FORTY-EIGHTH

Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System

COVERING OPERATIONS FOR THE YEAR

1961

Digest of Principal Federal Reserve Policy Actions, 1961

Period	Action	Purpose of action
January	Limited net sales of U.S. Government securities from Federal Reserve portfolio to about $500 million. Member bank borrowing at Reserve Banks averaged only $50 million.	To encourage bank credit and monetary expansion by absorbing only part of seasonal inflow of reserve funds not otherwise offset by a large gold outflow.
February-August	Bought substantial amounts of U.S. Government securities with maturities over 1 year, following February 20 announcement that System open market operations would include securities outside the short-term area. These purchases were partly offset by net sales of short-term securities. Total System holdings of Governments increased about $700 million. Member bank borrowings averaged $75 million.	To encourage bank credit and monetary expansion while avoiding direct downward pressure on short-term interest rates, thereby moderating pressures on the U.S. balance of payments from outflow of short-term capital attracted by higher interest rates abroad.
September-December	Bought or sold at different times varying amounts of U.S. Government securities, including securities with longer maturities. Total System holdings of Government securities increased about $1.6 billion. Member bank borrowings at Reserve Banks remained generally low.	To continue to encourage bank credit and monetary expansion while allowing for changing reserve needs due to seasonal and other factors, including a large gold outflow, and while continuing to give consideration to the balance of payments problem.
December	Raised, effective Jan. 1, 1962, maximum interest rates payable by member banks on any savings deposit from 3 to 3½ per cent, and to 4 per cent on those left in the bank for 1 year or more; also raised maximum rates on time deposits with a maturity of 6 months to 1 year from 3 to 3½ per cent, and to 4 per cent on those deposits with a maturity of a year or longer.	To enable banks to compete more effectively for savings and other time deposits, including foreign time deposits, thus moderating pressures on the U.S. balance of payments, and, over the long run, to offer additional incentive for the accumulation of savings required for financing future economic growth.

Although available reports suggested that the U. S. balance of trade was showing some improvement, the over-all balance of payments continued to pose a serious problem for the international strength of the dollar.

Taking all of these factors into consideration, it was the consensus of the Committee that in view of the state of the domestic economy the System should seek to maintain approximately the same amount of ease in the market as it had since the preceding meeting, at the same time paying close attention to developments in the international area. There was a minority view favoring greater ease in order to do what was possible to reverse the trend of the economy in this country. There were, on the other hand, some who believed that the System should "mop up" more of the ease that had prevailed, it being argued that the System had injected sufficient credit into the market and should concern itself more at this point with endeavoring to assure a short-term interest rate level conducive to checking the outflow of funds and possibly reversing it.

January 24, 1961

Authority to effect transactions in System Account.

The Federal Open Market Committee directed the Federal Reserve Bank of New York to continue to conduct open market operations with a view toward encouragement of monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments.

> Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Bryan, Fulton, King, Leedy, Mills, Robertson, Shepardson, and Szymczak. *Votes against this action: none.*

The decline in economic activity was continuing, with no discernible signs of a bottom having been reached. There was evidence of a continued rise in seasonally adjusted unemployment figures, and declines in employment and in industrial production were rather general. A further weakening in personal income and retail sales, along with a sharp drop in housing

starts during December, had also contributed to the decline. However, some encouraging developments were beginning to appear in the economic picture, including a continued large export surplus, signs of greater availability of mortgage money, though this had not yet led to noticeably lower interest charges or to expansion in residential construction, and slight signs of pick-up in steel production and orders.

There was ample evidence of continuing money market ease. However, after taking into account the usual seasonal patterns, bank credit developments during the first part of January were somewhat mixed. Bank loan-deposit ratios, while still relatively high by historic standards, had declined somewhat. Also, while there had been only a modest gain in the money supply proper during the second half of 1960, total nonbank liquid assets had risen at a rate almost equal to the average for the last 10 years.

A delicate situation existed in international financial markets, stemming mainly from the continued U. S. balance of payments deficit, and this created something of a dilemma for monetary policy. The problem was one of providing sufficient reserves to the banking system to encourage growth of the domestic economy, which was operating at a relatively low level, while endeavoring to prevent short-term rates from declining to levels that might aggravate the already sizable payments deficit of the United States. The consensus as to policy for the period immediately ahead was that there should be no change in the existing degree of monetary ease and that in operating the Open Market Account the Management should continue to give close attention to the level of short-term rates in view of the current international financial situation. However, at least one member of the Committee (Mr. Robertson) favored a moderately greater degree of ease, in view of the level of domestic economic activity.

