William McChesney Martin, Jr., Papers

Box 26/Folder 2

July 1960 -

Series V, Subseries D

Hearings, July 1960-June 1961 (cont.)

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Miss Muehlhaus

July 21, 1961

The Honorable Wright Patman,
Chairman,
Joint Economic Committee,
Congress of the United States,
Washington 25, D. C.

Dear Mr. Chairman:

The Federal Open Market Committee has carefully considered the requests for copies of its minutes and certain other materials for the year 1960, made of Mr. Rouse and me during the Joint Economic Committee Hearings of June 1 and 2, 1961. You and I have discussed these requests by telephone, and they were referred to in your letter of June 14, 1961. It is the view of the Federal Open Market Committee that it should act as follows on your Committee's requests:

1. A memorandum outlining the considerations taken into account on the last occasion when the Committee instituted a policy of restraint is enclosed. In this connection, I should point out, as do the answers I have already submitted to the list of questions you raised at the Hearings, that the determination of monetary policy is a continuous process, and thus it is difficult to pinpoint the moment of a change. To repeat a comment I made on this subject more than five years ago,

> Monetary policy...must be tailored to fit the shape of a future visible only in dim outline. Occasions are rare when the meaning of developing events is so clear that those who bear the responsibility can say, "As of today, our policy should be changed from ease to restraint"--or from restraint to ease, as the case may be. What is true of a change in policy is also true of a shift in policy emphasis: it is rarely decided upon in a single day. More typically, as is evidenced by open market operations, the outline of a shift in policy emphasis, like the outline of the future, emerges gradually from a succession of market developments and administrative decisions. It is a poor subject for the photo-flash camera to capture as a clearly defined still life, or for a news story to etch in spectacular outline. Getting a perfect garment for the future may require several fittings.

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Therefore, factors considered and analyses undertaken by the Committee during the meeting immediately preceding and during other meetings farther back in time might not seem strikingly different from those at the meeting that may be selected as marking the beginning of a policy of restraint.

2. Copies of the wires referred to in your letter as being from the Board to Mr. Hayes and Mr. Rouse are enclosed. These wires, prepared at the offices of the Board of Governors and sent to all Reserve Bank Presidents as well as Board members, contain a detailed summary of the 11:00 a.m. daily conference call which, you will recall, was fully described by Mr. Rouse in his statement that he read at the hearing on June 1 and submitted for the record. Most of the information contained in each wire is a rundown of developments in the money and securities markets during the first hour of trading that morning. The last part of the wire indicates what the Account proposes to do that day, given the situation as seen at 11:00 a.m.

3. Regarding the notes and interpretative memoranda referred to in your letter:

(a) There is very little in the way of note taking beyond that done by the secretarial staff of the Committee and by a staff member of the New York Bank to record what actually transpires at the meetings. Any notes taken at the meetings by Committee members are usually no more than scribbled abbreviations for the purpose of keeping for the moment a running memory aid of the discussion as it proceeds, and such notes are not customarily retained. The minutes are prepared promptly by the secretarial staff and drafts thereof are usually in the hands of the Committee members and Mr. Rouse, as Manager of the System Open Market Account, within a week to 10 days. The Secretary of the Committee also furnishes Mr. Rouse by the morning of the day following a meeting a brief unedited synopsis of each member's policy recommendations and of the consensus of the Committee. The notes taken by the staff member of the New York Reserve Bank are recast in the form of an internal memorandum for working purposes, and this memorandum and the synopsis are available to Mr. Rouse as an aide memoir pending receipt of the preliminary draft of minutes and the final minutes. Since these are merely staff working papers and their content is fully covered in the minutes, it seems needless to furnish them separately.

(b) As to interpretative memoranda, these may be taken to include the economic summary prepared by the Board's staff, projections of reserve figures and factors, and the

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detailed record of open market operations undertaken since the previous meeting, all of which are furnished to Committee members prior to the meeting. Copies of these are enclosed, although their substance is covered to some extent in the minutes.

Also, there is enclosed the pertinent opening paragraph of a memorandum dated August 2, 1960, and sent by Mr. Rouse to the members of the Federal Open Market Committee and the Federal Reserve Bank Presidents not then serving on the Committee, expressing his understanding of the consensus of the Committee at its July 6, 1960 meeting relative to possible open market operations in short-term securities in addition to Treasury bills. This is included because it might be considered to be interpretative of a Committee discussion.

4. Verbatim records of the meetings of the Federal Open Market Committee are not made. The minutes, however, present a faithful and comprehensive record of the Committee's proceedings. The Open Market Committee is prepared to make these minutes of its meetings held in 1960 available to the Joint Economic Committee on the understanding that they will be treated as confidential. It should be noted, however, that some members of the Committee feel that normally it might be more appropriate for a request for the minutes to come from the Banking and Currency Committee of the House or of the Senate. With regard to the request that the minutes be handled as confidential, the Committee believes that it would not be in the public interest to have such minutes for 1960 made public in whole or in part at this time, and its reasons for this position are as follows:

(a) There are references in the minutes to information obtained on a confidential basis. This information, and its sources, should be kept confidential, certainly for a substantial time period.

(b) From time to time there are references in the minutes to long-term prospects and possible monetary policy action should these eventuate. To guard against a reduction in the effectiveness of Committee actions or potential actions, there should be some considerable elapse of time before the minutes of any given meeting are given public access.

(c) The minutes contain a full account of the proceedings at the meetings, including the participants' statements. However, a person will frequently compress his remarks by omitting matters of background perspective that are fully understood by others present at the meeting, but which might lead to misinterpretation on the

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part of one merely reading the minutes without the advantage of having been present.

