly affects the net liquidity position of the U.S. economy, and therefore does not have the same adverse connotation as a deficit in the so-called "basic" balance.

Less encouraging are the continuing net gold sales to foreigners, which still seem to be running at a monthly rate in the neighborhood of $100 million.

Developments abroad are on the whole favorable to U.S. trade prospects in the developed countries, but less so in underdeveloped areas. Canada's recovery seems to parallel our own. In Britain, the downturn may have run its course, and international reserves have increased. Until recently, the market expected some relaxation of monetary policy, especially in the form of a decline in bank rate, but it has apparently given up that hope for the time being.

France, the Netherlands, and Austria acknowledged the continuation of boom conditions by taking mildly restraining actions. On the other hand, Italy and Belgium relaxed monetary restraint a little, presumably in view of their continued balance-of-payments surpluses. In Germany, economic activity has been no higher than last spring, but the labor situation continues extremely tight. A spectacular drop in official reserves in January reflected not so much a change in the country's basic international payments, but rather the shifting of foreign exchange holdings from the Federal Bank to the commercial banks, encouraged by forward cover granted by the Federal Bank at lower than market rates.

In Japan, restrictive policies have apparently succeeded in improving the balance-of-payments and reserve positions, at the cost of ending, at least temporarily, the rise in industrial production.

In less developed countries, inflation remains the main danger. The Philippines have started on a stabilization program, but the most important countries of South America, Argentina and Brazil, are still (or again) unable or unwilling to check inflationary pressures. These pressures may tend to inflate imports from the United States for the time being, but their continuation will force these countries to take more drastic restrictive action in the future.

On the foreign exchange and gold markets, the past three weeks were on balance favorable to the U.S. dollar. The spot dollar rate strengthened slightly in relation to the main Continental European currencies, in particular the Netherlands guilder and the Swiss franc. For the first time in many weeks, the dollar was quoted approximately at par with the Netherlands guilder. Sterling was very strong, reflecting heavy commercial demand and some capital inflow from the Continent; there does not seem to have been any sizeable movement of U.S. capital to Britain. The London gold market showed very active private demand late in January, reportedly because of gold purchases connected with the activities of the French "secret army" organization. Since then, the market has been quiet and has not required substantial support by the Bank of England at the expense of our gold stock.

After noting that Mr. Hayes had been unable to attend this meeting because of illness in his family, the Chairman called on Mr. Treiber, who presented the following statement of his views on the business outlook and credit policy:

> The domestic business situation is about unchanged from three weeks ago. Despite the very sizable rise in gross national product in the fourth quarter, the statistics for December, and apparently for January, show signs of a slight hesitation; and the pronounced business optimism that was beginning to appear around the turn of the year is now somewhat tempered. Consumer buying in the past two months has slowed somewhat from the very high pace reached in November, and industrial production has leveled off. Nevertheless, apart from the uncertainties connected with the steel wage negotiations and a possible steel strike, the probabilities continue to favor a further business expansion. Yet the employment situation does not show further improvement.
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> There are indications that the upward trend of business spending on plant and equipment is likely to continue. As for inventories, steel stockpiling does not appear to have been as extensive as some observers had expected earlier. Nevertheless, some rise in the rate of total inventory accumulation may be looked for during the first quarter. Prices continue to be generally fairly stable, with perhaps a bit more upward pressure than earlier.
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> As for credit, an unusually sharp loan contraction took place at weekly reporting member banks in January, following the pronounced upsurge in December. For the two months together, however, loan expansion at weekly reporting banks was better than seasonal, and the January loan picture at all commercial banks may be somewhat better than at the weekly reporting banks alone. Visibility with respect to the strength of bank loan demand is obscured in January by seasonal factors, but the recent sluggishness of demand fits logically with our general impression of conservative inventory policies on the part of business concerns and perhaps with the bolstering of corporate liquidity brought about by a large total of security issues floated last year. Loan officers of the major New York City banks have been disappointed by the absence of sizable demand for loans since the turn of the year. However, the capital markets are showing considerable strength.
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> The relatively satisfactory domestic picture continues to contrast sharply with the gloomy balance-of-payments outlook.

The latter shows signs of further deterioration, while domestic conditions continue strong. Therefore, may we not be justified in giving somewhat greater relative weight to international considerations than we were giving three, six, or twelve months ago?

It is hard to find much cheer in any analysis of the recent balance-of-payments figures. The so-called "basic deficit" was at an annual rate of about $3 billion in both the third and the fourth quarters--a rate about half again as high as the "basic deficit" for the full year 1960 and clearly far higher than we can afford to see continue. Yet the probability of higher imports, as the domestic expansion continues, highlights the difficulty of achieving an early correction of this heavy imbalance. Meanwhile the outward flow of short-term capital has been far too high, accounting for the increase in the over-all deficit from an annual rate of some $3 billion in the third quarter to one of nearly $6 billion in the fourth quarter. To a considerable extent the British economic difficulties of the first half of the year and the subsequent Berlin crisis shielded us temporarily--that is, until the fourth quarter--from the impact of strong influences working in the direction of a seriously adverse flow of short-term capital. In view of the very heavy total deficit of the last six months, it is hardly surprising that we are experiencing a continuing drain on our gold stock; and the publication of the fourth quarter figures within the next week or so could accentuate our difficulties and lead to further gold losses.

Relative interest rate levels and relative credit availability here and abroad certainly have an important bearing on the capital flows of recent months. The fact that our over-all balance-of-payments problem cannot be solved by monetary policy alone does not relieve us of the responsibility for contributing to a solution. Our failure to do so could subject the System to severe and justified criticism if the situation should deteriorate to a state of crisis. While domestic conditions, considered by themselves, certainly do not call for any change of policy, the momentum of domestic expansion seems strong enough to reduce to a minimum whatever risk to that expansion may be involved in a policy of reduced monetary ease.

For some time we have been looking towards the latter part of February and early March as a "free period" for monetary policy, i.e., a period in which we would not be forced to maintain an "even keel" because of Treasury financing programs. Now there seems to be a strong possibility that an advance refunding operation may be announced in the very near future. If so, our hands may be tied until close to the time of the next meeting. On the other hand, if the advance refunding program is not undertaken, I believe we should now move moderately but clearly towards a policy of less ease.

In terms of open market operations, this would mean an objective of a short-term bill rate in the 3 per cent range, with a reduction in free reserves to the extent necessary to bring this about.

Probably our most difficult decision over the next few weeks will concern the discount rate. Assuming that the Committee would agree to move toward less ease--to the extent to which the Treasury's program might leave us free to do so--there would still be the question at what point the discount rate might be raised, say by 1/2 per cent. We could, of course, wait until our open market operations had been reflected in a rise of short-term market rates above the present discount rate. Perhaps the upward trend in market rates by itself would be regarded abroad as clear evidence of our determination to adjust monetary policy to our international needs. And a delay to this extent in a discount rate increase would make our tightening action much more easily reversible in the event that the risks on the domestic side should loom larger than they do now. On the other hand, a discount rate increase that would lead rather than follow the market rate rise would constitute a more decisive and dramatic signal clearly understood abroad, and would point dramatically to the need for more forceful coordinated measures of other kinds in this country to cope with our bad balance-of-payments deficit. There is, of course, a middle ground between these extremes, with discount rate action coming soon after the tightening process had gotten under way. I think this is about where I come out, although I recognize that our directors may be reluctant to make a move which might seem premature in the light of the needs of the domestic business situation, taken by itself. It will not be an easy decision, but I believe we can't escape the logic of the System's heavy responsibility for the defense of the dollar.

Mr. Ellis reported that economic conditions in New England had been favorably affected by unusually mild weather, which had stimulated construction activity and retail trade. At the same time, weather conditions in the upper part of New England were conducive to good business at the ski resorts. Manufacturing output was up in December from the year-ago level and the average work week in manufacturing was substantially longer than a year earlier in all States. Gains in earnings were coupled with a pronounced leaning on the part of consumers to use credit more freely, and both department stores sales and automobile sales exceeded the previous year's levels. Less favorable developments included a seasonal increase in unemployment, which had resulted in two labor market areas being moved downward in classification, and the fact that nonresidential construction contract awards were lagging behind a year ago.

As to the financial picture in the District, Mr. Ellis noted that demand deposits rose rapidly over an extended period ending in November and since that time had been relatively level. District banks had continued to buy Federal funds and to shorten the maturity of their portfolios of Government securities. A study of the rates of interest being paid on savings deposits indicated that the chief factor in deciding on increases was whether the bank had a large proportion of its deposits in the form of savings deposits, along with the proximity of savings banks competing for those funds.

Turning to policy considerations, Mr. Ellis commented that although the most recent statistics showed some hesitation in the pace of economic expansion, economic visibility always tended to be low at this time of year. On balance, the weight of evidence suggested to him that economic expansion was proceeding satisfactorily in relation to the standard cyclical pattern. At the same time, the weight of evidence on the balance of payments suggested that a critical imbalance was continuing. In the circumstances, it seemed appropriate to ask whether monetary policy was making its maximum contribution to the balance-of-payments problem while at the same time avoiding serious disturbance to domestic expansion. His opinion was that there could afford to be some further adjustment in monetary policy in recognition of the balance-of-payments problem.

Mr. Ellis said that he had been comparing the situation in February 1961 with the most recent three weeks, from the standpoint of the general posture of System policy. The average of free reserves was almost identical, borrowings from the Federal Reserve Banks were down, the Federal funds rate was running at around the same level, and the 90-day bill rate was slightly higher. In the meantime, the System had greatly expanded its portfolio of Government securities and the total amount of available credit. In summary, after a period of 12 months System policy was now substantially the same as it had been at the bottom of the recession. Therefore, it could not be claimed that policy had been altered to make any real impact on the balance-of-payments problem, except perhaps in the way of support given to the short-term Treasury bill rate.

Mr. Ellis went on to say that he had come to this meeting prepared to argue that the Committee should try to make some visible progress in the next three weeks in trending toward less ease. In view of the prospect of an imminent Treasury advance refunding, it might be necessary to postpone such progress, but he would like to feel that the basic position of the Committee was one of trending toward less ease. Such a position might mean that free reserves would fall to a target range of $350-$400 million, that the growth target for nonborrowed reserves would be slowed down to perhaps a 3 per cent annual rate, that the target for the Treasury bill rate would be raised above 2-3/4 per cent, and that the Federal funds rate would hold occasionally at 3 per cent. As to the discount rate, he would prefer to withhold action until short-term interest rates had advanced. The current policy directive might be revised to eliminate the reference to Treasury financing and refer instead to a slower expansion of reserve credit, with increasing attention to the avoidance of declines in short-term interest rates.

Mr. Irons reported that Eleventh District conditions were showing the mixed movements typical of this season of the year. Expansion was progressing satisfactorily, though with perhaps a little hesitation. Figures for the past 3 or 6 weeks indicated that some items were steady, some were moving up, and some were drifting downward, in line with typical seasonal movements. This was true also on the financial side. During the latest period for which figures were available, loans and demand deposits were down about seasonally, investments were up slightly, and time and savings deposits were up substantially. The last-mentioned development was due in considerable measure to the fact that a relatively large proportion of the banks had increased their rates of interest. About 70 or 75 per cent of the banks had announced some kind of increase since the first of the year, with a substantial number going to 4 per cent. Borrowings from the Reserve Bank were negligible. Purchases of Federal funds had exceeded sales, but not in large amount.

As to policy, Mr. Irons stated that he would not want to argue for any substantial change, that is, for anything in the way of dramatic or overt action. For some time, however, he had felt that as the opportunity presented itself, it would be desirable to trend toward a little less ease. On balance, therefore, he came out at approximately the same position as Mr. Ellis. He would still follow a policy of providing reserves as needed, at the same time striving to maintain the covered bill rate in a balanced position with foreign short-term rates. During the past three weeks, this kind of balance had prevailed. The prospect of the Treasury coming into the market shortly was a factor that argued for holding steady. Even without that prospect, however, he would do no more than trend toward less ease unless there was some dramatic factor in the international situation of which he was unaware that might call for prompt and forceful action.

In summary, Mr. Irons said, that he would come out that System policy should stay roughly about as it had been, with some slight trend toward less ease as and when the opportunity presented itself. He would have in mind a bill rate of 2-3/4 per cent or somewhat higher, but more particularly a level that would be in satisfactory relationship to foreign short-term rates. He would not raise the discount rate at this time. As to the directive, it might be well to include some reference to the possibility of an imminent Treasury financing, although at present it was not know with certainty whether or not that would occur.

Mr. Swan said that the Twelfth District had continued in January with conditions a little better, perhaps, than in the country as a whole. This situation was true through the latter part of 1961 and represented a reversal of the situation earlier in the year. Although District figures for January were still incomplete, it seemed doubtful that there had been any significant developments during recent weeks. Department store sales achieved a record for January, but were down slightly from the December figures. Similarly, new car registrations in California, after reaching an all-time high for the month of December, were off somewhat in early January. The lumber market appeared to have strengthened a little in January, according to preliminary figures. However, if there was a lack of ebullience anywhere, it was in the lumber-producing areas.