February 7, 1961

1. Authority to effect transactions in System Account.

The Committee's directive to the Federal Reserve Bank of New York, calling for the encouragement of monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments, was continued without change.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Fulton, King, Leedy, Mills, Robertson, Shepardson, Szymczak, and Irons. Votes against this action: none.

There appeared to have been little or no improvement in the levels of output, employment, and trade since the preceding meeting. Although steel mill operations were up slightly from the depressed December levels, automobile assemblies had slipped further, and it seemed likely that the industrial production index would show a further decline of 1 point for January. Long-term unemployment continued to increase, and there was no significant change in the seasonally adjusted rate of total unemployment. Lagging automobile sales and department store sales, reflecting in part severe weather conditions in many areas, had pulled down total retail trade. While there were some signs of a leveling off or bottoming out in a few economic sectors, none of them seemed poised for a rapid upward surge. Nevertheless, there appeared to be a continued optimistic sentiment in business and financial markets.

Total loans and investments of banks appeared to have declined less than seasonally in January, largely a reflection of banks continuing to add to their holdings of U. S. Government securities. The bulk of these additions were in shorter-term issues, mainly Treasury bills, and this growth, together with other factors, had improved the liquidity of the banking system. The seasonally adjusted money supply increased substantially in the latter part of January after dipping somewhat in the first half, and preliminary data indicated that by the beginning of February the money supply was above the year-earlier level. Demand deposits, which ordinarily fall in January, fell less than usual for the month, and time deposits continued to show sizable gains. Member bank reserve positions continued relatively easy on average during January, although they showed wide week-to-

week fluctuations. In general, indications were that the reserves supplied in recent months had permitted or perhaps encouraged monetary expansion relative to the usual seasonal pattern without having depressive effects on the Treasury bill rate.

The gold outflow had declined in January from the December and November 1960 levels. While the rate was still high, it was felt that short-term balance of payments forces were working toward some reduction in the rate of outflow.

The consensus of the Committee favored no change in open market policy, with the Treasury bill rate to be watched closely in conjunction with market needs for reserves. However, within the framework of the directive, which was broad enough to encompass his own position, one member (Mr. Robertson) felt that open market policy should be aimed toward providing a more ample supply of reserves in order to enable the banking system to make what contribution it could toward reversing the downward economic trend. This member suggested that, as the economy began to move upward, interest rates would rise and the current outflow of capital, to the extent that it was based on interest rate differentials, would be reversed.

2. Authority to effect transactions in intermediate- and longer-term securities.

The Federal Open Market Committee authorized the Federal Reserve Bank of New York, between this date and the next meeting of the Committee, within the terms and limitations of the policy directive issued at this meeting, to acquire for the System Open Market Account intermediate- and/or longer-term U. S. Government securities having maturities up to 10 years, or to change the holdings of such securities, in an amount not to exceed $500 million.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Fulton, Leedy, Mills, Shepardson, Szymczak, and Irons. Vote against this action: Mr. Robertson.

The Committee's decision to authorize transactions in intermediate- and longer-term securities reflected a conclusion that under prevailing circumstances such transactions might facilitate the implementation of current monetary policy. This policy called for providing reserves to the banking system to meet the needs of the current business situation and also for avoiding direct downward pressure on short-term interest rates or not resisting any tendency for them to rise, in view of the relationship of short-term rates to the balance of payments problem. While maintenance of the Treasury bill rate could possibly be accomplished by reducing the availability of reserves to the banking system, this would be inconsistent with one of the current objectives of monetary policy. On the other hand, the purchasing of securities in the intermediate- and longer-term areas, as contrasted with the short-term area, offered the possibility of supplying reserves without creating direct pressure on short-term rates. Also, such purchases, by having a moderating influence on long-term interest rates relative to short-term rates, might have the effect of facilitating the flow of funds through the capital and mortgage markets, thereby encouraging the progress of recovery. Accordingly, the combination of domestic and international circumstances confronting the Committee seemed to call for a high degree of flexibility in open market operations. While some members of the Committee were uncertain as to the feasibility of attaining the aforementioned policy objectives through the increased flexibility provided by operating in intermediate- and longer-term securities as well as short-term securities, the Committee believed that a determined effort was warranted. However, it was understood that it would not be the objective to seek a given fixed rate for Government securities of any maturity.