(d) The minutes contain statements by individual members which are often made to raise points of discussion or to probe the possibilities of different courses of action in implementing System policies. These statements do not necessarily represent a firm view of the individual member and, in fact, the member may raise a particular matter merely to obtain discussion and clarification of the issues involved. Needless to say, individual views expressed early in a meeting may well be modified by subsequent discussion during the meeting. Therefore, the participants should feel free to raise questions and express their views--either tentative or firm--with the knowledge that their comments will not be released within a short period of time after the meetings. This freedom of discussion and the exchanges of viewpoints prior to the final decision are essential features of the process of decision-making.

It is largely for the foregoing reasons that the Open Market Committee believes that the public interest would not be served if the minutes for 1960 were to become public documents at this time, either in whole or in part. The Committee is particularly of this view, in the light of the comprehensive Record of Policy Actions made available some months ago in the 47th Annual Report of the Board of Governors of the Federal Reserve System.

The official records of the Federal Open Market Committee are maintained in the Board's offices, where the original copy of the minutes for 1960 is available for examination by representatives of your Committee. However, with the thought that it would be more convenient, the duplicate original signed copy of the 1960 minutes is being delivered herewith to the custody of your Committee for its perusal. It will be appreciated if this duplicate original is returned to us for safekeeping as soon as it has served its purpose.

Sincerely yours,

Wm. McC. Martin, Jr.

Enclosures

Staff:me

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To Members of the Federal Open Market Committee and Federal Reserve Bank Presidents Not Presently Serving On the Committee

August 2, 1960

From Robert G. Rouse

Subject: Operations in Short-term Securities Other than Treasury bills

At the July 6 meeting of the Open Market Committee there was considerable discussion of the possibility that open market operations might, under certain circumstances, be conducted in other short-term securities in addition to Treasury bills. It was the understanding of the Account Manager that the consensus of the Committee was that it was the Manager's responsibility to initiate operations in short-term securities other than bills if the general state of the market and the reserve situation suggest that such a course of action is desirable. If such an occasion should arise, the Account Management expects to state its intention at the time of the 11 o'clock call. This will allow members of the Committee an opportunity to register an objection, if they have one.

* *

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COPY

July 14, 1961.

To: Bill Johnson

From: J. W. Shay

Enclosed are two copies of a letter of this date to Mr. Patman. The original has been delivered to Mr. Patman today.

(on note paper)

To: Mr. Johnson, Executive Director,
Joint Economic Committee.

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COPY

July 14, 1961.

The Honorable Wright Patman,
Chairman,
Joint Economic Committee,
Congress of the United States,
Washington, D. C.

Dear Mr. Chairman:

In response to your letter of July 13, 1961, the requests presented in your letter of June 14 to Chairman Martin were considered fully by the Federal Open Market Committee at its meeting on July 11. The materials that the Committee authorized be furnished are now being gathered. The complete response to the June 14 letter, as well as the replies to the two remaining questions presented during the hearings of the Joint Economic Committee on June 1-2, should be in your hands not later than the end of this coming week.

Sincerely yours,

(Signed) C. C. Balderston

C. Canby Balderston,
Vice Chairman.

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Congress of the United States

Joint Economic Committee

July 13, 1961.

The Honorable
William McC. Martin
Chairman, Board of Governors
The Federal Reserve System
Washington 25, D.C.

Dear Mr. Martin:

Yesterday I received your letter of July 11 attaching answers to certain of the questions which were asked of you at the conclusion of your testimony before the Committee on June 2.

It is most disturbing to note that your letter is silent concerning the three requests set out in my letter to you of June 14, a letter which was written at your insistence, repeating requests made to you orally during your testimony on June 2.

Among the three requests repeated in my letter of June 14 is that for the minutes of meetings of the Open Market Committee during the year 1960. It was my understanding of your telephone call to me following my letter of June 14, that you would inform the Committee what decision had been reached concerning the request for these minutes immediately following the July 11 meeting of the Open Market Committee. It is my further understanding that promptly after the July 11 meeting you would supply such other information as had been requested, in order that the record of the June 1 and 2 hearings could be closed and printed.

It now appears that although several successive delays have been granted, the Committee is now confronted with a new, unscheduled delay of unknown duration. Any hint you can provide as to when our outstanding requests will be honored, if ever, will be appreciated.

Sincerely,

Wright Patman
Chairman

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July 21, 1961

The Honorable Wright Patman,
Chairman,
Joint Economic Committee,
Congress of the United States,
Washington 25, D. C.

Dear Mr. Chairman:

With my letter of July 11, 1961, I transmitted the replies to 12 of the 13 questions that you presented to me at the Hearing before the Joint Economic Committee on June 1 and 2 this year.

There is now enclosed the reply to the thirteenth question that you asked at that time, as well as a joint reply by Mr. Hayes, President of the Federal Reserve Bank of New York, and myself, to the question that you asked of each of us regarding the question of effects of changes in reserve requirements and open market operations.

Sincerely yours,

(SIGNED) WM. McC. MARTIN, Jr.

Wm. McC. Martin, Jr.

Enclosure

MS:me

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13. For each of these actions (1) what combination of economic indicators prompted the action, (2) what evidence is there of market response, and (3) did the response match, fall short of, or surpass expectations or aims?

In answering these questions, it needs to be recognized that formulation and execution of monetary policy is a continuous process that requires constant review of economic and financial developments and adaptation to such developments. Consequently changes in the directive do not necessarily represent a sharp change in the direction of policy. Moreover, within a given directive there is room for variation in policy execution in response to changes in credit conditions and market behavior. Such variations are generally reflected in the consensus of the Committee that is reached at each meeting as to the course of policy execution in the period ahead.