Continuing, Mr. Swan said that District weekly reporting banks reflected the usual loan decrease in January, virtually all in commercial and industrial loans. There was little change in other categories, except for some further increase in real estate loans. Savings and time deposits continued to rise through the end of January, while demand deposits declined. Along with the decline in loans went a small reduction in the security holdings of the weekly reporting banks. So far this year these banks had been net buyers of Federal funds in every week except one.

Turning to policy, Mr. Swan said he recognized that seasonal factors were difficult to weigh at this time of year. However, in terms of what he sensed to be the general behavior of the business situation, it did not seem to him that the Committee should take any deliberate action to induce a substantially less easy situation. Rather, the Committee should continue about as it had been, at least since the week ended January 24, when the theretofore excessive free reserve figures were reduced. He would think in terms of a bill rate of 2-3/4 per cent, certainly not below that figure, and free reserves of around $400-$450 million. In other words, he would try to meet ordinary seasonal demands for reserves, with perhaps a very moderate growth factor added. If there should be a much more significant increase in credit demands than appeared likely at the moment, he would allow that increase to exert an effect on interest rates and on free reserves. However, in the present situation the System should allow any tightening to come from the market rather than from positive actions on the part of the Federal Reserve. Although recognizing the problem involved in the balance of payments, it seemed to him that with a bill rate of 2-3/4 per cent there was probably not a great deal more that the System should or could do under present conditions. There had been references at the January 23 meeting to the question of borrowing from abroad, but he had some doubt whether the Federal Reserve could affect that situation significantly without a considerably more sizable interest rate increase, both in the short-term rate and out through the rate structure, than would be appropriate in view of the domestic situation.

Mr. Swan concluded by saying that, as suggested by his previous comments, he thought this was not the time to raise the discount rate. He would rather wait until there was a somewhat clearer signal from the credit markets than at present.

Mr. Deming commented that January figures on Ninth District business conditions were not yet complete. However, the available statistics did not indicate as much economic pause in the District as apparently had occurred in the nation as a whole. Except for retail sales, which were affected by severe winter weather, the indexes watched in the District showed a continuation of some strength. In January, bank debits were 13 per cent ahead of a year earlier, and construction contracts were up rather sharply. Nonagricultural employment in Minnesota showed a 2-1/2 per cent gain from a year earlier, and manufacturing employment in the State was up 5.3 per cent. The gains were better than had been predicted in December on the basis of employer interviews, and stronger than the trend then anticipated by State employment officials. Prospects for the next several weeks were viewed as moderately optimistic.

On the banking side, Mr. Deming said there was some strength in the District loan picture and considerable strength in the deposit picture. City banks reported a seasonal loan decline equal to about one-third of the average decline for the past five years, while the pattern at country banks was fairly normal for this time of year.

As to policy, Mr. Deming said he had gone through an analysis not greatly different from that presented by Mr. Treiber. As he saw it, however, the pause in the general economic advance argued for no change in the posture of policy. While the credit picture showed no significant gains in strength, it was stronger than the economic situation and stronger than normal for this time of year. This could be said to argue for caution and perhaps a mild trending toward a little less ease, but any further tightening should come through market forces rather than a deliberate policy on the part of the System.

Accordingly, Mr. Deming said, his prescription would be for no change in open market policy in the next three weeks. This left him vaguely unhappy because a period when the Federal Reserve would be free to act had seemed at hand, and such periods are relatively scarce at this time of year. Of course, if there was an advance refunding, the opportunity would be foreclosed. In fact, however, an even keel was what he thought the general economic situation called for at this time Consequently, he would favor "staying where we are" even if the Treasury should not be in the market. With respect to the directive, there would seem to be no reason to make a change if it was certain that the Treasury was going to undertake an advance refunding. If it was not certain, there was a question whether the final sentence of the directive could be retained in its present form, but otherwise he saw no reason to change the directive. The view on policy that he had expressed would argue for making no change in the discount rate at this time.

Mr. Scanlon said that he thought the prospects were good for further moderate gains in business activity in the Seventh District. Production, employment, and manufacturing were continuing to rise, although production schedules for passenger cars had been reduced somewhat as dealers' inventories approached the one million level. New orders were rising in the capital goods industries. Purchasing agents in the area reported some tendency for order lead times to stretch out, and one out of five reported higher prices in January than in December. This was similar to what had developed in 1959, but the increases were much less widespread than in 1955, when an inflationary boom was taking shape. Some small manufacturers of construction machinery had been encouraged by increased demand to raise prices, but most capital goods producers saw little prospect for price increases unless current orders strengthened considerably. Prospects for heavy construction continued to improve. Apartment building was strong, but the construction of individual homes showed little, if any, improvement. Savings and loan associations had an abundance of funds for mortgages, and banks and other lenders were showing greater interest in Government guaranteed and insured mortgages as well as conventional mortgages. Those banks that increased their interest rates on time and savings deposits to 3-1/2 or 4 per cent, mainly in Illinois, reported that such deposits had increased sharply. However, it was not clear what proportion of those deposits had come from demand deposits in the same banks. Those banks that had raised the rate of interest only on time certificates of deposits reported sizable shifts from regular savings accounts. In Indiana, where the State authorities had retained a 3 per cent maximum rate, there had been some shifting of funds to out-of-state institutions. The increase in share accounts at savings and loan associations in January in those places where commercial banks were now offering 4 per cent was about one-fourth less than a year ago. Savings and loan associations had moved rather cautiously in adjusting their dividend rates, with many apparently experiencing some difficulty in finding favorable outlets for their funds.

Mr. Scanlon said that his views with regard to policy, so far as the international situation was concerned, were similar to those of Mr. Ellis. Domestically, except for the possibility of an excessive build-up of steel inventories, the current business expansion in the

Seventh District seemed to be orderly and balanced. There was still no strong rise in the demand for credit. In view of the amounts of unused labor and plant capacity, he saw no need for any material change in policy at this time. Accordingly, he would favor maintaining essentially the same posture as in recent weeks. He would not favor changing the discount rate at this time.

Mr. Clay expressed the view that the weight of recent evidence on the performance of the domestic economy indicated clearly the need for a monetary policy designed to encourage further expansion in the volume of economic activity. Moreover, the available evidence made it equally clear that the domestic economic situation did not justify any lessening in the degree of stimulation that had generally been the objective of Federal Reserve monetary policy in recent weeks. The Committee would need to remain alert to the international balance-of-payments problem, but, so far as the Treasury bill rate was concerned, it would not appear appropriate at this time to lift the rate above the range previously determined. In keeping with this policy posture, no change should be made in the Reserve Banks' discount rate.

While he would not favor pushing the Treasury bill rate to higher levels at this time, Mr. Clay noted that such action was suggested at the last meeting of this Committee and had again been suggested at this meeting. If that were done, it would tend to tighten credit and, in the present state of the economy, he felt that this should be avoided if possible. If, in the judgment of the Committee, it could not be avoided, offsetting open market operations in longer maturities should be undertaken in order to maintain the necessary reserve position and to minimize upward pressure on interest rates in those sectors of the market.

It should be borne in mind, Mr. Clay suggested, that actions affecting interest rates in the Government securities market would also have repercussions upon interest rates in the private capital markets. The progress of the domestic economy toward a satisfactory level would depend to an important degree upon substantial expansion in those very sectors of the economy that would be adversely affected by higher long-term interest rates.

Mr. Wayne said that recent weeks had produced little change in the plodding progress of Fifth District business into new high ground. The unevenness of the advance was apparent in both employment and man-hour statistics. A slight ebbing of seasonally adjusted nonfarm employment occurred in December, occasioned by the first decline in the number of nonmanufacturing jobs since last February. At the same time, both factory employment and man-hours, which had been lagging, turned upward again. Variety in the manufacturing sector was readily apparent. The current outlook, judging by trade reports, statistics, and the Reserve Bank's latest opinion survey, was moderately good for most District manufacturers. Furniture manufacturers closed 1961 with orders, production, and shipments well above year-end 1960 (close, in fact, to December records set in 1959), and dealers attending the January furniture shows made substantial additions to factory backlogs, showing that they expected the expansion in sales which began last summer to develop further strength this spring. Textiles, on the other hand, had recently shown only slight improvement and faced many uncertainties as spring drew nearer, while the lumber business still waited for real evidence that the recession had ended. In contrast to the generally uncertain pattern of progress, retail trade had consistently done rather well since about the middle of the fall, construction activity had retained its vigor, the coal business viewed the future with growing optimism, and agricultural prospects were good for the coming year. Most respondents to the Bank's latest survey were fairly confident about business volume, but many were skeptical about the outlook for profits.

Turning to banking, Mr. Wayne commented that recent activity at Fifth District weekly reporting banks paralleled closely the situation in the rest of the country. Seasonal forces and the Treasury's January refinancing appeared to have been the dominant factors. Loan volume fell off about seasonally, with only real estate loans showing better than usual strength. Sizable increases in holdings of short- and long-term Governments accounted for a contraseasonal rise in total investments.

In the policy area, Mr. Wayne noted that the Desk had been quite successful in the past three weeks in maintaining an even keel despite wide fluctuations in market forces and some downward pressure on bill rates during part of the time. He was disturbed, as he felt sure the Desk was, by the great difficulties encountered in compiling reliable estimates to be used as a guide to the Desk in day-to-day operations and by the large adjustments frequently made in free reserve figures after they were first released. He hoped that ways could be found to improve techniques in this area.

Now that a period of even keel in the financial markets for the accommodation of Treasury financing was nearing completion, Mr. Wayne said it appeared to him that the Committee might follow an even-keel policy to accommodate the economy. The domestic economy was showing no signs of speculative activities or overexpansion that needed to be curbed. In fact, the incomplete evidence now available suggested that in recent weeks the upthrust of business activity may have lost just a little of its momentum. Internationally, the situation seemed to be fairly stable, and there appeared to be nothing in the immediate picture that would override consideration of domestic conditions.

Mr. Wayne said he found himself in almost complete agreement with Messrs. Swan, Deming, and Scanlon. For the next three weeks, he would favor a policy that would in general be a continuation of recent policy. A free reserve target between $400 and $450 million seemed to him appropriate. He would hope this would produce a bill rate within five or ten basis points of 2-3/4 per cent. He would not favor any change in the discount rate at this time and would renew the current economic directive after eliminating the references to Treasury financing. He had come prepared to suggest the addition of a phrase reading: "and allowing slightly higher rates to develop if they are generated by market forces," but he would not now urge that such wording be included in the directive.

Mr. Mills noted that, as already mentioned, the first quarter of each year tends to be dull and a time when commerce and industry regroup their positions in advance of a new sortie. If history was repeating itself in 1962, there was seemingly no reason for the Federal Open Market Committee to take alarm and attempt to inject undue credit ease into the economy. Instead, advantage should be taken of this pause to review and observe developments carefully before positive actions were taken.

In that connection, Mr. Mills said, he thought the Committee might do well to look back to the deeper past. In one or two of the papers that had been prepared by economists and submitted to the Joint Economic Committee, the observation had been made that the primary difficulty that must be contended with was a lack of demand. Transferring that line of reasoning back 30 years, the terminology used in that period was oversaving and underconsumption. He did not think it had been clearly determined whether that phase of history was being repeated. Transfer payments, including social security and unemployment compensation, had tended to sustain the economy, but it was not impossible that structural unemployment and the problems associated with it were more deep-seated problems that must be reckoned with and went back to the lack of demand emphasized in the papers he had mentioned. Whether the slack at the present time was seasonal or whether it was of a more deep-seated nature, the Federal Reserve had an opportunity to wait and observe rather than to jump the gun and attempt to stimulate the economy with excessively easy credit, because there was no reason to believe that credit could be a substitute for demand. In fact, excessively easy credit could produce, if it had not done so already, the situation that was referred to by economists some years ago as repressed inflation. At present the economy was not strait-jacketed by wage and price controls, but there was the possibility that the growing liquidity in the hands of the public was in a sense a type of repressed inflation that, subject to economic influence and consumer attitudes, might break out into inflationary pressures at some time not long distant.

Therefore, Mr. Mills said, looking both at the near term and the historical references for examples that were worthy of review and analysis, he could not feel there was any occasion for permitting greater ease in the credit structure or for placing a greater supply of reserves at the disposal of the commercial banking system for some time to come. On the contrary, with Government securities markets having been conditioned by official utterances leading to the anticipation of a somewhat firmer interest rate structure at the short end, there was an opportunity to take advantage of that psychology to move in the direction Mr. Treiber had recommended (in which recommendation Mr. Mills joined), to produce somewhat higher rates of interest, approaching 3 per cent at the short end, as an indication that the United States had not relegated the balance-of-payments problem to a subordinate position in its policy making. As far as higher interest rates were concerned, he could not believe that they would be any detriment to the kind of sustainable economic growth that was being sought, and which could be derived from the use of idle resources and the application to more dynamic uses of the liquid holdings now in the possession of all sectors of the economy.

Mr. Robertson said he was not overly concerned about the apparent slippage in economic activity recently. This was something that frequently tended to occur at this time of the year. He saw a need for a continued availability of credit to permit growth in the economy, but he would not favor a greater degree of ease than had been achieved recently. As a matter of fact, he felt that the Committee was getting near to the point at which policy must tend in the opposite direction. He would favor, therefore, permitting some growth of total reserves, but only at approximately the same rate as during the past two or three weeks--not at the rate which was permitted somewhat before that time. Until credit demands pushed interest rates upward, the System should do nothing toward that end. On the other hand, if credit demands did exert that effect, he would not attempt to offset it. Further, in his view it would not be appropriate to change the discount rate before that circumstance occurred. If it did occur and rates moved up, then a change in the discount rate should be considered.

In view of the statements that had been made concerning the possibility of Treasury operations in the near future, it seemed to Mr. Robertson that it would be advisable for the current policy directive to make provision for the maintenance of a steady money market should the prospective refinancing take place. This might be accomplished by changing the last sentence of the existing directive to state that in view of the possibility of Treasury financing in the immediate future, emphasis should be placed on maintaining a steady money market.

Mr. Shepardson said he shared the view of those who felt that the apparent pause in economic activity could not be disassociated from the season of the year, which was one frequently marked by a development of this kind. In general, it seemed to him that the outlook for continued economic growth and expansion was encouraging. As to the recent operations of the Desk, which had achieved or permitted some slowing down of the rate of growth of bank reserves and the money supply, he felt that such operations were desirable and that the Committee should continue to press in that direction, not with a view to actual tightening but with a view to reducing the rate of growth of total reserves. In other words, while he did not feel that the Committee should take a strong position at this time, it should, in his opinion, aim at allowing a somewhat lesser rate of growth. If the demands for credit developed as he thought they were apt to develop in the period ahead, such a policy would be reflected in a somewhat lower level of free reserves.

Mr. Shepardson also said that he did not think the Committee could afford to overlook the continuing seriousness of the balance-of-payments situation. He was not at all optimistic at this time about the prospect of meeting the competitive problem as successfully as it should be met or about the prospect of obtaining the needed adjustment of items in the balance of payments outside the trade accounts.

In summary, Mr. Shepardson said, his view on open market policy for the ensuing three weeks would be to continue along about the same lines as in the past three weeks, with the aim of bringing about, to the extent possible, some lesser rate of growth in reserves and the money supply. With respect to the prospect of a Treasury advance refunding, he recognized that such an operation, if undertaken, would have some impact on the course that the Committee should follow. In the present circumstances, however, he was not certain as to how the current policy directive might best be phrased. One possibility would be to include a conditional statement along the lines that if the Treasury should engage in financing operations during the forthcoming period, any tendency toward lesser ease should be foregone.

Mr. King said he did not profess to know at this time the significance of the recent pause in some economic indicators. Nevertheless, if attention was paid to these indicators when they were moving up, he felt that attention must also be paid to them when they were declining. As to policy, he would align himself with the several persons who had spoken in favor of no basic change at the present time.

Mr. Mitchell commented that the latest information with respect to the domestic economy seemed to him to have justified the cautious policy that the Committee had been pursuing. Even before January data became available, he had had some question about the basic strength of the upswing that the economy had been experiencing. These questions related particularly to consumer spending, including home buying, and business outlays. In this connection, Mr. Mitchell cited certain statistics which seemed pertinent to the question whether System policy should become more or less restrictive. First, retail sales had declined both in December and in January on a seasonally adjusted basis. Second, industrial production at best was level, with possibly some decline. Against this backdrop of what had been going on, he felt that there was reason for considerable pause when dealing with the problem of what the System's policy ought to be.

Mr. Mitchell said it seemed to him that the Committee was now in a position where it was going to have to spend more time on the international situation as a major factor in determining credit policy in this country. In this connection, he read the following portion of a paper that had been presented by Mr. Reynolds of the Board's staff at an economic review presented to the Board yesterday:

Net gold and dollar transfers to the rest of the world appear to have been substantially smaller in January than in any of the preceding three months. At this early date, our January data, which show net transfers of only $50 million, are still very incomplete and could well be in error by as much as $150 million. Also, the erratic behavior of the monthly series in the past argues against over-stressing results for a single month. But despite these two caveats, we know enough, I think, to feel sure that the sudden swelling of our over-all balance-of-payments deficit in the fourth quarter was a temporary phenomenon.

For the fourth quarter, the over-all deficit is now estimated at $1-1/4 billion, or $1-1/2 billion, seasonally adjusted. This can, of course, be blown up to an annual rate of $6 billion, and we are likely to be seeing that figure frequently as fourth quarter data are published over the next few weeks. The third quarter annual rate of deficit had been $3-1/2 billion, and I think that figure gives a better indication of the magnitude of our balance-of-payments problem than does the swollen fourth quarter figure.

The sharp and temporary deterioration from the third to the fourth quarter had two main causes. First, there was a great bulge in outflows of U. S. capital. Second, foreign aid payments increased very sharply.

Foreign economic aid has increased substantially in the last two years, from a rate of about $2-1/2 billion a year (net of repayments) in the first half of 1960 to a rate of about $4 billion a year in the second half of 1961. In the fourth quarter alone, the rate seems to have gone above $4-1/2 billion. While it is likely that net aid outlays will stay above the $4 billion level, it is unlikely that there will be further sharp increases.

Turning to capital outflows, we can see several ways in which heavy outflows in the fourth quarter were clearly exceptionally large. Claims on foreigners reported by U. S. banks increased $700 million in that quarter, compared with only $50 million in the third quarter. Only about one-third of that change was seasonal; the rest was not. There were credits of $150 million to Japan, including $100 million drawn on a $200 million loan from three New York banks. There were credits of $110 million to the Philippines. Long-term bank loans were extended to Norway, Austria, and Belgium. There were increases in bank acceptance and other short-term credit to a number of Latin American countries.

Additional capital outflows, not included in these bank claims figures, included large deposits made by U. S. corporations with Canadian banks. These deposits were denominated in U. S. dollars, and placed in Canada to take advantage of higher Canadian interest rates on time deposits.

None of the increase in the over-all balance-of-payments deficit from the third to the fourth quarter was explained by merchandise trade. In fact, the export surplus, seasonally adjusted, increased to an annual rate of $5 billion from $4-1/2 billion in the third quarter, as exports rose and imports were little changed. Neither imports nor exports changed significantly from November to December.

Continuing, Mr. Mitchell expressed the view that the contribution monetary policy could make to the balance-of-payments problem, unless the System was prepared to introduce stagnation in this country in order to push down prices, probably was limited to the impact on confidence and an influence on interest rates. At the present time, interest rate developments seemed to him not too unfavorable, and he did not see a need to make many small changes in domestic interest rates to meet interest rates abroad. On the question of the confidence factor, it seemed to him that with unrest and political instability sweeping from one country to another in Europe, the time might be coming when confidence in America was about to be restored. The United States might begin to look like a more stable place and a better place for funds. This would be particularly true if the domestic economy could be kept strong. Further, unless the domestic economy was kept strong, there could not be a balanced budget. If a gross national product of $570 billion could be attained this year, the budget could be balanced on a conventional basis, with a surplus on the income and product account basis. Accordingly, it seemed to him that this country had gotten its house fairly well in order. With the budget on a balanced basis and inflation stopped, an environment had been produced that should inspire confidence among foreigners.

Mr. Mitchell noted that at the January 23 meeting the Committee had adopted in principle a new technique of operations, namely, dealing in foreign currencies. He had not been enthusiastic. However, the action had been taken, and he wanted to see the program work as well as possible. The Committee ought to give this new tool a vote of confidence and look for it to help make a contribution to the international problem. At the same time, it should stop trying to edge up the short-term rate, which might jeopardize the recovery and growth of the domestic economy.

Mr. Fulton said the economic summary presented by Mr. Noyes fitted the Fourth District situation quite well. There had been a slow-down in many of the sectors of business. As to unemployment, reductions had taken place almost wholly in the steel centers, with increased unemployment in many of the other areas of the District. Department store sales were holding up quite well; for the year to date they were 5 per cent above a year earlier. Time deposits at banks had risen very substantially. Construction--in Cleveland and Cincinnati particularly--had been quite good in terms of heavy engineering projects and some school building, but this did not extend to the residential sector.

In the steel industry, Mr. Fulton said, operations were being conducted at a very high rate. There were beginning to be some doubts about the occurrence of a strike, but a substantial number of users of steel were proceeding with inventory accruals. A survey among users indicated that about 85 per cent were putting in greater inventories than their current needs would require. Also, some suppliers were requiring parts contractors to stock up against a possible strike. As a consequence of doubts about a work stoppage, however, new orders had dropped to less than 1/3 the volume of ten days ago. In this connection, Mr. Fulton noted that orders can be cancelled without penalty to the purchaser provided they are not on the schedule for rolling.

After further comments on the likelihood of a strike and various factors that might influence the terms of a settlement, Mr. Fulton turned to the current pause in business activity and expressed the view that one could hardly be guided by happenings of the past in analogous situations because this country was now in a completely different position among the industrial nations of the world. Unless this country was ready to maintain a fully competitive position, the things that happened before would not necessarily indicate what might happen now. Many businessmen did not appear to feel that the country was in a situation of real boom. They were hopeful that the present rate of activity would be fairly well maintained. However, in nearly every instance they claimed, quite naturally, that the profits picture was not what they would like from the standpoint of ability to invest funds in plant modernization.

As to policy, Mr. Fulton indicated that he would favor maintenance of the present posture. The Desk had done a good job, he thought, in maintaining the bill rate at about the target that the Committee had felt was appropriate. He would not want to suggest a free reserve target, preferring that attention be directed more closely to the bill rate, but he did feel that the availability of credit should not be restricted until the economic visibility became more clear. He would not favor changing the discount rate at this time. As to the current policy directive, it was not known at this time whether Treasury financing was in the offing. Except for that question, the existing directive minus the last sentence would seem to him appropriate.

Mr. Bopp characterized the Third District as recovering mildly from a mild recession. The troubled areas of the District were still in trouble, although not in quite as bad shape as a year ago. There were still many areas with large unemployment; Wilkes-Barre, for example, had moved up in classification, but only from F to E. The healthier regions of the District were enjoying a good year, but by no means sensational. Production and construction were continuing to recover, along with consumer demand. Nevertheless, the absolute levels of employment, output, and unemployment left something to be desired. District banks were buying Federal funds, although not borrowing at the Reserve Bank. They had holdings of bills and felt that they could handle any increased demands for credit. They had been disappointed in the failure of loan demand to pick up.

Mr. Bopp said that the best evidence of business and financial conditions today was the kind that had been given by Messrs. Noyes and Thomas. It was not possible to read the future with certainty. Therefore, it seemed appropriate to continue System policy approximately as it had been. As to the directive, if there was some feeling that Treasury financing, should it occur, would call for a different policy than if it did not occur, then the directive should take that factor into account. In his own view, he would favor no change in policy irrespective of whether or not Treasury financing was involved.

Mr. Bryan said he found himself in rather complete agreement with what he sensed to be the majority sentiment around the table. The few statistics that had become available recently seemed to him to indicate a rather more modest advance than the statistics of the immediately preceding months. However, short-term movements of this sort, particularly when they came on the heels of an accelerated advance, did not alter his general impression but the business expansion was continuing at a satisfactory pace, although not of boom proportions. The month of January saw less vigor in bank loan statistics. Unemployment was still on the high side, and it would be surprising if the rate declined substantially in the near future. Industrial prices had remained remarkably stable. In his opinion, therefore, the time had not yet come for a deliberate tightening, nor were price pressures in the near future so assured as to suggest that System policy should anticipate them. This was not to say, on the other hand, that unlimited supplies of reserves should be provided to the banking system. For some time, he had thought that the System should be cautious about allowing an overdose of credit availability. He was satisfied that the rate of growth of reserves had slowed down during the past two months; this policy should in his judgment be continued. Thus, the Committee should not take any large overt move toward a further restriction in reserves. Instead, he felt that System policy should continue to allow for some reserve growth. In terms of criteria, he felt that reserves, rather than interest rates or the interest rate structure, should guide the Committee. He would continue to advocate that reserve growth be held to an annual rate of about 2 or 3 per cent.

Mr. Bryan indicated that he would concur in the remarks of Mr. Mitchell regarding the balance-of-payments problem and the contribution that monetary policy could make to it. If he understood correctly, Mr. Mitchell was saying--and he thought wisely--that the System could make no fundamental remedy of that situation without creating economic stagnation in this country. He believed that on the grounds he had mentioned, and every other ground he could think of, it would be at this time a blunder of policy.

Mr. Francis commented that in the Eighth District business activity and bank credit rose rapidly in the autumn of 1961. In the past two months, however, the expansion had been less certain and vigorous. Output of manufacturing firms, employment, department store sales, and debits were higher in the fourth quarter of 1961 than in the previous quarter. Each of these series, however, appeared to have been leveling off in the last month of 1961 and in the first month of this year. Preliminary January data displayed a mixed picture. Initial claims for unemployment compensation were averaging somewhat higher than during corresponding months of recent years. As in the nation, Eighth District department store sales, seasonally adjusted, were down more than seasonally in January. However, bank debits in the District rose from December to January. Cash farm income in the District states had continued very strong.

Total deposits in Eighth District banks averaged about the same in January as in December after adjustment for seasonal factors. This behavior of deposits was in sharp contrast to the rapid increase that was characteristic of the previous four or five months. Both loans and investments of District banks rose from December to January. Business loans, seasonally adjusted, declined moderately, while most other categories of loans increased. There was a slight increase in District bank investments.

Summarizing, Mr. Francis said that recent economic developments in the Eighth District had been similar to those of the rest of the country, but on the whole had been less strong.

Mr. Balderston said he was impressed by the fact that economic activity, which seemed to be moving into a phase of further expansion two months ago, was not progressing as he personally had thought it would. In his view, the pause that Mr. Noyes had reported could not be ignored. He was also impressed by the fact that the price situation during the past year had been more stable than in any comparable period he could recall during his tenure as a member of the Open Market Committee. As noted in the staff memorandum on economic and financial developments that had been distributed prior to this meeting: (1) although the wholesale commodity price index edged up between November and the end of January, the total index was estimated at 119.5 (1947-49 = 100) compared with 119.9 a year earlier; (2) although industrial commodity prices had risen slightly (about .2 per cent) since November, the level estimated for the end of January was slightly below January 1961; (3) although the index of sensitive industrial materials was up 2.0 per cent in January from the previous February, this index rose 5 to 6 per cent in the comparable periods of 1954-55 and 1958-59; and (4) although the consumer price index rose .5 per cent during 1961, retail prices of commodities in December were about the same as a year earlier and the increase of 1.7 per cent in the average price of consumer services was the smallest of any postwar year. In summary, the pause in the expansion of industrial activity plus the stability of prices during the past year argued for a continuation of some increase in the supply of reserves to the commercial banking system. On that basis, he would be content to see the 4 per cent rate of increase in total reserves that had occurred since November continued for the next three weeks, except for the fact that he felt less secure about the international situation than Messrs. Mitchell and Bryan. Thus, he found himself caught in a dilemma of the kind that the Committee had been facing for many months. Were it not for international considerations, he would like to see the System continue to supply reserves at about the rate that had prevailed in recent weeks.

However, the foreign problem is before us. And so, despite the fact that the dealers are short of bills, he would like to see an effort made to encourage the bill rate to move above 2-3/4 per cent. This might require letting free reserves fall somewhat below the level of around $425 million that had prevailed recently. He would be satisfied with a free reserve target as low as $350-$400 million if that were necessary to maintain the bill rate above 2-3/4 per cent.

In a further comment, Mr. Balderston noted that free reserves had been running around $425 million if one allowed for float. Yet a year ago, from February through April 1961, free reserves averaged around $525 million, which was about $100 million higher than at present, but which has not prevented the System from being able to continue the increase of reserves behind private deposits at an annual rate of from 4 to 5 per cent. Faced with a choice between the current international problem and the pause in domestic business expansion, he would chance a somewhat lower level of free reserves to help bring about a firmer bill rate.

Chairman Martin said he did not think that the members of the Committee were very far apart in their thinking this morning. He would like to make only the personal observation, in respect to the February doldrums, that he thought there was less urgency today for tightening than at the time of either the January 23 or the January 9 Committee meetings. He continued to feel that this was not a good period of the year on which to base longer-term policy. A Treasury advance refunding was, he thought, more than a possibility. Instead, there was a fairly clear probability that the Treasury would go ahead, in which event the Committee should attempt to maintain a steady money market, unless it felt compelled to tighten at this juncture. In his view, an advance refunding would be complementary to monetary policy, and in line with the thinking of those who had indicated that they would favor some slight diminution of the availability of funds. Therefore, the System ought to be glad to see the advance refunding take place.

The Chairman went on to say, however, that he thought the Committee must anticipate the possibility of further gold losses. That would also be a factor, perhaps, in the market. It might accentuate the necessity for the System to look at the discount rate at a later stage as a confidence factor.

To sum up today's meeting, the Chairman said, he thought the consensus favored maintenance of approximately the status quo for the next three weeks, whether on the basis of a Treasury advance refunding or economic policy considerations. Accordingly, he would think that the existing directive would be acceptable for the next three weeks, if the Committee followed a suggestion such as that of Mr. Robertson's and said that in view of the possibility of a Treasury financing, emphasis should be placed on maintaining a steady money market. A minor adjustment also could be made in the first paragraph of the directive.

The Chairman then inquired whether such a directive would meet the views held by the Committee today. The only reservation expressed was by Mr. Robertson, who said that he would prefer to see the Committee tie its policy to the question of supplying reserves rather than interest rate considerations.

Accordingly, the Federal Reserve Bank of New York was authorized and directed, until otherwise directed by the Committee, to execute transactions for the System Open Market Account in accordance with the following current economic policy directive:

It continues to be 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 monetary conditions consistent with the needs of an expanding domestic economy, taking into account this country's adverse balance of payments as well as a possible Treasury financing.

To implement this policy, operations for the System Open Market Account during the next three weeks shall be conducted with a view to maintaining a supply of reserves adequate for further credit expansion, while minimizing downward pressures on short-term interest rates. In view of the possibility of a Treasury financing, emphasis shall be placed on maintaining a steady money market.

Votes for this action: Messrs. Martin, Balderston, Irons, King, Mills, Mitchell, Robertson, Shepardson, Swan, Wayne, Fulton, and Treiber. Votes against this action: None.

The meeting then recessed and reconvened at 1:00 p.m. with the following attendance:

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, Scanlon, and Clay, Presidents of the Federal Reserve Banks of Philadelphia, Atlanta, Chicago, and Kansas City, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Hexter, Assistant General Counsel
Mr. Thomas, Economist
Mr. Noyes, Associate Economist
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Furth, Adviser, Division of International Finance, Board of Governors

Mr. Francis, First Vice President, Federal Reserve Bank of St. Louis
Mr. Coombs, Vice President, Federal Reserve Bank of New York

Chairman Martin noted that the next meeting of the Committee, scheduled for March 6, 1962, would be the annual organization meeting.

In this connection, he referred to a matter that might come up for discussion at such time, namely, the Committee's By-laws as they related to the selection of the Manager of the System Open Market Account. He then asked Mr. Hackley for a brief background statement, adding that some documentation would be provided to the Committee before the next meeting.

Mr. Hackley commented that the law contains no specific provisions with respect to the selection of an Account Manager or the selection of a Reserve Bank to execute transactions for the Open Market Account. The law requires only that the Open Market Committee meet at least four times each year and that the Reserve Bank representatives on the Committee shall be selected for one-year terms beginning on March 1 of each year. The practice had grown up of regarding the first meeting after March 1 as the annual organization meeting, and the By-laws provide that at such meeting the officers of the Committee shall be elected for the coming year. However, the By-laws do not provide specifically when the Manager of the Account shall be selected; only that a Reserve Bank shall be selected to execute transactions for the Open Market Account, and that such Bank shall select an Account Manager who shall be satisfactory to the Committee, shall serve at the pleasure of the Committee, and shall attend all of its meetings. Mr. Hackley also pointed out that the Committee's Rules on Organization and Information, last amended in 1955 when the executive committee was abolished, state that one of the Federal Reserve Banks, selected by the Committee to execute transactions for the Open Market Account, selects a Manager of the System Open Market Account, satisfactory to the Committee.

Chairman Martin then turned to the subject of Federal Reserve System operations in foreign currencies, concerning which various additional documents, as follows, had been distributed to the Committee since the meeting on January 23, 1962:

1. Proposed instructions regarding open market transactions in foreign currencies. (Draft dated February 2, 1962; revised draft dated February 9, 1962.)

2. Proposed guidelines for System foreign currency operations. (Draft dated February 2, 1962.) (Revised draft dated February 13, 1962, distributed at this meeting.)

3. Outline of initial program for System foreign currency operations. (Draft dated February 2, 1962.)

This was superseded by:

Memorandum from Messrs. Coombs and Young dated February 6, 1962, attaching (a) a draft paper of the same date on scope and character of initial foreign currency operations of the System, as agreed to by Treasury-Federal Open Market Committee representatives; and (b) a second draft paper, also of the same date, submitting a proposal for a short-term program of coordinated Treasury and System operations consistent with this understanding.

4. Memorandum on Treasury and Federal Reserve foreign currency operations and policy -- relationships and coordination. This memorandum was submitted by Treasury representatives as a statement of the Treasury's viewpoint on the problem of operating relationships between the Treasury and the System. It had been amended by the Treasury representatives under date of February 1, 1962, in accordance with suggestions made by Messrs. Coombs and Young.

5. Proposed initial directive from the Federal Open Market Committee to the Federal Reserve Bank of New York on System

foreign currency operations. (Draft dated February 6, 1962.)

6. Letter from Robert H. Knight, General Counsel of the Treasury, transmitting a confidential Treasury memorandum on Treasury experience in the foreign exchange markets. (Letter dated February 9, 1962.)

7. Memorandum from Mr. Hackley, dated February 8, 1962, on an alternative approach to System foreign currency operations under which such operations would be regulated, directed, and supervised by the Board of Governors rather than by the Federal Open Market Committee.

The Chairman stated that he would first review briefly what had happened since the January 23 Committee meeting. The day before that meeting, he recalled, Mr. Hayes had made an address in which he referred to the possibility of System foreign currency operations. Then, at the January 23 meeting, he (Chairman Martin) had been authorized to make reference to the subject in his testimony before the Joint Economic Committee on January 30 in connection with hearings on the President's Economic Report. He presumed that the members of the Committee had seen the testimony. Rather surprisingly, the Chairman said, there had been little comment, either favorable or adverse, since that time.

The Chairman also recalled that at the meeting on January 23 the Committee, with two dissenting votes, had approved in principle a program of System foreign currency operations and had requested Messrs. Young and Coombs to begin negotiations with the Treasury with a view to drawing lines of responsibility between the Treasury's Stabilization Fund operations in foreign currencies and Federal Reserve activities. Messrs. Young and Coombs had since met with Treasury representatives and some progress had been made, although the difficulties involved in a pioneering operation of this kind were considerable.

The Chairman stated that he would ask Mr. Young to report on what had been done to date. He would then ask Mr. Coombs to provide some orientation on procedures that the New York Bank would have in mind in connection with foreign exchange operations. This, he thought, would be helpful to the Committee, and the members should feel free to ask questions.

Mr. Young said that the persons designated by the Treasury to consult with Mr. Coombs and himself were Robert H. Knight, General Counsel, and Alan R. Holmes of the Under Secretary's staff. He and Mr. Coombs met with Messrs. Knight and Holmes for two days following the January 23 meeting of the Open Market Committee, and since that time there had been several further informal conversations. The Treasury tendered a memorandum setting forth its point of view on the problem of operating relationships, which memorandum had been reproduced and distributed to the Committee substantially as submitted, although with a few changes. The Treasury had originally included certain reservations that related to the longer run, and he and Mr. Coombs had raised the question whether those were important and necessary. Accordingly, the Treasury withdrew these points.

Mr. Young said he and Mr. Coombs proceeded by laying on the table the point of view that had been presented in a memorandum, distributed previously to the Committee, which had been suggested as a beginning point for discussions with the Treasury. In the end, however, it developed that the fact that the System was proposing to undertake a new program on an experimental basis handicapped trying to pursue the matter to what might be a fairly definitive allocation of responsibilities. In the circumstances, it seemed that it would be desirable to try to reach an agreement on the outline of a beginning program to which both the Treasury and the Federal Reserve might agree, and it was understood that Messrs. Coombs and Young would prepare a memorandum that would propose a more specific program for the beginning of Federal Reserve operations in this area.