Also, there had been a great deal of controversy in recent years as to the efficacy of the System's policy of operating exclusively in the short-term area of the market. Inherent in this controversy was an apparent feeling that the System was maintaining an unduly rigid attitude in the position it allegedly took toward its own operating procedures and policies. The entire

issue of the proper techniques for conducting System open market operations had become one of conceptual contention. It was felt by the Committee that the conduct of operations outside the short-term sector of the Government securities market might contribute to determining whether the criticisms of the System's policy of confining its open market operations to short-term securities, except in the correction of disorderly markets, was warranted. Likewise, it was envisaged that the procedure might throw some light on the possibility of influencing longer-term rates while maintaining the short-term rate level.

The initial entry into the market under the program agreed upon by the Committee contemplated moderate purchases in the 1- to 5½-year maturity range. Then, after the market had become accustomed to the change in System open market procedures, it was contemplated that the Manager of the System Open Market Account would undertake operations in the 5½- to 10-year maturity range. However, all open market operations under the special authorization were to be consistent with the monetary policy set forth in the Committee's current policy directive. (At this particular time the directive called for encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments.) The amount by which the Account's holdings of intermediate- and longer-term securities could be changed between this date and the next meeting of the Committee, i.e., $500 million, was part of the $1 billion limitation contained in the policy directive.

The Committee's action represented a departure from certain policies set forth in its operating policy statements, which were last reaffirmed on March 22, 1960, not only because it authorized operations in intermediate- and longer-term securities but also because it permitted "offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System portfolio." Within the terms of the policy directive it was possible, for example, that short-term interest rate considerations might suggest the sale of short-term securities at a time when the System did not want to absorb reserves. In such a circumstance, it might be expedient to buy longer-term securities simultaneously with the sale of shorter-term securities or to make offsetting transactions within an interval of a few days.

Mr. Robertson, in dissenting from this action, expressed the opinion: (1) that the established operating procedures and policies of the Committee were, in fact, the product of careful empirical and analytical study; (2) that they had proved in practice to be sound, both in terms of monetary policy and in terms of fair dealing with the market; (3) that in deviating from its established policies the Federal Open Market Committee was in effect asserting, without reason, that it had made a critically incorrect judgment 8 years ago and had pursued incorrect operating practices since; and (4) that critics of present methods of operating in the market were relying on the simplest theories of determination of market interest rates and making allegations on postulates having little if any basis in empirical fact. In his opinion this departure from established operating techniques would not constructively influence market rates, and he gathered from the discussion that not many (if any) at the table were confident of such a result. What he was confident of, however, was that the Committee was running serious risk (a) of undermining domestic and foreign confidence in the System's integrity and judgment and the reliability of the new Administration's assertions of an intent to maintain the stability of the dollar, (b) of impairing the market for Government securities by placing dealers and investors in the position of having to guess which area of the market the Federal Reserve was going to enter and hence affect prices, and (c) of impeding Government financing by making it extremely difficult for the Treasury to determine objectively appropriate market rates for future intermediate- and long-term financing. It was his view that these risks were too large to run.

In addition, Mr. Robertson believed it to be inadvisable for the Committee virtually to abdicate its authority and responsibility by giving practically unlimited authority to the Manager

of the Open Market Account (1) to buy and sell securities in any area of the market up to 10 years, as he saw fit, for the stated purpose of affecting rates as distinguished from providing or withdrawing reserves from the banking system, and (2) to engage in "swap" transactions—i.e., buying securities in one maturity area and selling in another—to effect changes in rates and hence marshal the System's portfolio of Government securities against market forces.

Note: On February 20, 1961, the date of initial operations in the longer-term Government securities market, the Account Manager, at the direction of the Chairman of the Open Market Committee, issued the following press statement:

The System Open Market Account is purchasing in the open market U. S. Government notes and bonds of varying maturities, some of which will exceed 5 years.

Price quotations and offerings are being requested of all primary dealers in U. S. Government securities. Determination as to which offerings to purchase is being governed by the prices that appear most advantageous, i.e., the lowest prices. Net amounts of all transactions for System Account will be shown as usual in the condition statements issued every Thursday.

During recent years transactions for the System Account, except in correction of disorderly markets, have been made in short-term U. S. Government securities. Authority for transactions in securities of longer maturity has been granted by the Open Market Committee of the Federal Reserve System in the light of conditions that have developed in the domestic economy and in the U.S. balance of payments with other countries.

March 7, 1961

1. Authority to effect transactions in System Account.

The Federal Reserve Bank of New York was directed by the Committee to continue to conduct open market operations with a view toward encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments.