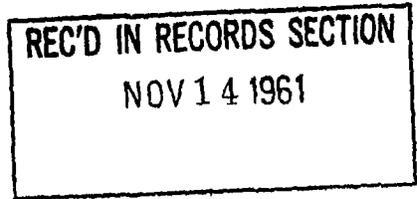




BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON



November 13, 1961

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Young

There is enclosed a copy of a letter from the Federal Reserve Bank of San Francisco commenting on operating policies and directive of the Committee.

Ralph A. Young
Ralph A. Young, Secretary,
Federal Open Market Committee.

Enclosure

FEDERAL RESERVE BANK OF SAN FRANCISCO

SAN FRANCISCO 20, CALIFORNIA

November 10, 1961

REC'D IN RECORDS SECTION

FEB 13 1962

Mr. Ralph A. Young,
Secretary, Federal Open Market Committee,
Board of Governors of the Federal Reserve System,
Washington 25, D. C.

Dear Mr. Young:

This relates to "Discussion of changes in the Committee's procedures" of September 6, 1961. Since our comments are so late, we have had the advantage of reviewing the suggestions from other banks and a number of our suggested changes reflect our agreement with points raised by others. However, for purposes of comparison, there are attached restatements of the Standing Rules, the Continuing Authority Directive, and the Current Economic Directive.

The changes we suggest in the attachments to your letter of September 6, and our comments on them, are as follows:

ATTACHMENT I--Standing Rules

Page 1, line 6

"by helping" is inserted to make clear that the principle governing open market operations is consistent with our national economic objectives rather than apart from them.

line 9

As Mr. Irons has suggested, change "a strong position in the world economy" to "a sound international position of the dollar".

line 12

Insert "primarily" in accordance with Mr. Ellis's recommendation.

lines 14-15

The change would relate operations to the principle already stated.

item 2

Mr. Wayne's suggested wording (except that "as authorized" is eliminated) has been substituted.

Page 2, item 3, second sentence

We would agree with Mr. Hayes that "such action as it deems appropriate" is preferable to "appropriate corrective action".

item 4, line 4

"generally" is inserted in accordance with Mr. Ellis's suggestion.

Page 3, item 5

We would eliminate the entire item from the Standing Rules since it seems to us to be a matter of procedure.

FOR FILES
Ralph A. Young

Mr. Young, Secretary, Federal Open Market Committee.

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Page 3, item 6

Change first sentence to read: "Repurchase agreements in Government securities and prime bankers' acceptances may be entered into with nonbank dealers to supply reserves on a temporary basis."

Eliminate the rest of item 6 since it appears more appropriately in Attachment II.

items 7-8

We have included as written, as we believe they are less appropriate in the standing directive than in the Standing Rules.

We visualize the Standing Rules as being a statement of broad principles, subject to quite infrequent changes, and not incorporating operating procedures. We believe a separate continuing Directive (Attachment II) is desirable since there are certain items which change so infrequently as to be inappropriate to incorporate each meeting into a current directive, but which should not be in the Standing Rules as they are, for the most part, limitations on operations. In this connection, with regard to your Attachment II, we have the following specific changes in the standing directive to suggest.

ATTACHMENT II--Continuing Authority Directive

Page 1, item 1, line 2

Omit "as authorized".

Page 2, first complete sentence

While we do not feel strongly about this, we question whether this sentence is necessary in view of item 3 of the Standing Rules. In any case, it is on a somewhat different level than is the rest of the material in the Continuing Directive.

--at end of item 1

We would add the following sentence: "Holdings of bankers' acceptances are not to exceed \$75 million, or 10 per cent of total bankers' acceptances outstanding." This limitation it seems should be in this directive along with other dollar limitations prescribed.

While we suggest that item 5 of the Standing Rules should more appropriately be incorporated in the Continuing Directive, we have some question even here unless "concurrently" is further defined, since we are in fact in the position of altering the maturity composition of the System's portfolio on occasion, not for its own sake, but in connection with efforts to prevent short-term rates from declining.

Turning to the current directive (ATTACHMENT III), we would strongly prefer some combination of alternatives "C" and "D". For example, to the first

FEDERAL RESERVE BANK OF SAN FRANCISCO

Mr. Young, Secretary, Federal Open Market Committee.

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sentence of "C" we would add a sentence as shown in our Attachment III relating to the comparative degree of ease or tightness, and would then go on to specify what particular quantitative variables appear to fit. These variables would not, of course, necessarily remain the same from one meeting to the next. Despite their limitations, however, free reserves have been more generally mentioned as a quantitative policy guide than have any other one measure.

Similarly, in view of the concern over international flows of funds, the 91-day bill rate has received much attention in recent months.

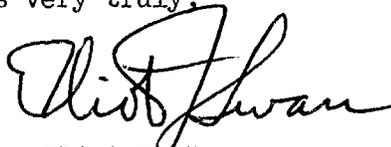
There are, of course, other important quantitative variables, such as the Federal funds rate, the rate of growth of the money supply, required and nonborrowed reserves, and the level of member bank borrowings. However, we would prefer to avoid trying to specify too many quantitative guides, especially in view of our imperfect knowledge of how they are related.

Nevertheless, we believe it would ordinarily be desirable to specify at least two quantities in the directive so as to give explicit recognition to reference points which are to some degree now available to the Manager in the consensus.

Finally, turning to the question of public understanding of Federal Open Market Committee determinations, we do not believe this can be accomplished through publication on a quarterly basis of the policy record including a more detailed directive, and such publication would in all probability encourage more frequent Congressional inquiry.

We still believe, as we indicated earlier, that what is needed is a separate publication of System policy positions and accomplishments (and failures). This should involve a more explicit review of both policy decisions and of the changes in the economy which occurred either in response to, or in spite of, such decisions than could or should be provided in the formal policy record of the Federal Open Market Committee. This would be a considered statement of what the System is trying to do, how it tried to do it, and what seems to have been accomplished. In other words, we need some economic analysis of policy on a fairly current basis, done within the System, and presented regularly to the public. We would recommend that a quarterly presentation in the Federal Reserve Bulletin be prepared along these lines but we believe it should not be an official statement of the Committee itself. Perhaps, to insure that such a statement is authoritative but something less than official, it might be entrusted to the Economist and Associate Economists of the Committee. To test the practicability of this suggestion, the Committee could direct this group to prepare such a study covering the second quarter of 1961.

Yours very truly,



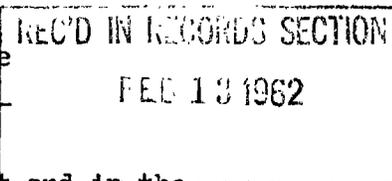
Eliot J. Swan,
Member, Federal Open Market Committee.

November 9, 1961

CONFIDENTIAL (FR)

ATTACHMENT SF I

Standing Rules Governing Open Market Practice
of the Federal Open Market Committee



As provided in section 12A of the Federal Reserve Act ~~and in the~~
Regulations of the Federal Open Market Committee, open market operations of
the Federal Reserve Banks are conducted "with a view to accommodating commerce
and business and with regard to their bearing upon the general credit situation
of the country." To implement this governing principle by helping to achieve
and maintain a high level of economic activity and employment, sustainable
growth, stability of the price level, and a sound international position of
the dollar, the Committee adopts the following standing rules regarding open
market practice, subject to change by the Committee at any time:

1. Open market operations are conducted primarily to supply
or absorb bank reserves consistent with the credit and monetary
needs of the United States, in light of the above principle.

2. Open market operations may be conducted in United States
Government securities of any maturity and in prime bankers'
acceptances. Market conditions and practices, however, will
usually require that the bulk of the operations be confined to
short-term securities.

3. Open market operations are not for the purpose of fixing
or pegging the price of any issue of Government securities. If
conditions in the market for Government securities should become
disorderly, the Committee will take such action as it deems
appropriate.

4. During Treasury financings, open market operations are
conducted in such manner as to change as little as possible the
conditions prevailing in the money markets. Consequently, open

market operations generally are not conducted in (a) maturing issues, (b) when-issued securities, or (c) comparable issues available in the market.

5. Repurchase arrangements may be entered into with nonbank dealers to supply reserves on a temporary basis.

6. The Federal Reserve Bank of New York is selected as the Federal Reserve Bank to execute transactions in the open market pursuant to directions issued by the Committee from time to time.

7. The Committee will meet at least once a month, but other meetings may be held at the call of the Chairman.

November 9, 1961

CONFIDENTIAL (FR)

ATTACHMENT SF II

Federal Open Market Committee's Continuing Authority
Directive to the Federal Reserve Bank of New York

REC'D IN RECORDS SECTION
FEB 13 1962

(To be adopted at the first meeting in March every year)

During periods between meetings of the Committee, the Federal Open Market Committee, with a view to implementing its current economic policy directive, instructs the Federal Reserve Bank of New York:

- (1) To make such purchases, sales, or exchanges of Government securities and prime bankers' acceptances (including replacing Government securities that mature, or allowing such securities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary to carry out the Committee's current policy directive. The authority of the Bank to increase or decrease the aggregate amount of Government securities (including forward commitments) held in the System Account, other than such special short-term certificates of indebtedness as may be purchased for the temporary accommodation of the Treasury under the provisions of (2) below, is limited to \$1 billion during any period between meetings of the Committee, except as otherwise authorized. Holdings of bankers' acceptances are not to exceed \$75 million or 10 percent of total bankers' acceptances outstanding.