From that point, Mr. Young said, the discussion backtracked into the documents that had been prepared earlier for the Committee, particularly the suggested guidelines, in an attempt to work things out in a way that seemed from Treasury experience and what the Federal Reserve had in mind to be appropriate for System operations. The Federal Reserve representatives showed the Treasury representatives the proposed "action" memorandum and the various implications of that document were discussed. The memorandum was subsequently revised in the light of that discussion, and some further suggestions had resulted from discussion within the Board of Governors. Likewise, there had been some further discussion within the Federal Reserve regarding the guidelines, and as a result there were one or two fresh suggestions. Mimeographed copies of the guidelines in a form reflecting those suggestions were now available for distribution. (Distribution was made at this meeting.)

Mr. Young also referred to the report that had been furnished by the Treasury on the operations of the Stabilization Fund in the exchange markets since March 1961. From the standpoint of the Treasury, he noted, this was a highly confidential document. The Treasury was much concerned that it be so regarded within the Federal Reserve System.

Mr. Young then reverted to what had been agreed upon by the Treasury and Federal Reserve representatives as the appropriate character and scope of an initial program of foreign currency operations by the Federal Reserve System. This provided for the System to acquire in the market or direct from foreign central banks small amounts of authorized foreign currencies whenever pressure on the dollar relaxed and the rate of one of those currencies fell from recent high levels. This would be with the thought of developing a modus operandi. The System would dispose of this inventory only on such occasions as market conditions might make sales desirable. Also, to facilitate the breaking into the business by the Federal Reserve System, the Secretary of the Treasury would stand ready to sell to the Federal Reserve modest amounts of currencies already held by the Stabilization Fund. The amounts mentioned were not necessarily the amounts that the Federal Reserve would be expected to purchase to get into business; they were arrived at rather arbitrarily as amounts that it seemed appropriate for the Treasury to offer at this particular time. The System would be free to take whatever it wished. The Treasury would be free to continue operations under existing agreements with four countries (Germany, Switzerland, the Netherlands, and Italy), but the System, according to the program described in the paper that had been distributed, would stand prepared to acquire currencies of those countries from the Treasury, either outright or under mutually satisfactory resale agreement, in the event that adverse exchange market developments caused the Stabilization Fund to exhaust its available resources. The Treasury and the System would consult before either entered into any agreements with foreign central banks or governments regarding possible foreign currency operations.

To be in a position to meet any unusual demands for foreign currencies that might arise, the System would stand ready, within agreed-upon limitations, to enter into reciprocal currency transactions with designated foreign central banks, especially those of France and England, and to purchase from the Stabilization Fund part or all of foreign currency amounts acquired under Treasury credit arrangements with major European central banks or governments already negotiated or, after consultation with the System, to be negotiated. Also, the System would stand ready to acquire part or all of the foreign currency amounts drawn by the Treasury from the International Monetary Fund in the event of a U. S. drawing.

Mr. Young reiterated that the Federal Reserve-Treasury discussions had developed the thought that, inasmuch as the System operations would be experimental, a complete understanding as to division of responsibilities between the Treasury and the Federal Reserve would not be feasible at this time. However, it was felt that this would be possible on the basis of experience, and therefore that it might be a good thing to leave to experience a precise delineation. In the meantime, the only arrangement that needed to be made would be for the exchange of information, that is, the establishment of channels for regular communication and procedures for continuing consultations. The Treasury memorandum, Mr. Young noted, elaborated on the mechanism for the exchange of information and general communication at some length. Therefore, he and Mr. Coombs had not prepared any paper on that. In general, they felt that the Treasury memorandum was reasonable.

Mr. Young also pointed out that the National Advisory Council on International Monetary and Financial Problems had some responsibility in connection with this matter. After some consideration, however, the Treasury and Federal Reserve representatives had come to the conclusion that it was only necessary to inform the Council in general language of the plan that the System had in mind. It was not thought necessary to get the Council involved in any of the detail. The Council would be informed by the Chairman of the Board of Governors at one of its meetings, and the other members of the Council would be given an opportunity to raise questions. Then there presumably would be an action, for the records of the Council, showing that the subject had been discussed and whether any objection was raised to this undertaking.

Chairman Martin commented that a lot of ground had been covered in the Treasury-Federal Reserve negotiations, and as effectively, he thought, as the nature of the operation permitted. As Mr. Young had mentioned, the Treasury was concerned that its memorandum on Stabilization Fund activities be held in strict confidence.

The Chairman then inquired whether members of the Committee had questions about foreign exchange operations that they would like to ask Mr. Coombs, in view of the latter's experience in handling operations conducted by the New York Bank as fiscal agent of the Treasury.

Reference was made to the extent of operations of the Stabilization Fund in the forward market, as opposed to spot transactions, and Mr. Coombs said the basic reason was that the Stabilization Fund was short of money. Also, those operations had occurred in a period of heavy attacks on the dollar. It had seemed at the time that the most effective form of collaboration with the foreign monetary authorities would be in the forward markets, because such markets tend to be thin and it was felt that a given amount of intervention might have a greater effect on confidence and the general standing of the dollar than an equivalent amount of spot operations. Mr. Coombs then described the general nature of the forward operations that had been conducted.

In reply to a question as to how the General Fund of the Treasury came into the picture, Mr. Coombs said that the total resources of the Stabilization Fund were only about $330 million. Within that total, moreover, there were commitments to several countries, including Latin American countries, for stabilization credit, and there was some gold in the Stabilization Fund. As a rough guess, the availability of Fund resources for the acquisition of hard currencies was in the order of only about $125 million. However, by using its General Fund the Treasury could borrow foreign currencies. Thus the General Fund was in a sense a reservoir for the Stabilization Fund. As to limitations on the borrowing of currencies, this would depend on negotiations with particular foreign countries, but presumably there was no dollar limitation on the use of the General Fund except the debt ceiling.

Mr. Mitchell asked a series of questions concerning the responsibility for decision making. He asked whether, for example, the question of operating in the currency of a particular foreign country would be a decision of the Federal Reserve or of the Treasury, or a joint decision.

Mr. Coombs indicated that, since the Treasury was not really in a position to operate in the currency mentioned because the Stabilization Fund did not have enough money, he thought the initiation of such an operation would have to be a Federal Reserve matter. He would assume, however, that the Federal Reserve would consult closely with the Treasury in terms of what it planned to do, and obtain any suggestions that the Treasury might want to make.

Mr. Mitchell asked whether Mr. Coombs would view such a decision as setting up a continuing relationship with the country in question, and

Mr. Coombs replied that personally he would consider it desirable to have a continuing relationship. There had been a heavy yield in terms of cooperation and understanding as the result of Stabilization Fund operations. The Federal Reserve would be throwing away much more than it accomplished if it entered into one-shot operations.

Mr. Mitchell also inquired about the mechanism of decision making within the System. He inquired, for example, how the goal would be determined if there was a question of operating in the currency of a given country, and Mr. Coombs replied that this would be a decision for the Open Market Committee.

Further questions by Mr. Mitchell related to the means of establishing a basis for a Committee determination, including a determination as to how much money should be set aside for a particular venture.

Mr. Coombs suggested that it might be well for the Committee to set a reasonably high figure to allow room for various unforeseeable contingencies. However, that would be a decision for the Committee. Mr. Coombs also described how he would envisage, once a basic decision had been made, that actual negotiations would be instituted and carried out with a foreign central bank. As to the need for consultation with the Committee on a day-to-day basis at that point, Mr. Coombs said he assumed the Special Manager of the System Open Market Account would be given some latitude, within the framework of the basic decision, for the exercise of discretion in working out the most orderly procedure for accomplishing the directive.

Mr. Coombs also responded to questions regarding what he would anticipate might be accomplished through operations up to a certain amount in a particular foreign currency. In the course of these comments, he brought out that it would be assumed that central banks would never be operating at cross purposes. All of the Stabilization Fund transactions had been fully discussed with the foreign central banks concerned, and it had always been possible to achieve full agreement.

Chairman Martin commented at this point that he liked to think of this type of operation as a kind of lubricating device. These operations could not effect a fundamental cure for the balance-of-payments problem, but it should be possible to lubricate the market to a certain extent. The System's operations should not be so large as to try to correct a basic deficit, but they should be sufficient to give some assistance until the more fundamental problems could be corrected.

Mr. Coombs commented that the whole point of these operations was to gain time until the basic situation changed.

There followed discussion, at the instance of Mr. Mitchell, regarding the possibility that the judgment of a central bank would be substituted for the judgment of the market. Mr. Coombs conceded that on occasion it was possible that there might be some difference of opinion as to a central bank's appraisal of a given situation. However, he did not think that a central bank would want to hold up the exchange rate in its favor artificially if it knew that the tide was running in the other direction. He had found central banks anxious to have the exchange rate reflect basic trends.

In reply to a question as to the authority of the Treasury to borrow abroad, Mr. Coombs cited a statutory reference and said he understood there was no doubt as to the Treasury's authority. Mr. Hackley confirmed this conclusion; he also noted that in a general sense the Federal Reserve Banks may extend credit to foreign banks by the establishment of reciprocal currency arrangements.

At the request of Chairman Martin, Mr. Coombs then described circumstances that would entail the possibility of loss to the Federal Reserve System from foreign currency operations. He indicated that the most basic risk would be involved in the revaluation of a foreign currency. The solution that had been found in operations for the Stabilization Fund was to obtain an agreement with the foreign central bank concerned to give two days' notice of any intention to revalue its currency upward. This agreement had been more or less readily conceded, and the two-day notice would allow time to cover.

Returning to the question of decision making, Mr. Mitchell inquired how much communication between the Committee and the Special Manager would be needed, assuming that the Special Manager had been given some substantial latitude in which to operate under a basic determination by the Open Market Committee. The response of Mr. Coombs brought out, through examples, that much might depend on the nature of the instruction given to the Special Manager.

At the suggestion of Chairman Martin, Mr. Coombs then commented on the existing arrangements at the New York Bank for the conduct of foreign exchange operations. He also touched briefly on the procedures followed by the New York Bank in executing transactions on behalf of foreign central banks.

In further discussion, question was raised as to whether, in the course of day-to-day operations that would involve consultation with the Treasury, the Treasury would find it necessary to consult with other agencies of the Government, including, for example, the State Department. Mr. Young replied that there would be no day-to-day interest on the part of anyone except the Treasury. The Chairman of the Board of Governors might report occasionally at meetings of the National Advisory Council, and some material of a retrospective nature might be prepared for the Council's annual reports to the Congress. Most of that information would already have been published. As to the Treasury, the Federal Reserve would keep that Department informed from day to day on the basis of a daily conference telephone call, which would be handled in much the same manner as the daily call on regular open market operations. Also, there would be Treasury-Federal Reserve staff discussions from time to time, in much the same manner as those with regard to regular open market operations. Questions of policy would be discussed by the Chairman of the Board with the Secretary of the Treasury, but the Treasury would not have a veto. Information on the foreign economic policy of the United States, which falls under the general guidance and control of the National Advisory Council, would be available to the System through its association with the Council apparatus at the staff level.

Mr. King raised a question with respect to the comment made earlier by Mr. Young that there would be no specific rules at the outset on relationships between the Treasury and the Federal Reserve, the thought being that these might evolve out of experience. He asked whether it would not be better to have such rules, subject to an understanding that they could be revised in the course of events if necessary. In this connection, Mr. King indicated that he had some concern about the proposed buying of currencies from the Stabilization Fund and inquired whether it would not be desirable to have at the outset a specific understanding that the Federal Reserve would buy from the Stabilization Fund only in nominal amounts and purely for the purpose of opening accounts.

In response, Mr. Young expressed the view that no general rule was needed; the Federal Reserve simply would not buy currencies from the Stabilization Fund unless it wanted to make such purchases. He did not think that the Treasury would be apt to come to the System with the idea of selling from the Stabilization Fund unless something happened in the development of the over-all program of foreign currency operations that would make it seem desirable, from the Treasury's standpoint, to get unloaded. There could always be that kind of development. For example, an underdeveloped country might need temporary help and there would be no way to arrange it except to give a commitment from the Stabilization Fund. In that event, the Treasury might need to convert some of its resources.

Mr. Robertson inquired as to the advantages seen--aside from the Federal Reserve's "unlimited pocketbook"--in having two agencies operating in this field instead of one, and Mr. Coombs replied that he did not think there were any. It just so happened by circumstance that there were two agencies that were interested in the field.

With respect to the possibility that had been mentioned of purchasing currencies from the Stabilization Fund, Mr. Swan inquired whether it was reasonable to think that the disposal of such currencies, if acquired, would be up to the Federal Reserve. He asked whether it was not possible that the Federal Reserve would just be in the role of supplying funds to the Treasury rather than conducting foreign currency operations. Mr. Coombs replied that he thought that the Treasury would relinquish any further claim to the currencies.

Mr. King again expressed the view that it would be a mistake not to have any clearly drawn rules setting out the lines according to which the Treasury and the Federal Reserve would conduct their respective operations.

In the ensuing discussion of this point, Chairman Martin expressed the view that Messrs. Young and Coombs had negotiated well with the

Treasury and in tones of firmness. There should be an effort to establish principles. However, he considered it difficult to sit down and attempt to draw up such principles while the Federal Reserve was in the process of learning.

After further comments, Chairman Martin turned to the question that had been raised in a memorandum from Mr. Hackley dated February 8, 1962, concerning the possibility of making System operations in foreign currencies subject to supervision by the Board of Governors rather than the Open Market Committee. He pointed out that the consideration of this subject had started with the assumption that such operations would be under the supervision of the Committee, and the discussions thus far had been on that basis. However, the question discussed in Mr. Hackley's memorandum had been raised recently, and it seemed well to throw the matter open for full consideration. The Chairman said he had talked with Mr. Hayes at some length last Saturday and that Mr. Treiber would express himself at this meeting on behalf of the New York Reserve Bank.

The Chairman then turned to Mr. Hackley, who said that his memorandum was in no sense intended as a proposal, recommendation, or endorsement of the alternative approach as against the approach heretofore considered. The question had come up during Board discussions last week, and his memorandum was in the nature of observations on the legal aspects of the alternative possibility without intent to recommend it as a more desirable approach. He did feel that in at least some respects this approach might be more defensible from a legal standpoint. The so-called alternative approach, however, would not in any way affect the basic legal question of the System's authority to engage in foreign currency operations. There were certain arguments that would seem to support placing authority in the Board of Governors, with certain complementary actions by the Open Market Committee so far as open market operations were involved, but his memorandum was not intended to indicate that the approach heretofore considered would not be legally supportable.

Mr. Wayne inquired whether Mr. Hackley meant that the law was sufficiently uncertain so that either approach would be legal.

Mr. Hackley replied that, as indicated in his memorandum of November 22, 1961, any operations in this field would necessarily involve activities with respect to which both the Board and the Committee would have statutory responsibilities, the Committee with respect to open market transactions, including the purchase and sale of cable transfers, and the Board with respect to the opening of accounts and supervisory authority over all foreign relationships.

Mr. Wayne then inquired whether the law appeared to be sufficiently clear that a discussion by the Open Market Committee would not be in order, to which Mr. Hackley replied that the law was not that clear. He reiterated that the memorandum was not intended to express any recommendation on his part.

Chairman Martin said that he thought this matter deserved full discussion around the table. In one sense, it could be said that the authority was in the Board to use the New York Bank as agent in somewhat the same manner as the Bank was used by the Treasury. As fiscal agent of the Treasury, however, the New York Bank was removed to that extent from the System as a whole, and in his judgment this was a defect and a matter of concern. Also, there was the question of an officer of the New York Bank operating for the Stabilization Fund and also for the System. This was all part of a broad problem, involving difficult questions of relationships within the System as a whole.

In further discussion, Mr. Mills inquired whether he was correct in thinking that whatever arrangements might be entered into would be regarded as experimental and subject to amendment or revocation. Chairman Martin replied that he thought there was no question. The matter had to be on that basis.

Chairman Martin then turned to Mr. Treiber, who presented substantially the following comments:

> After reading Mr. Hackley's memorandum of February 8, 1962, outlining an alternative approach with respect to the conduct of foreign currency operations, I re-read that portion (pp. 23-33) of Mr. Hackley's memorandum of November 22, 1961, dealing with the respective jurisdictions of the Board of Governors and the Federal Open Market Committee.
>
> Certainly the statute is not crystal clear in setting forth the line of demarcation between the authority and responsibility of the Board and the authority and responsibility of the Committee. It does seem clear that the statute places in the Board the authority and responsibility for regulating the opening and maintenance of accounts with foreign central banks. On the other hand, it

appears to be the intent of the statute that the Committee direct open market operations, and transactions in cable transfers, bankers' acceptances, and bills of exchange are open market transactions.

I thought that Mr. Hackley very neatly and quite properly distinguished in his memorandum of November 22, 1961, those activities that basically seem to be within the purview of the Board and those that seem to be within the purview of the Committee.

It seems to me that the basic reason why the Federal Reserve would undertake transactions in foreign currencies is to influence the market relationship of such currencies to the dollar; the primary concern is with the market and transactions in the market. At times the Federal Reserve would buy foreign currencies in the market; at other times it would sell them in the market. At the present, our attention is focused on the selling of foreign currencies. In order to be able to sell them, it is necessary to acquire them, as for example through reciprocal accounts. But the reason for the reciprocal accounts is to enable the Federal Reserve to conduct transactions in the market.

To say that the sale of foreign currency is an incident to the maintenance of the foreign account and the reciprocal credits is, it seems to me, a misdirection of emphasis--a blurring of objectives. No new account has been opened by a Reserve Bank in a foreign central bank for decades. The reason for opening such an account at this time is to facilitate the basic purpose of engaging in market transactions in a foreign currency in order to defend the international position of the dollar.

I submit that the reconciliation of the respective responsibilities of the Board and the Committee, as outlined in Mr. Hackley's memorandum of November 22, 1961, is appropriate.

The Federal Open Market Committee has become the forum for the formulation of national credit policy. It is a manifestation of the strength of the Federal Reserve System--a blending of national and regional elements, bringing forth the greatest contribution of the various parts of the System. It seems to me that it is highly desirable that the Reserve Bank Presidents, as well as the members of the Board, join together through the Open Market Committee in directing over-all policy with respect to Federal Reserve operations in foreign currencies.

Mr. Ellis stated that he subscribed generally to the position Mr. Treiber had expressed, with this additional observation. He was impressed by the memorandum relating operations in foreign currencies to operations in domestic markets. He thought there was a similarity of approach and of technique that deserved consideration on the part of the Committee. With respect to administrative techniques and operational routines, it seemed necessary to go through a smaller group to a larger group, whether that be the Board of Governors or the Open Market Committee. In either event, there would apparently have to be a delegation of responsibility to a small group that would turn for policy direction to a larger group, and he could see no reason why the larger group might not be the Open Market Committee as effectively as the Board of Governors. On balance, therefore, while the question was a close one, he would favor the use of the Open Market Committee.

Mr. Irons said he had come to the same conclusion as Messrs. Dreiber and Ellis. He was inclined to regard the purchase and sale of foreign currencies as much more than an incident to the opening and maintenance of accounts with foreign central banks, and from that standpoint the earlier view would prevail. Also, there was much to be said in support of that position from the standpoint of the Open Market Committee having developed into a kind of central forum with regard to System policy matters. He did not think that the international and domestic aspects of this problem could be divorced. Also, the participation of the Open Market Committee would provide education and information in an area where there was a need for everyone to obtain a much broader knowledge. One could see the difference since the abolishment of the executive committee of the Open Market Committee in terms of the broadened knowledge and participation of people throughout the System who should be expected to contribute to the formulation of monetary policy. If the balance was reasonably equal from a legal standpoint, he would favor having the responsibility for System operations in foreign currencies placed with the Open Market Committee.

Mr. Swan expressed agreement with Mr. Irons. He felt that this question had serious implications in the longer run, apart from the specific question of foreign exchange operations, from the point of view of the structure of the Federal Reserve System and what was considered to be its strength. Many of the Committee members were admittedly not experts in the field of foreign exchange operations, but he thought everyone could become sufficiently versed in the subject to discharge the necessary responsibilities. To shift from the Committee to the Board might give support to those who would like to change rather basically the fundamental structure of the System.

Mr. Deming said he had nothing to add to what already had been said by Mr. Irons and the others who had spoken.

Mr. Scanlon said he had had the same questions with respect to Mr. Hackley's memorandum as were raised by Mr. Wayne. It was not clear to him which approach was preferable legally. He was not sure he understood the intent of the last sentence in the memorandum, which stated that the alternative approach would probably have certain practical and operating advantages.

Mr. Hackley made the comment that perhaps this sentence should not have been included in a strictly legal memorandum. However, he had been thinking, for example, of the almost daily meetings of the Board of Governors as opposed to the less frequent meetings of the Open Market Committee.

Mr. Clay said he was rather inclined to agree with Messrs. Ellis and Irons, and the others who had spoken in like vein. At the present moment, however, he was not sure just what the Open Market Committee was likely to be called upon to decide and whether it would be in a position to add a great deal, if operations in foreign currencies were included among its responsibilities. There would be some benefit to the System, perhaps, in having the Open Market Committee involved, for in time there would no doubt be a big job of interpretation to the public and the banking system. Thus, there would be some advantage if the Reserve Bank Presidents were involved to such an extent that they could at least have an opportunity for learning. At the present time, however, he had some doubt whether his own contributions to decisions in this area would be of great value.

Mr. Wayne said he was still disturbed about the question of legal uncertainty that was revived in Mr. Hackley's memorandum. He had thought that the last sentence in the memorandum, referred to previously by Mr. Scanlon, was not just an inadvertent expression. It seemed to him that in some ways it was true. Mr. Mitchell had been discussing earlier the matter of decision making, and Mr. Coombs' replies had clarified his (Mr. Wayne's) thinking to some extent. He had been thinking that the matter of dealing with foreign central banks, and their preference for limited groups, might make it difficult for the Open Market Committee to function in this area; that perhaps there could not be real freedom of discussion. However, he gathered from Mr. Coombs that the necessary element of confidentiality would not be inconsistent with the making of policy decisions by the Committee. The problem seemed more analogous to domestic System operations than he had thought before this afternoon. If this was true, then he would feel that the placing of the responsibility in the Open Market Committee would be advantageous from the standpoint of having a broader group discuss matters of policy in this area. He was impressed by the relationships between foreign exchange operations and domestic open market operations; they would suggest that both types of operations should be considered in the same forum. It would not be too long, he felt, before someone would have to do some explaining, and he would like to have the opportunity to become familiar with the System's activities in foreign currencies if he was going to attempt an explanation.

Mr. Mills said he would prefer the original concept of operating through the Open Market Committee as it would provide an opportunity for the Committee to review, ratify, and confirm the actions taken by a smaller management group. He would hope that such reviews could be accomplished on a constructive basis. However, the injection of the Committee would bring a rather unwieldy body into the decisions; as time passed, it might prove difficult to handle matters in this way. If so, then he would feel that in the interest of more direct and prompt action it might be advisable to turn to the alternative approach and place the direction of foreign currency operations in the Board of Governors.

Mr. Robertson recalled that he had opposed the whole program of operations in foreign currencies on legal, practical, and policy grounds because it had seemed to him that the only basis for the entrance of the Federal Reserve into this field would be to supplement the resources of the Stabilization Fund and because the program was being undertaken without specific Congressional approval. It involved putting two agencies of Government into the same field, with the possibility of differing judgments and operations that were at cross purposes. Consequently, he felt that it would be preferable if there was just one agency in the field. He felt that if the size of the Stabilization Fund was inadequate, the Treasury should seek to augment it by a request to Congress for additional appropriated funds, or possibly seek Congressional authority to freely utilize the unlimited funds of the Federal Reserve System.

From a legal point of view, Mr. Robertson said, he did not think it made much difference whether Federal Reserve foreign currency operations were under the direction of the Open Market Committee or the

Board. In his opinion, there would be a stretching of the statute in either case. However, the statute does specifically authorize the Board to exercise special supervision over foreign relationships. Therefore, it probably would come closer to meeting the statute to conduct operations through the Board rather than through the Open Market Committee. Also, the Board came closer to being purely a Governmental unit; it was composed entirely of publicly-appointed representatives. Accordingly, he felt that the Board should bear the responsibility and the burden of this operation. From a practical point of view, moreover, the Board was in a position to act more promptly in this field because it could meet not only daily but hourly if necessary. No matter which alternative was followed, however, the function should be discussed fully within the Open Market Committee so that everyone could have a complete understanding of the problem.

Mr. Shepardson said that from Mr. Hackley's memorandum it seemed possible that on a fine reading of the law there might be some weight of argument in favor of placing the responsibility in the Board of Governors. However, either approach involved an interpretation of the law that was rather nebulous in some respects. On the assumption that the original proposal would be legally supportable, he thought that it would contain advantages from the standpoint of the System as a whole, even granting the possible mechanical advantages of a Board operation. Participation of the entire Open Market Committee would be desirable from the standpoint of System unity and understanding, as well as from the standpoint of the close interrelationship of foreign and domestic operations. Accordingly, he felt that the original proposal would be preferable in the longer run.

Mr. King said that if the Open Market Committee was going to take direct charge of these operations, perhaps that approach would be better. In practice, however, it would seem that any group of men who met practically every day would be in a better position to make prompt decisions. The real question, as he saw it, therefore, was whether the Open Market Committee would be able to assume full responsibility and discharge it. If it delegated responsibility to a few members, he thought that would be a mistake, and under the proposed plan of organization he believed that was what the Committee would be doing. For that reason, he thought the Board would be preferable because it could meet every day and make what decisions had to be made. Perhaps he was magnifying in his mind the number of decisions that would have to be made, but he felt that the Open Market Committee would have to act largely after the fact. Also, he saw merit in Mr. Robertson's point that the Board consisted of persons publicly appointed. He favored the present mechanism for the conduct of System open market operations and felt that a great deal was gained by having the full Open Market Committee and other Presidents meet together every three weeks. In this particular field, however, because of the lesser frequency of meetings, he doubted whether the Open Market Committee would be able to discharge its responsibility effectively.