Broad economic objectives of the Committee are by their nature expressed in general terms. The processes and procedures through which policy is executed in the short-run are necessarily more specific and concrete. Monetary policy exerts its influence most immediately and directly upon the volume of commercial bank reserves, the amount of which can be promptly and accurately measured and can be largely controlled by Federal Reserve actions on its own initiative. This control is not complete because member banks may on their initiative borrow reserves or use reserves to reduce borrowings at the Reserve Banks. Through the medium of bank reserves, policy actions influence the amount of credit that commercial banks extend and thereby influence the money supply. These secondary effects are in turn strongly affected by the attitudes and actions of banks in adjusting to changes in reserves and in their willingness to borrow from

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the Reserve Banks. They are also affected by the decisions of borrowers with respect to the use of bank credit.

Ultimate consequences of changes in the money supply upon general economic activity, employment, and prices are determined by eventual holders of funds, who are motivated by many factors other than cash holdings. More especially, the bulk of current financial transactions reflects the use of existing funds rather than changes in the total volume of cash balances and these uses are likewise influenced by many factors of a nonmonetary nature. All of this means that, although monetary policy actions have marginal effects of significance, assessment of these consequences is generally difficult and sometimes impossible. It must be to some extent a matter of judgment.

Answers to the first section of this question, namely what indicators prompted the Committee's actions, are fully, though briefly, set forth in the record of policy actions for the meeting at which the new directive was adopted. This record gives the essential points of the Committee's discussions that formed the basis for the decision as to the directive and that served as a guide for subsequent operations by the Account Management. Material presented in this answer represents principally a summary of the points set forth in the policy record.

Answers to the second section of the question, relating to market response to System actions, require an analysis of events that followed each change in the wording of the directive, as well as an appraisal of actions by the Account Management in carrying out the directive, in light of more specific instructions growing out of the Committee's deliberations and also in the light of changing money market conditions.

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Answers to this question can also generally be found in the records of deliberations at subsequent meetings of the Committee. These records contain brief analytic descriptions of economic developments that accompanied or followed preceding System actions. They often specifically point out relationships between these events and System aims and actions.

The third section of the question, which would relate response to expectations, requires a hindsight analysis and is most difficult, if not impossible, to answer in any concrete terms. As noted above, monetary policy execution is a continuous process, one which usually involves probing or testing actions. If in the course of events these actions do not seem to be obtaining the desired results or seem to be unnecessary or in the wrong direction they are modified or discontinued. A process of constant adaptation to current developments is a part of the task of conducting current System operations to promote the desired aims.

More importantly, it is not to be expected that Federal Reserve actions alone can assure the attainment of ideal economic conditions. The effects of other factors are difficult to appraise. It is possible to determine quickly the amount of bank reserves that were available, and information as to changes in the volume of bank credit and the money supply can be had fairly readily and accurately. It is a matter of judgment, however, rather than of precise measurement, to make an assessment of the secondary effects of these direct and measurable consequences of monetary policy, relative to the effects of various other factors, in determining the course of interest rates, prices, employment, and general economic activity. To make such a judgment it is essential to consider and appraise not only monetary policies but also other significant influences, including private actions, as well as various Government policies.

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Five versions of clause (b) in the Open Market Committee's policy directives, including the one in force at the beginning of the year, governed Federal Reserve operations in the course of 1960. The three parts of this question are discussed separately with respect to each of these directives.

I.--January 12, 1960

Directive, clause (b): "to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities."

(1) What combination of economic indicators prompted the action?

This particular directive had been first adopted on May 26, 1959, and had been continued since that time. The principal factors providing the basis for this directive, as set forth in the policy record for May 26, 1959, included: expanding productive activity; a growing belief that creeping inflation was inevitable and actions to hedge against its results; highest level of construction contracts on record; rising industrial prices; robust expansion in consumer instalment credit; other unseasonably large private credit demands, accompanying heavy Treasury borrowing; further significant expansion in the money supply and in the turnover of deposits; and increased borrowing by member banks at the Reserve Banks to sustain bank credit expansion.

As these or other similar forces continued to be evident with some variations in degrees of intensity or in composition during the rest of 1959, the policy directive remained unchanged. The steel strike in this period was an especially potent and disturbing influence both in limiting resources and in creating uncertainties as to future commitments.

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At times there were variations in the conduct of policy with respect to the degree of restraint or ease, but the general aim continued to be one of restraint on inflationary bank credit expansion in the face of vigorous current and prospective private credit demands, along with heavy borrowing by Federal, State, and local governments and an increased flow of individual savings. Expansion in total credit in 1959 was larger than in any previous year, with bank loans contributing to the growth. Because of restraint on bank credit expansion, banks obtained funds to increase their loans by selling securities to nonbank investors. The bulk of the growth in credit was supplied directly or indirectly by nonbank lenders making use of available funds.

At the beginning of 1960, principal economic indicators were moving up, and settlement of the prolonged steel strike was believed to remove a major element of uncertainty. Increases in interest rates and severe pressures on the money market in December were attributed to inventory restoration and to widespread market expectations of a forthcoming boom, as well as to usual seasonal factors that generally involve very large cash needs at that time. Declines in interest rates in January were due in part to seasonal influences but also to some slackening in credit demands and to anticipations of a Federal budgetary surplus. The prevailing view as to economic prospects, however, was one of great optimism, with expectations of continued expansion in activity and pressure on resources. Although there was some sentiment in the Committee at the time for a slight lessening of the degree of restraint, the consensus was that, in view of the prevailing attitude of extreme optimism, relaxation of restraints would be likely to stimulate excessive reliance on credit financing, particularly from banks.

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(2) What evidence is there of market response?

Federal Reserve policies under this directive, which was in force from late May 1959 until March 1, 1960, were directed toward restraint on bank credit and monetary expansion in view of vigorous credit demands and limited resources. Response is indicated by the moderate rate of total bank credit expansion in the period. The record increase in total credit--bank and nonbank--and the rise in interest rates that occurred in 1959 are indicators of the vigor of credit demands in that period. The total of funds advanced in all credit and equity instruments exceeded $60 billion in 1959, compared with an average for previous years of around $40 billion. The Federal debt increased $11 billion and other debt increased by a record $50 billion. Growth in bank credit was a moderate $5.5 billion and the money supply, which had expanded abruptly during 1958 and the early months of 1959, declined somewhat in the latter part of 1959 and in early 1960. The turnover of money increased throughout the period and other liquid asset holdings of the nonbank public continued to increase at a rapid pace.

Vigor of over-all credit demands, together with restraint on bank credit expansion, resulted in rising interest rates, which in turn helped to bring forth savings to meet credit needs without undue monetary expansion. The limited increase in total bank credit and the money supply and the drawing in of such large amounts of savings to meet the large credit demands that developed in 1959 reflected the influence of Federal Reserve policy. The resulting rise in interest rates served to draw savings into use and made unnecessary the creation of additional money to finance the high level of economic activity that prevailed.

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In the early weeks of 1960, increased supplies of steel and other products became available, while the Federal budget developed a surplus. Savers continued to invest in securities; they bid securities from banks to such an extent that interest rates declined, while the money supply decreased. Although private credit demands were well sustained and total liquid assets of the public continued to increase, total loans and investments of banks and the money supply showed a greater than seasonal decline. It began to become evident that there could be some relaxation from the degree of restraint on bank credit that had been necessary in 1959. At successive meetings of the Committee in January and February, sentiment for relaxation of credit restraint increased.

(3) Did the response match, fall short of, or surpass expectations or aims?

In 1959, the aim of monetary policy was to limit the creation of additional money at a time when credit demands were exceptionally strong, while liquidity in general was large and the resources available for further expansion in output were limited. In view of the steel stoppage, which placed a limit on available productive resources, a higher level of economic activity could hardly have been attained in 1959. Under the circumstances, unrestrained expansion in credit-financed demands would no doubt have exerted strong inflationary price pressures with little or no sustainable contribution to increased employment. Had bank reserves been more readily available, it is reasonable to conclude that credit and monetary expansion would have been much greater with more unstabilizing consequences.

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It cannot be inferred that credit restraints in 1959 were the sole or even the principal factor moderating inflationary developments or that the downturn that developed later was due to shortage of credit. It might be concluded, rather, that monetary policy by helping to prevent excesses made a positive contribution to avoiadance of a more severe and prolonged recession. A key influence in stopping further expansion in economic activity was the failure of consumer buying to keep pace with potential or even actual output of consumer goods or with consumer income. This was in large part due to factors other than credit availability, such as resistance to prices, uneven distribution of increase in income, and shifts in consumer tastes. It is possible that by early 1960 the higher interest rates and resulting stimulus to saving may have been a factor in limiting consumer buying.

The lag in consumer buying, relative to output, was reflected in business inventory accumulation, which was the most outstanding element of instability in 1959 and 1960. Disturbances in the pattern of normal business expansion that were forced by the prolonged steel stoppage, with a tentative resumption of operations while negotiations were in process, also exerted an unstabilizing influence with respect to inventories and to business plans and commitments. For example, early in 1960 it began to be apparent, to the surprise of many, that inventories of steel and steel products had been built up to a much higher level than would be needed with resumption of productive operations. The continued large Federal budget deficit during the period of expanding private activity in 1959 and the quick shift to a moderate surplus was also an element of instability.

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Early in 1960 the slackening of credit demands and a general market re-evaluation of the business outlook, with continued strong nonbank demand for securities, obtained an immediate market response in a decline of interest rates. The money supply also declined somewhat more than seasonally, reflecting in large part continued purchases of Government securities from banks by nonbank investors. Thus total nonbank holdings of liquid assets continued to increase, even though the money supply declined. This was reflected in a greater than seasonal decline in required reserves. The reserves released were not fully offset by Federal Reserve actions, and there was a moderate decline in net borrowed reserves. This brought about an easing of the credit situation before there was any indication of an economic downturn.

In summary, it may be said that Federal Reserve policy under this directive served in 1959 to prevent excessive bank credit expansion at a time of relatively full utilization of resources that were limited by the steel strike and when there were strong credit demands with widespread expectations of inflationary tendencies. Early in 1960, for a variety of reasons, the underlying forces changed--contrary to prevailing expectations at the time--and it gradually became increasingly evident that credit restraints could be relaxed.

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II.--March 1, 1960

Directive, clause (b): "to fostering sustainable growth in economic activity while guarding against excessive credit expansion."

(1) What combination of economic indicators prompted the action?

Although reports of economic developments at this time indicated continuance of underlying economic strength, it appeared that some earlier exuberant expectations were not being fully realized and that there was less need for restraint to guard against credit excesses. Resumption of inventory expansion seemed to be an indication of a slackening of demand relative to output rather than a factor of strength. Although the increase in bank loans was substantial, particularly to finance the increase in business inventories and also to finance consumer purchases on credit, the increase was exceeded by bank sales of Government securities to nonbank investors, and total bank credit and the money supply were decreasing. Accordingly the Committee concluded it would be appropriate to supply reserves more readily and to follow a policy of moderately less restraint.

In view of these developments, the Committee decided to eliminate from the directive the reference to inflationary credit expansion. Retention of safeguards against permitting excessive credit expansion were deemed essential, however, as the basic situation seemed to be strong, particularly in other countries, and there was some uncertainty as to how much the slowdown in trade might be due to the temporary influence of severe weather conditions.

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(2) <u>What evidence is there of market response?</u>

During the two months or more following adoption of this directive, economic activity was generally maintained at a high level with little or no further growth. With more favorable weather conditions in April, there were some evidences of a resumption of upward tendencies, but with no pronounced upturn or shift in tone. In the financial area, although private credit demands were moderately strong, bank holdings of Government securities and the seasonally adjusted money supply continued to decline. Growth in nonbank holdings of liquid assets other than money tended to level off, reflecting in part a reduction in the volume of short-term Government securities outstanding. Turnover of demand deposits continued at a higher level than during the preceding year.

Federal Reserve operations added to the availability of reserves, supplementing amounts released through the more than seasonal decline in required reserves. Member bank borrowings were reduced from over $800 million in February to about $500 million in May, and net borrowed reserves declined to a small amount. Interest rates showed marked declines, in reflection of both reduced credit demands and increased availability of bank reserves.

(3) <u>Did the response match, fall short of, or surpass expectations or aims?</u>

Federal Reserve operations under this directive increasingly moved in the direction of supplying more reserves to banks but the response was not altogether satisfactory. One of the most striking developments of this period (March to May 1960) was the sharp decline in interest rates, along with the maintenance of a fairly high level

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of economic activity and moderately strong private credit demands. This course of events may be attributed in part to a shift in the Federal Government's fiscal position from large net borrowings to net retirement of debt. It may also have reflected the effect of the previously higher interest rates in drawing savings from cash-type assets into income-yielding liquidity instruments and other investments and perhaps stimulating additional saving. This decline in interest rates was enhanced by the Federal Reserve policies and actions during this period.

Neither borrowers nor lenders, however, responded with alacrity to increased availability of credit. The Federal Government was reducing debt and private credit demands did not increase sufficiently to offset the decline. Interest rates declined, but showed tendencies to fluctuate widely in reflection of actual or anticipated variations in supply or demand conditions in credit markets. Although availability of bank reserves increased, many banks still found it necessary to borrow reserves either from the Reserve Banks or from each other.

In this period, although consumer incomes continued to increase and consumer credit extensions were at a high level, consumer spending failed to keep pace with actual or potential output. It was becoming apparent that the net accumulation of business inventories had been excessive. This period was characterized by a lag in spending relative to current income as well as to resource availability. It was apparent that there were important factors other than the availability of bank credit that shared responsibility for this lag and for the shifts in attitude, which together provided the basis for subsequent downward adjustments in output and employment.

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III.--May 24, 1960

Directive, clause (b): "to fostering sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion."

(1) What combination of economic indicators prompted the action?

Information available at the time of this meeting, partly preliminary, suggested that gains in economic activity that seemed to be developing in April may not have been realized and in any case were not general. Although System operations under the former directive had increasingly moved in the direction of supplying more reserves to banks, total credit demands were moderate and the seasonally adjusted money supply was tending to decline. In addition, there had been a pronounced relaxation of the inflationary psychology prevalent earlier.

Under the circumstances, it was evident that the directive needed to be revised to call for a further supplying of reserves with a view to fostering moderate expansion in the bank credit and encouraging an increase in the money supply that might be needed for sustainable growth.

(2) What evidence is there of market response?

Under this directive, operations were more vigorously conducted toward increasing the availability of bank reserves, enabling banks to reduce their borrowing, and bringing about declines in interest rates. Federal Reserve holdings of securities increased by over $1 billion from May to August; Federal Reserve Bank discount rates were lowered from 4 per cent to 3-1/2 per cent in June and to 3 per cent in August, and action was announced in early August to release reserves

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by authorizing member banks to count additional amounts of vault cash as reserves and reducing reserve requirements at central reserve city banks to become effective late in August and on September 1. Also in late July margin requirements on stock market credit were reduced moderately from 90 per cent to 70 per cent, following a decline in stock prices, relatively low trading activity, and a reduction in stock market credit.

Member bank borrowings at the Reserve Banks decreased from an average of $500 million in May to less than $300 million in August, with net free reserves averaging about $250 million in the latter month. Interest rates declined sharply in all sectors of the market. Both loans and investments at banks increased, and the seasonally adjusted money supply turned up in June and continued to increase in July. Long-term borrowing by corporations and by State and local governments increased.

Outside the financial area, economic activity, although continuing into the summer at a high level, was evidencing no upward momentum. Uncertainty regarding future trends was becoming more widespread and there was a gradual increase in unutilized plant capacity and manpower. Reports from business corporations indicated a decline in profits. While consumer demand was a sustaining influence, it was not providing a stimulus for economic expansion. Final sales of goods were running short of output and inventories continued to expand.

(3) Did the response match, fall short of, or surpass expectations or aims?

In reviewing developments from May to August, it would appear that in the financial area the response to shifts in Federal

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Reserve policies and operations was in the desired direction. Credit and monetary contraction ceased and there was in fact some monetary expansion. Interest rates declined. Although economic activity in general seemed to be continuing at a relatively high level with no evidence of a downturn, the lack of growth and the underutilization of resources were matters for concern. Failure of the economy to expand could appropriately be attributed to factors which caused spending and investment not to increase, while production was maintained and incomes continued to expand. As a result, inventories were accumulating, although they did not appear to be excessive relative to sales, and unemployment of labor and idle resources were tending to increase. Under the circumstances, although the lag in spending could not be attributed to shortage of credit, it appeared that availability of credit could be made easier with little risk of excess and with possibly some stimulating effect.