- (2) To purchase directly from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate \$500 million, except as otherwise authorized.
- (3) To supply reserves to the money market on a temporary basis, when consistent with the current policy directive, by purchasing for the account of the Federal Reserve Bank of New York from nonbank dealers Government securities having a remaining maturity of 15 months or less or prime bankers' acceptances, under resale agreements maturing in up to 15 calendar days. The rate on such agreements will normally be the discount rate of the Federal Reserve Bank of New York, but in no event shall it be a rate below (1) this discount rate, or (2) the average issuing rate on the most recent issue of three-month Treasury bills, whichever is the lower.

November 9, 1961

CONFIDENTIAL (FR)

ATTACHMENT SF III

Current Economic Directive

Alternative Suggestions as to Formulation

In view of the fact that there is still substantial underutilization of resources, despite the healthy upward movement of the economy, the Committee directs that open market operations be undertaken to encourage bank credit expansion. Over the next three weeks, operations should be designed to maintain a degree of ease about the same as that prevailing since the last meeting. This implies a range of \$500 to \$550 million of free reserves and a money market condition producing a 91-day bill rate of between 2.25 and 2.50 percent.

11-71-61

■B

Note: The essence of the proposals below is with respect to form rather than specific substance.

REC'D IN RECORDS SECTION

FEB 13 1962

Proposed Standing Rules

1. Open market operations are conducted in United States Government securities and prime bankers' acceptances^{nces}. They include (a) outright transactions for cash, regular and forward delivery and (b) repurchase arrangements with nonbank dealers. Ordinarily the bulk of operations involves outright transactions in short-term Government securities.

2. Open market operations are conducted for the purpose of helping to achieve and maintain a high level of economic activity and employment, sustainable growth, stability of the price level, and a sound international position of the dollar, and for other purposes consistent with section 12A of the Federal Reserve Act.

3. Open market operations are not conducted for the purpose of fixing or pegging the price of any issue of United States Government securities. If conditions in the market for Government securities should become disorderly the Committee will take such action as it deems appropriate.

4. During Treasury financings open market operations are conducted in such a manner as to change as little as possible prevailing market conditions. Generally, open market operations, except those involving repurchase arrangements, are not conducted in (a) maturing issues, (b) when-issued securities, and (c) outstanding issues comparable to those involved in the financing.

5. All outright open market transactions are made at prevailing market prices. Repurchase arrangements are made at rates authorized by the Committee from time to time.

- 2 -

6. Open market operations are conducted on behalf of the Committee by the Federal Reserve Bank of New York, under the terms of directives issued by the Committee from time to time. Outright transactions in United States Government securities are made for the Federal Reserve System Open Market Account. Outright transactions in bankers acceptances and all repurchase arrangements are made for the account of the Federal Reserve Bank of New York. Purchases of Special Certificates of Indebtedness (discussed below) are made for the account of the Federal Reserve Bank of New York, with participations to one or more Federal Reserve Banks authorized when they appear desirable.

7. In addition to transactions for the purposes described in (2) above, open market transactions are made by the Federal Reserve Bank of New York on behalf of United States Treasury Investment Accounts and on behalf of foreign central banks. ^{§18.} Transactions in Government securities not made on the open market are confined to a) purchases from the Treasury of newly issued Treasury bills, b) purchases from the Treasury of special Certificates of Indebtedness under the provisions of Public Law _____ as amended, c) exchanges of matured United States Government securities with the Treasury under terms and conditions publicly announced in exchange offerings, and d) transactions with the accounts of foreign central banks.

- 3 -

Proposed Continuing Authority Directive

During periods between meetings of the Committee, the Federal Open Market Committee instructs the Federal Reserve Bank of New York to engage in open market operations and other transactions in United States Government securities and prime bankers' acceptances that are consistent with the Committee's Standing Rules and the Committee's Current Policy Directive, subject to the following limitations:

1. The ~~aggregate~~ amount of securities held in the System Account (including forward commitments, but excluding special Certificates of Indebtedness as may be purchased for the temporary accommodation of the Treasury under Public Law _____ as amended) shall not be increased or decreased by more than \$1 billion;

2. The aggregate amount of bankers' acceptances held at any one time shall not exceed \$75 million, nor 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York;

3. The aggregate amount of special Certificates of Indebtedness purchased under Public Law _____ as amended shall not exceed \$500 million.

4. Repurchase arrangements shall mature in 15 days or less, and any Government securities bought under repurchase arrangements shall have a remaining maturity of 15 (24?) months or less. The rate on such arrangements will ordinarily be the discount rate of the Federal Reserve Bank of New York, but in no event shall it be a rate below (a) this discount rate, or (2) the average issuing rate on the most recent issue of three-month Treasury bills, whichever is the lower.