Mr. Mitchell stated that his philosophy was quite close to that expressed by Mr. Wayne. He went on to say that as a practical matter there seemed to be three possibilities for conducting a program of operations in foreign currencies: through the Open Market Committee, through the Board of Governors, or through a subcommittee of the Open Market Committee. As between a subcommittee of the Open Market Committee and the Board of Governors, he would prefer to place the program in the hands of the Board. If it appeared that the full Open Market Committee would be able to do the job, then he would have a slight preference for that approach. However, he was not sure that what would be involved was entirely clear. If the Open Market Committee was going to consider international and domestic factors together, the members would have to become as conversant with the international considerations as the domestic. Also, the problem of confidentiality in foreign exchange operations was involved, and the conduct of operations through the Open Market Committee would bring in a substantially larger number of principals along with advisers. Finally, there was the question involved in the lesser frequency of meetings of the Open Market Committee. Putting all of these factors together, much would seem to depend on the nature of the decisions that would have to be made, including how often decisions would have to be made and what they would be like. If they could be made at three-week intervals, his thinking would run in the direction of proceeding through the Open Market Committee; if frequent decisions would be required, however, then he would be inclined to place the responsibility in the Board.

Mr. Fulton said that he concurred almost completely in the views expressed by Mr. Robertson. He went on to say that he doubted whether all of the background information that would be necessary in making decisions on foreign currency operations could be made available to the full Open Market Committee. Further, while the international situation was of significance to the Committee, in his opinion the Committee should direct its attention primarily to the domestic economy and to supplying the reserves to the banking system that were necessary to promote the domestic economy. He felt, also, that the responsibility for foreign currency operations should be lodged in a public body, and the Board of Governors met that description. From the practical standpoint, he noted that the Board is able to meet at any time and that it is more available for conference than the Committee. If the responsibility were in the Open Market Committee, it might be necessary to delegate substantial powers to a subcommittee, and he doubted that the full Committee would actually have control of the operations except in terms of broad principles. For these reasons, he felt that it would be preferable to place the responsibility in the Board of Governors.

Mr. Bopp commented that he was somewhat disturbed by the implication that the Board was a public body while the Open Market Committee was not. Further, if this line of thinking was pursued, he doubted whether one could avoid the conclusion that both domestic and international facets of monetary policy should be handled by that same public body. He would not favor such an approach. As to the foreign currency operations, on the grounds developed by Mr. Irons, including the nature of the Federal Reserve System and the fact that problems arising out of such operations would have to be defended by the System as a whole, he would favor placing the responsibility in the hands of the Open Market Committee.

Mr. Bryan said he could see a number of longer-run arguments of a rather theoretical nature for having the responsibility placed in the Open Market Committee. However, he was persuaded that for a considerable time, at least, the responsibility should preferably be with the Board and the New York Bank on the grounds that such an approach would be more practical. In his opinion, it was questionable whether a body as large as the Open Market Committee could deal with the subject properly, at least in the experimental and developmental stages. He felt that a lot of decisions were likely to be required, that such decisions would have to be made quickly, and that they might have to be of an ad hoc nature. Accordingly, he would prefer that the Board of Governors deal with those matters, with the Open Market Committee kept informed as a matter of information and education.

Mr. Balderston said he had the feeling that the System's domestic and international goals were so closely interrelated that it would be a mistake to divorce the new program from the operations of the Open Market Committee. Also, he was impressed with the point that the System community might be endangered if the new program were administered by the Board and the New York Bank without the other Reserve Banks participating. The funds employed would be System funds, he noted, adding that he felt that five or ten years from now it would seem to have been a mistake if, merely because of certain practical advantages in getting the new operation started, a plan had been initiated that involved divisionary tendencies. While there might be a practical problem--in view of the confidentiality of the operations--if the responsibility were vested in a body as large as the Open Market Committee, it seemed to him that a solution was easy to visualize. If the Committee met at three-week intervals, what had transpired in the field of foreign currency operations could be reported to the Committee and the actions made known to all of the members. The Special Manager would be expected to operate under general guides furnished by the Committee in much the same manner that the Account Manager had operated during the past year under the special authorization to conduct transactions in intermediate- and longer-term U. S. Government securities. The Manager knew in general terms how the Committee expected him to operate. Then, each time the Committee met, the Manager had advised it of what he had done and the operations were approved, ratified, and confirmed. The reporting on foreign currency operations ought to be as complete as confidentiality would permit. In terms of immediate guidance, if the Special Manager should feel that his guidelines in this new and unexplored area were not sufficiently clear, he should have an opportunity to call upon a small group, such as the subcommittee that had been suggested, in order to be able to act quickly and decisively. Therefore, Mr. Balderston said, he would see the subcommittee serving not as a substitute for the full Committee in the sense of corraling secrets of the trade, but rather serving in times of need to provide a means whereby the Special Manager would be able to get on with his job.

Chairman Martin said that this was also his general position. He added that he had one or two observations. First, he did not believe it was possible, with the world developing as it was, to separate domestic and international considerations. This might be false thinking on his part. But he had heard some people try to rank economic goals such as employment, growth, and other factors, and in his opinion they were all interrelated. Second, he did not feel that the Committee members and other Reserve Bank Presidents would necessarily have to become foreign exchange experts. To become an expert, a person would have to devote his entire energy to the problem of foreign exchange alone. The Committee members would have to understand the broad principles, but they would not have to become foreign exchange experts. Therefore, he did not think there ought to be a tendency to exaggerate the burden that would be involved.

The Chairman also made the comment that the world was changing quite a bit today. He was inclined to feel that ten years from now operations in foreign currencies probably would be just as much a part of the System as open market operations in Government securities.

Chairman Martin commented that he thought the System was proceeding along the right lines. There were those, he noted, who felt that the law was not sufficiently clear. It might be desirable to seek legislation in this area at some time, but at the moment he doubted whether it would be feasible, with so little experience, to determine exactly what kind of legislation was needed. Rather, it seemed to him that the best move would be first to gain some experience. If it was clear from the law that the Federal Reserve did not have the authority to enter into foreign currency operations, that would be different, but opinions were available from the Committee's General Counsel and from the General Counsel of the Treasury, and the Attorney General had concurred. The availability of those decisions, along with lack of System experience in foreign currency operations, would handicap the System if it tried to get legislation. The System would be asked what kind of additional legislation it needed, and the Congress probably would not want to put itself in the position of approving something if the Federal Reserve was not clear about its wishes in the matter.

Where he came out, the Chairman said, was that the System was confronted with a pioneering operation. The System would be feeling its way for a period of time and, as pointed up by Mr. Mills' earlier comment, the Committee would not be doing anything irrevocable. There should continue to be full discussion of the matter. It was desirable to have full expressions of opinion, and time should be spent on the subject at every opportunity.

At the same time, the Chairman continued, the Committee had made a decision in principle to move forward. There was a commitment at this juncture to move forward, in the absence of compelling reasons to the contrary, and this would require the acceptance of some kind of framework. Such a framework had been proposed in the documents heretofore distributed to the Committee. From the standpoint of practical operations, it was his feeling that the establishment of a subcommittee of the full Open Market Committee, on the basis outlined in the staff proposal, would be an acceptable procedure at the outset.

Mr. Mitchell commented that the latest draft would authorize the subcommittee to operate only when there was not time for the full Open Market Committee to act, except in the matter of consultation with the Treasury. This was different from the previous draft.

Mr. Young confirmed this point, but noted that the Open Market Committee could delegate to the subcommittee at any time.

Mr. Robertson said he understood the use of the subcommittee would be contemplated in meeting an emergency situation if the circumstances called for quick action.

Mr. Young agreed, adding however that he supposed the Committee would not object if the Special Manager consulted with the subcommittee in getting operations started.

Chairman Martin then proposed that the documents placed before the Committee be accepted as a starting basis, with the understanding that the Committee could review in three weeks what had transpired.

Mr. Treiber inquired whether this would mean going forward with the acquisition of foreign currencies, and the Chairman replied in the affirmative.

Attention was directed at this point to section XI of the February 6, 1962, draft of proposed action regarding open market transactions in foreign currencies. Under this section all profits from System foreign currency transactions would be set aside in a special reserve against losses from such transactions until the reserve reached 15 per cent of the established maximum of System holdings of foreign currencies.

Question was raised as to the necessity for the establishment of such a reserve fund, and several views were expressed to the effect that this would not seem necessary. (Mr. Deming expressed some reservation, saying that in this kind of new operation questions were likely to be raised concerning the results from the standpoint of profits and losses. In this framework, he thought there was something to be said for establishing a reserve fund for a time.)

After discussion, Chairman Martin inquired whether there were strong views within the Committee, and there was no indication of a strong feeling that such a reserve fund should be established. Accordingly, it was agreed that this section of the draft document should be stricken.

Chairman Martin then turned to Mr. Hackley, who commented that any activities in this field would require actions by both the Open Market

Committee and the Board of Governors. The proposed actions of the Open Market Committee were partially premised on action by the Board. Therefore, if the Committee was proposing to act on the authorization and on the guidelines, there should be simultaneous action on the part of the Board amending Regulation N, Relations with Foreign Banks and Bankers, along with action on the part of the Board designating specific countries with the central banks of which accounts were authorized to be opened and maintained by the Federal Reserve Bank of New York.

Accordingly, the meeting of the Open Market Committee recessed at this point and at a meeting of the Board of Governors the actions described previously by Mr. Hackley were taken by the Board.

The meeting of the Federal Open Market Committee then reconvened.

> Upon motion duly made and seconded, the Federal Open Market Committee then approved, effective immediately, the following Authorization regarding Open Market Transactions in Foreign Currencies:

AUTHORIZATION REGARDING OPEN MARKET TRANSACTIONS IN FOREIGN CURRENCIES

Pursuant to Section 12A of the Federal Reserve Act in accordance with Section 214.5 of Regulation N (as amended) of the Board of Governors of the Federal Reserve System, the Federal Open Market Committee takes the following action governing open market operations incident to the opening and maintenance by the Federal Reserve Bank of New York (hereafter sometimes referred to as the New York Bank) of accounts with foreign central banks.

I. Role of Federal Reserve Bank of New York.

The New York Bank shall execute all transactions pursuant to this authorization (hereafter sometimes referred to as transactions in foreign currencies) for the System Open Market Account, as defined in the Regulation of the Federal Open Market Committee.

II. Basic Purposes of Operations.

The basic purposes of System operations in and holdings of foreign currencies are:

(1) To help safeguard the value of the dollar in international exchange markets;

(2) To aid in making the existing system of international payments more efficient and in avoiding disorderly conditions in exchange markets;

(3) To further monetary cooperation with central banks of other countries maintaining convertible currencies, with the International Monetary Fund, and with other international payments institutions;

(4) Together with these banks and institutions, to help moderate temporary imbalances in international payments that may adversely affect monetary reserve positions; and

(5) In the long run, to make possible growth in the liquid assets available to international money markets in accordance with the needs of an expanding world economy.

III. Specific Aims of Operations.

Within the basic purposes set forth in Section II, the transactions shall be conducted with a view to the following specific aims:

(1) To offset or compensate, when appropriate, the effects on U. S. gold reserves or dollar liabilities of those fluctuations in the international flow of payments to or from the United States that are deemed to reflect temporary disequilibrating forces or transitional market unsettlement;

(2) To temper and smooth out abrupt changes in spot exchange rates and moderate forward premiums and discounts judged to be disequilibrating;

(3) To supplement international exchange arrangements such as those made through the International Monetary Fund; and

(4) In the long run, to provide a means whereby reciprocal holdings of foreign currencies may contribute to meeting needs for international liquidity as required in terms of an expanding world economy.

IV. Arrangements with Foreign Central Banks.

In making operating arrangements with foreign central banks on System holdings of foreign currencies, the New York Bank shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee.

The Bank shall instruct foreign central banks regarding the investment of such holdings in excess of minimum working balances in accordance with Section 14(e) of the Federal Reserve Act.

The Bank shall consult with foreign central banks on coordination of exchange operations.

Any agreements or understandings concerning the administration of the accounts maintained by the New York Bank with the central banks designated by the Board of Governors under Section 214.5 of Regulation N (as amended) are to be referred for review and approval to the Committee, subject to the provision of Section VIII., paragraph 1, below.

V. Authorized Currencies.

The New York Bank is authorized to conduct transactions for System Account in the currencies and within the limits that the Federal Open Market Committee may from time to time specify.