IV.--August 16, 1960

Directive, clause (b): "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment."

(1) What combination of economic indicators prompted the action?

This new directive was designed to give greater emphasis to the need for operations that would help stimulate expansion, by removing the limiting words "moderate" and "needed" from the directive previously in force. The reason for its adoption was principally the failure of the economy to expand in preceding months, with a resulting widening of the gap of unutilized resources and unemployment. Action had just been taken to release additional reserves and to lower discount rates.

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It was the Committee's intention that these measures be strengthened by operations that would further expand the availability of reserves and give greater encouragement to bank credit and monetary expansion. It was also thought possible that reserves supplied through the release of vault cash might not be fully utilized promptly and that, therefore, somewhat larger amounts of excess reserves would be needed to obtain the desired stimulus.

(2) What evidence is there of market response?

Following adoption of this directive, rather large amounts of reserves were made available through increases in Federal Reserve holdings of Government securities, as well as through the previously announced action with respect to vault cash and reserve requirements. The reserves thus made available were adequate to cover heavy seasonal needs and to offset an accelerated gold outflow as well as to make possible greater than seasonal additions to the volume of reserves. Member bank borrowings declined, with some weekly fluctuations, to a negligible figure by the end of the year, and net free reserves rose to an average of nearly $500 million in October and to over $600 million in November.

Although banks responded rather slowly to the increased availability of bank reserves and there was no credit growth in August, bank loans subsequently increased more than seasonally, especially business loans, and banks also added to their investments. The money supply, though leveling off in August, increased moderately in September and October, but declined in November. The principal counterpart to the expansion in total loans and investments of banks

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was an exceptionally rapid growth in time deposits. Nonbank holdings of Government securities declined somewhat. Long-term financing by corporations and by State and local governments continued moderately heavy.

Notwithstanding the easing in the banks' reserve positions interest rates showed little or no further decline after mid-August. This leveling out of interest rates may be attributed in part to the continuation of private demands for credit at fairly good levels and the reduced liquidity position of corporations. Interest rates were also maintained to some extent by large-scale advance refunding operations by the U. S. Treasury, when institutional investors made significant readjustments in their holdings of Government securities. A technical market factor was a reduction in the inventories of securities dealers, following a buid-up during the summer.

One new factor of particular importance in maintaining interest rates, in the face of declining economic activity and an easy money policy, was the flow of funds abroad that accelerated in September and resulted in exceptionally heavy drains on the country's gold stock during the remainder of the year. Although the drain on bank reserves exerted by these gold movements was offset by Federal Reserve actions, the shifting of funds incidental to the movement had a disturbing effect on credit markets. This flow of funds abroad was also an influence toward holding down the expansion in the domestic money supply. Since this outward flow of funds was due in part to the lower level of interest rates in this country than in foreign money markets, as well as to confidence factors, more vigorous action on the part of the Federal Reserve to supply additional reserves would have incurred the risk of accelerating the gold outflow and thus would not have served the intended purpose.

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In September and October, moderate recession in economic activity became increasingly evident. Although aggregate final takings of goods and services were maintained or increased somewhat, inventory contraction and some curtailment in purchases of durable goods resulted in a moderate decline in total production. The accompanying increase in unemployment was more marked. There were also decreases in residential construction and curtailment in business plans for plant and equipment expenditures.

(3) Did the response match, fall short of, or surpass expectations or aims?

In this period, as in the preceding one, monetary policy was directed toward encouraging credit expansion in order to foster growth in the economy. The adoption of more vigorous measures was inhibited and the effectiveness of the action taken was diminished by the outflow of funds to foreign markets. This movement, which caused a drain on United States gold reserves, was induced by interest rate differentials and uncertainties as to future developments. Interest rates stopped declining, though they remained much lower than in previous months; further measures to lower rates, it was believed, would accelerate the gold outflow. Moderate expansion of bank credit and the money supply did occur, although the rate of expansion was sometimes disappointing. Nevertheless, largely for reasons other than credit availability, recession in economic activity developed.

V.--October 25, 1960

Directive, clause (b): "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration international developments."

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(1) What combination of economic indicators prompted the action?

The only change in the directive from that previously in force was the addition of the clause with respect to international developments. Deepening of economic recession in the United States called for continuation of action to maintain ready availability of bank reserves. Yet the persistent outflow of capital abroad, induced in part by interest rate differentials and confidence factors, precluded policies that would vigorously push down interest rates, particularly short-term rates, or that would raise fears abroad that inflationary policies were being adopted during a period of serious balance of payments stress. It was to indicate recognition of this situation that the new clause was added to the directive.

Specific action to implement this directive taken by the Account Management was to extend open market operations to the purchase of short-term securities other than Treasury bills. There seemed to be a particularly strong demand for Treasury bills in the market but a more abundant supply of other short-term issues available for purchase. In view of the imminent very large seasonal needs for bank reserves to cover currency demands and credit expansion, as well as the gold outflow, the System Account faced the need for making very heavy purchases of securities in the weeks ahead. It was desirable that these be acquired with a minimum of downward pressure on the short-term Treasury bill rate, which occupies a key position with reference to international money flows.

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Sugsequently, action was taken to release a large amount of reserves by authorizing banks to count all of their vault cash holdings in meeting reserve requirements and at the same time making some partly offsetting adjustments in reserve requirements. This action, which was taken to put into effect legislation adopted in 1959, provided another means of supplying reserves while minimizing Federal Reserve purchases of Government securities and consequent effects on interest rates.

(2) What evidence is there of market response?

In order to carry out this directive, while meeting seasonal currency demands and increases in required reserves as well as a continued heavy outflow of gold, heavy purchases of securities were made by the Federal Reserve in late October and during November, including Treasury bills and other short-term issues, as well as some repurchase contracts. In December, reserves were plentifully supplied by the release of vault cash, and System sales of securities exceeded purchases. In this period member bank borrowings declined to a relatively negligible amount and free reserves exceeded $600 million.

Interest rates did not show the increase usual in the December period of heavy liquidity demands, and in fact some rates declined--in the medium- and long-term sectors, as well as in the short-term area. Bank credit increased more than usual, chiefly through acquisition of Government securities, and the seasonally adjusted money supply, after declining in November, turned up again in December. Total liquid asset holdings of the nonbank public, after showing little change during the first half of 1960, increased somewhat

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in subsequent months. Bank liquidity had also improved, with increases in holdings of short-term Government securities and in time deposits, while bank borrowings were reduced, but the banks' loan-deposit ratios were higher than in earlier years.

The moderate downdrift in economic activity continued during the last quarter of 1960, with unemployment rising to a seasonally adjusted rate of 6.8 per cent of the labor force. Prices of sensitive materials showed further declines. Consumer buying decreased somewhat, after seasonal adjustment, but most of the curtailment in output continued to be accounted for by inventory curtailment, particularly in the manufacturing sector. Trade inventories rose throughout the year. Personal incomes were well maintained, in part through transfer payments, but corporate profits were estimated to be relatively low. Government expenditures were tending to increase, while revenues remained at a high level, continuing to provide a seasonally adjusted cash surplus in the Federal budget.

(3) Did the response match, fall short of, or surpass expectations or aims?

Again it might be said that, under the circumstances prevailing with respect to nonmonetary forces and the international situation, the response in the financial area to Federal Reserve policies and operations in the late months of 1960 was about as much as could have been expected. Borrowing demands were light because of inventory curtailment and uncertainty as to future prospects. Yet total bank credit increased more than seasonally, as banks added to their holdings of Government securities and their loans to dealers in such securities. Demand deposits increased no more than seasonally, but time deposits showed a rapid rate of expansion.

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While a greater increase in the money supply would have been desirable, any more vigorous measures to supply banks with reserves so as to encourage them to expand investments and thereby increase the money supply might have resulted in a further gold outflow, either because of low interest rates or for confidence reasons. In that event, such measures would not have served the intended purpose of promoting monetary expansion and stimulating domestic activity. Interest rates remained steady, and there was some expansion in over-all liquidity. These achievements no doubt had some effect in moderating the intensity of the recession, which soon after came to an end.

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Joint Economic Committee

Reserve Requirement Changes and Open Market Operations: Quickness of Effects

When the Federal Reserve System is considering the choice of one instrument or another as the means for increasing the availability of bank reserves and fostering monetary expansion, one of the considerations is the speed and thoroughness with which the influence will be transmitted throughout the banking system, although this consideration may or may not be of prime importance in any given situation. It has been pointed out that a reduction in reserve requirements can have a widespread effect very quickly and that this may at times be a reason why such a reduction, rather than open market purchases, would be the preferable form of action.

The purpose of the present note is to discuss the quickness of effects of these kinds of Federal Reserve actions. The discussion is restricted to a comparison of alternative means of _increasing_ the availability of reserves, especially since Federal Reserve actions to reduce reserves are practically always directed toward absorbing redundant reserves being made available by market developments and never toward forcing a net contraction in credit.

It is impossible to trace exactly the effects of any particular System action affecting the supply of reserves, because the secondary and subsequent consequences of the flow of reserves and money throughout the financial structure are very much greater than the immediate effect of the initial action upon the banks

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first affected. Most Federal Reserve open market operations, furthermore, are in response to short-run market developments or pressures and are thus directed toward offsetting fluctuations in reserve availability that would otherwise have occurred due to market forces.

A change in their reserve requirements affects with unquestioned speed the reserve position of all member banks to which it is applicable. An open market operation also tends to affect the reserve positions of a great many banks rather quickly. It reaches most country banks indirectly, however, and there is room for difference of opinion as to the speed and pervasiveness with which the effects are transmitted to them.

Open market operations ordinarily affect, in the first instance, the reserve balances of so-called "money market banks" in New York and other financial centers. Through them the effects are quickly transmitted to the money market in general. This is true because these larger banks, which deal actively in money market instruments such as Federal funds, Treasury bills and other highly liquid paper, undertake to keep their available funds fully invested by buying such instruments whenever other credit demands do not completely use up their available funds. Many banks, especially country banks, do not attempt to keep all their funds continuously invested in this manner. Hence, changes in their reserve position may have less immediate impact on the market, although such banks, in adjusting their reserve positions, may affect the money market, particularly

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through shifts in their balances with city correspondents. The flow of reserves to or away from country banks is determined largely by the activities of their customers -- depositors and borrowers -- rather than by money market developments.

When a reduction occurs in reserve requirements for all classes of member banks, every member bank immediately has more funds available for lending or investing (or for reducing its indebtedness to the Federal Reserve System). In the case of money market banks, this tends to produce an extremely rapid response in terms of expansion of their loans and investments -- as would also be the case if the Federal Reserve action took, instead, the form of open market purchases.

On occasions when it is especially important that the effects of a Federal Reserve action influence the reserve positions of country banks as rapidly and as pervasively as possible, this would be a factor that would favor a change in the reserve requirements. On the other hand, country banks do not put newly released reserves to use as rapidly as money market banks, so that if a quick money market response is needed, open market operations would be preferred. Of course, the matter of relative promptness is only one consideration, and not necessarily the decisive one, dictating the choice of instrument.