VI. Methods of Acquiring and Selling Foreign Currencies.

The New York Bank is authorized to purchase and sell foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the Stabilization Fund of the Secretary of the Treasury established by Section 10 of the Gold Reserve Act of 1934 and with foreign monetary authorities.

Unless the Bank is otherwise authorized, all transactions shall be at prevailing market rates.

VII. Participation of Federal Reserve Banks.

All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G (1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

VIII. Administrative Procedures.

The Federal Open Market Committee authorizes a Subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board of Governors (or in the absence of the Chairman or of the Vice Chairman of the Board of Governors the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate) to give instructions to the Special Manager, within the guidelines issued by the Committee, in cases in which it is necessary to reach a decision on operations before the Committee can be consulted.

All actions authorized under the preceding paragraph shall be promptly reported to the Committee.

The Committee authorizes the Chairman, and in his absence the Vice Chairman of the Committee, and in the absence of both, the Vice Chairman of the Board of Governors:

(1) With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

(2) To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities;

(3) From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Problems.

IX. Special Manager of System Open Market Account.

A Special Manager of the Open Market Account for foreign currency operations shall be selected in accordance with the established procedures of the Federal Open Market Committee for the selection of the Manager of the System Open Market Account.

The Special Manager shall direct that all transactions in foreign currencies and the amounts of all holdings in each authorized foreign currency be reported daily to designated staff officials of the Committee, and shall regularly consult with the designated staff officials of the Committee on current tendencies in the flow of international payments and on current developments in foreign exchange markets.

The Special Manager and the designated staff officials of the Committee shall arrange for the prompt transmittal to the Committee of all statistical and other information relating to the transactions in and the amounts of holdings of foreign currencies for review by the Committee as to conformity with its instructions.

The Special Manager shall include in his reports to the Committee a statement of bank balances and investments payable in foreign currencies, a statement of net profit or loss on transactions to date, and a summary of outstanding unmatured contracts in foreign currencies.

X. Transmittal of Information to Treasury Department.

The staff officials of the Federal Open Market Committee shall transmit all pertinent information on System foreign currency transactions to designated officials of the Treasury Department.

XI. Amendment of Authorization.

The Federal Open Market Committee may at any time amend or rescind this authorization.

Votes for this action: Messrs. Martin, Balderston, Irons, King, Mills, Mitchell Robertson, Shepardson, Swan, Wayne, Fulton, and Treiber. Votes against this action: none.

Consideration next was given to the February 13, 1962, draft of proposed guidelines for System foreign currency operations, which had been distributed at this meeting, and Mr. Young explained the changes from the preceding draft. These were accepted, and certain minor changes in the February 13 draft also were agreed upon.

Thereupon, upon motion duly made and seconded, the Federal Open Market Committee approved, effective immediately, the following Guidelines for System Foreign Currency Operations:

GUIDELINES FOR SYSTEM FOREIGN CURRENCY OPERATIONS

1. Holdings of Foreign Currencies

Until otherwise authorized, the System will limit its holdings of foreign currencies to that amount necessary to enable its operations to exert a market influence. Holdings of larger amounts will be authorized only when the U. S. balance of international payments attains a sufficient surplus to permit the ready accumulation of holdings of major convertible currencies.

Holdings of a currency shall generally be kept sufficient to meet forward contracts in that currency (exclusive of contracts made under parallel arrangements with foreign monetary authorities which provide their own cover) expected to mature in the following three-week period.

Foreign currency holdings above a certain minimum shall be invested as far as practicable in conformity with Section 14(e) of the Federal Reserve Act.

2. Exchange Transactions

System exchange transactions shall mainly be geared to pressures of payments flows so as to cushion or moderate disequilibrating movements of volatile funds and their destabilizing effects on U. S. and foreign official reserves and on exchange markets.

The New York Bank shall, as a usual practice, purchase and sell authorized currencies at prevailing market rates without trying to establish rates that appear to be out of line with underlying market forces.

If market offers to sell or buy intensify as System holdings increase or decline, this shall be regarded as a clear signal for a review of the System's evaluation of international payments flows. This review might suggest a temporary change in System holdings of a particular convertible currency and possibly direct exchange transactions with the foreign central bank involved to be able to accommodate a larger demand or supply.

Starting operations at a time when the United States is not experiencing a net inflow of any eligible foreign currency may require that initial System holdings (apart from sums that might be acquired from the Stabilization Fund) be purchased directly from foreign central banks.

It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions in order that System transactions do not conflict with those being undertaken by foreign monetary authorities.

3. Transactions in Spot Exchange

The guiding principle for transactions in spot exchange shall be that, in general, market movements in exchange rates, within the limits established in the International Monetary Fund Agreement or by central bank practices, index affirmatively the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public.

Temporary or transitional fluctuations in payments flows may be cushioned or moderated whenever they occasion market anxieties, or undesirable speculative activity in foreign exchange transactions, or excessive leads and lags in international payments.

Special factors making for exchange market instabilities include (i) responses to short-run increases in international political tension, (ii) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, or (iii) market rumors of a character likely to stimulate speculative transactions.

Whenever exchange market instability threatens to produce disorderly conditions, System transactions are appropriate if the Special Manager, in consultation with the Federal Open Market Committee, or in an emergency the members of the Committee designated for that purpose, reaches a judgment that they may help to re-establish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified, curtailed, or eventually discontinued pending a re-assessment by the Committee of supply and demand forces.

4. Transactions in Forward Exchange

Occasion to engage in forward transactions will arise mainly when forward premiums or discounts are inconsistent with interest rate differentials and are giving rise to a disequilibrating movement of short-term funds, or when it is deemed appropriate to supplement existing market facilities for forward cover as a means of encouraging the retention or accumulation of dollar holdings abroad.

Proposals of the Special Manager to initiate forward operations shall be submitted to the Committee for advance approval.

For such operations, the New York Bank may, where authorized, take over from the Stabilization Fund outstanding contracts for forward sales or purchases of authorized currencies.

5. Exchange Rates

Insofar as practicable, the New York Bank shall purchase a currency through spot transactions at or below its par value, and should lower the rate at which it is prepared to purchase a currency as its holdings of that currency approach the established maximum.

The Bank shall also, where practicable, sell a currency through spot transactions at rates at or above its par value, and should raise the rate at which it is prepared to sell a currency as its holdings of that currency approach zero.

Spot transactions at rates other than those set forth in the preceding paragraphs shall be specially authorized by the members of the Committee designated in Section VIII of the Authorization for Open Market Transactions in Foreign Currencies.

Votes for this action: Messrs. Martin, Balderston, Irons, King, Mills, Mitchell, Robertson, Shepardson, Swan, Wayne, Fulton, and Treiber. Votes against this action: none.

Upon motion duly made and seconded, the Federal Open Market Committee then approved, effective immediately, the following continuing authority directive to the Federal Reserve Bank of New York on System foreign currency operations:

CONTINUING AUTHORITY DIRECTIVE ON SYSTEM FOREIGN CURRENCY OPERATIONS

The New York Bank is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines on System Foreign Currency Operations issued by the Federal Open Market Committee on February 13, 1962:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs

Total foreign currencies held at any one time shall not exceed $500 million.

Votes for this action: Messrs. Martin, Balderston, Irons, King, Mills, Mitchell, Robertson, Shepardson, Swan, Wayne, Fulton, and Treiber. Votes against this action: none.

The authorization that had been adopted regarding open market transactions provided that a Special Manager of the System Open Market Account for foreign currency operations would be selected in accordance with the established procedures of the Federal Open Market Committee for the selection of the Manager of the System Open Market Account. The

By-laws and Rules of Organization of the Committee provided that the Reserve Bank selected to execute transactions for the Open Market Account should select a Manager of the System Open Market Account who would be satisfactory to the Committee.

Chairman Martin inquired whether the Federal Reserve Bank of New York would wish to select Charles A. Coombs, Vice President, as Special Manager of the System Open Market Account for foreign currency operations, and Mr. Treiber replied in the affirmative.

> Thereupon, upon motion duly made and seconded, and by unanimous vote, the selection by the Federal Reserve Bank of New York of Charles A. Coombs as Special Manager of the System Open Market Account for foreign currency operations was approved, effective immediately.

Chairman Martin then turned to Mr. Hackley, who said he knew of no other actions that should be taken by the Open Market Committee at this time. He noted, however, that the amendment to Regulation N approved today by the Board of Governors would be published in the Federal Register. In this connection, he raised the question whether the actions taken by the Open Market Committee should be published in any form, to which he added that he saw no legal necessity for publication.

From a brief discussion that ensued, it developed to be the consensus that such actions need not be published.

With reference to the continuing authority directive on System foreign currency operations, question was directed to Mr. Coombs whether in his opinion the provision that total foreign currencies held at any one time should not exceed $500 million would be adequate. In reply, Mr. Coombs said he would assume that the $500 million limitation would be adequate for some time to come, particularly considering the shifts that might take place between holdings of various currencies. There followed some further discussion of this point in light of the amounts of individual currencies that might be held at any one time. Reference also was made to a letter that would be sent by the Board of Governors to the Federal Reserve Banks concerning the manner and timing of publication of total System holdings of foreign currencies.

Reference then was made to the draft document that had been distributed under date of February 6, 1962, concerning the scope and character of initial foreign currency operations of the System, as agreed upon by Treasury-Federal Open Market Committee representatives. This document, reviewed earlier during this meeting by Mr. Young, had been distributed to the Committee in company with a memorandum presenting a proposed short-term program for coordinated Treasury and System operations in foreign currencies that would be consistent with the understanding set forth in the first paper.

After discussion, during which Mr. Mitchell commented that he would like the record to show that the early stages of the Federal Reserve program, as set forth in the draft documents, involved questions of relations with the Treasury concerning which he had some reservations, the memorandum on the scope and character of initial System foreign currency operations was accepted as the basis of understanding concerning an initial program of System foreign currency operations. The document read as follows:

SCOPE AND CHARACTER OF INITIAL FOREIGN CURRENCY OPERATIONS OF THE SYSTEM

I. The System would acquire in the market or directly from foreign central banks small amounts of authorized foreign currencies whenever pressure on the dollar relaxes and the rate of one of these currencies falls from recent high levels. Holdings thus acquired would constitute a modest inventory to be used for sales in the market if market pressures or instability clearly warranted. Initially then, the System would enter the market only as an occasional buyer; barring unusual market conditions, the System would aim to defer any program of currency sales until minimum balances had been accumulated.

II. In order to facilitate the early stages of the Federal Reserve program, the Secretary of the Treasury would stand ready to sell to the Federal Reserve modest amounts of German marks (approximately $7 million equivalent), Swiss francs, Netherlands guilders, and Italian lire (approximately $1 million equivalent of each) at market rates of exchange on the day of the sale. The Federal Reserve already has accounts with the Bank of England and the Bank of France. These currency take-overs from the Treasury would permit the System to open accounts at once with four of the other central banks, to establish appropriate bookkeeping procedures for transactions through them, and to become familiar with procedures and techniques for administering and investing the accounts.

III. The Treasury would continue to conduct foreign currency operations under existing agreements with Germany, Switzerland, the Netherlands, and Italy. The System, however, would stand prepared to purchase currencies of these countries from the Treasury, either outright or under mutually satisfactory resale agreement, in the event that exchange market developments obliged the Fund to exhaust available resources. The Treasury and the System would consult before either entered into any agreements with foreign central banks or governments regarding possible foreign currency operations.

IV. With a view to being in immediate position to meet any unusual demands for foreign currencies, the System would stand ready, within agreed limits:

(a) to enter into reciprocal currency transactions with designated foreign central banks, especially the Bank of England and the Bank of France;

(b) to supplement any arrangement that the Swiss National Bank might make with the IMF or the Treasury;

(c) to purchase from the Treasury part or all of foreign currency amounts acquired under Treasury credit arrangements with major European central banks or governments already negotiated or, after consultation with the System, to be negotiated; and

(d) to purchase from the Treasury part or all of foreign currency amounts that may be drawn from the International Monetary Fund.

V. Since the System's foreign currency operations are to be on an experimental and trial basis, the Treasury and the Federal Reserve agree that a specific understanding as to a division of operations between them can be delayed until experience has made clear the way in which such a delineation can be most effectively achieved. Initially, there need only be arrangements for the exchange of information about currency operations, channels for regular communication, and procedures for continuing consultations.

VI. The National Advisory Council will be informed of the general plan for System foreign currency operations on an experimental and trial basis.

A question was raised with respect to the accompanying document containing a proposal for a short-term program of coordinated Treasury and System operations in foreign currencies, and in the ensuing discussion Chairman Martin made the comment that it might be well not to attempt to be more specific at this time than to proceed on the basis that initial System operations in foreign currencies would be generally along the lines discussed at this meeting, and within the scope of the understanding contained in the document that had been accepted by the Committee.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, March 6, 1962.

The meeting then adjourned.

Secretary