There are three main ways in which a country bank may respond to a reduction in reserve requirements. The bank may, of course, immediately make new loans (if there is a demand for loans)

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or acquire additional investments. Second, it may increase its balances with its city correspondent banks. The city bank receiving such deposits would typically be one that is active in the money market; it could therefore more readily put the additional funds to work until such time as the country bank might withdraw them in order to increase its own loans or investments. In either of the foregoing cases the total loans and investments of the banking system, and hence normally the money supply, are increased. Third, the country bank may simply leave its funds temporarily in the form of excess reserves at its Federal Reserve Bank or it may use the funds to repay indebtedness at the Reserve Bank. If it does either of these, there is no immediate increase in bank credit or money.

Analysis of member bank data indicates that on each occasion when the reserve requirements of country banks have been reduced, there has been a substantial temporary increase in their excess reserves. In the case of some banks, there were periods ranging up to several months during which the reduction in requirements was reflected mainly in excess reserves rather than in actual expansion of loans or investments.

Nevertheless, in this case as in the cases where the funds were immediately invested (either directly or through correspondent banks), the banker had a feeling of greater "ease" because he was in a position where he could more readily expand his loans or investments whenever any attractive opportunity might present itself.

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Furthermore, despite the temporary increases in the total excess reserves of country banks at times when reserve requirements have been decreased, more than half of the reserves released to these banks have usually gone into loans or investments or correspondent balances within a month from the date of each release.

If the additional lending power is made available instead by means of Federal Reserve open market purchases, rather than by reducing reserve requirements, the additional reserves tend to flow initially into money market banks, because these banks buy and sell money market instruments themselves, carry the accounts of other large investors whose transactions are important in this market, and also handle the financing of the securities dealers (to whom the Federal Reserve makes payment in the first instance). The money market banks tend to put their added reserves to use quite promptly, either by reducing their borrowings or by expanding their loans and investments from the level that would have prevailed in the absence of such Federal Reserve operations.

Such speedy response is facilitated by the normal channels of operations of the financial system, which tend to funnel net excesses of supplies or demands for funds from all parts of the country into the money centers. Added reserves that are received by money market banks are thus redistributed to other banks. This may occur directly, if the money market banks repay borrowings or buy securities from other banks or increase loans to them. Otherwise, the reserve redistribution will be indirect, as the money market banks

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increase loans to, or purchase securities from, nonbank customers, with a resultant prompt increase in the deposit liabilities of those banks and hence in the total money supply.

Such an increase in the money supply is normally accompanied or followed by an outflow of funds from money market banks to the rest of the banking system. These payment flows increase bank balances of many persons and firms engaged in economic activities everywhere, and hence affect all the banks in which they keep their accounts. The effect on individual banks, especially country banks, is indirect and not susceptible to accurate measurement, nor does it necessarily affect every bank. When a country bank's position becomes "easier" due to its having an inflow of deposits, the banker himself is normally unaware that this condition may be related to the Federal Reserve operation.

Because of this, the banker would not know whether or not he could expect the added funds to stay in his bank, and hence he might be hesitant about investing them in anything that could not be liquidated quickly if necessary. If his condition of relative ease had arisen instead from an announced reduction in reserve requirements, he might expect that this would not be reversed soon by an increase in the requirements and might therefore expand his loans with more confidence.

The foregoing discussion relates mainly to System moves to supply reserves for the purpose of exerting direct influence on bank credit in the direction sought by System policy. In other

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words, if the System's over-all policy should call for monetary expansion this would presumably be accomplished under varying circumstances by open market purchases or, alternatively, by lowering reserve requirements with the results described, or by coordinated use of both. Consideration must be given, however, to the System's objective of smoothing out the peaks and valleys in reserve availability so as to keep bank reserve positions and the tone of the money market consistent with the System's broader objectives of ease or restraint. This may at times require short-run moves in a direction contrary to longer run System objectives. For example, when market factors temporarily supply excessive amounts of reserves, the System may sell securities to mop up some of the excess, even though basic policy calls for monetary ease.

This continuing objective is carried out through day-to-day open market operations. Such operations provide the requisite flexibility in direction and timing, in addition to which it is possible, through judicious use of repurchase agreements, as well as outright purchases and sales, to direct operations toward particular areas of the money market as conditions may require.

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Miss Muehlhaus

JUL 11 1961

The Honorable Wright Patman,
Chairman,
Joint Economic Committee,
Congress of the United States,
Washington, D. C.

Dear Mr. Chairman:

When I appeared before the Joint Economic Committee on June 2, 1961 in connection with the hearings on the Board's 47th Annual Report, you presented a list of 13 questions to which you asked that answers be submitted later on.

The answers to 12 of these questions have been completed and are enclosed herewith. A response to the 13th question is in the course of preparation and it is expected that it will be sent to you in the near future.

At those hearings, there was also presented, to Mr. Hayes as well as to me, a request for a statement on the quickness of effects of reserve requirement changes and open market operations. That statement also is in preparation and should be ready for transmission to you within the next several days.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

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1. In framing its directive to the Manager of the Account and reporting to the Congress, what, if any, difference is there in the terms "credit expansion" as in the revision of May 24, and "monetary expansion" as in the revision of August 16? Are we to understand these terms to apply to an expansion of total loans and investments, of demand deposits, of demand deposits plus time deposits, or currency in circulation plus demand deposits?

No difference was meant by the two terms "bank credit expansion" as used in the May 24 revision of the Federal Open Market Committee's policy directive, and "monetary expansion" as used in the August 16 revision.

The term "bank credit expansion" refers more precisely to an increase in the total loans and investments of commercial banks, that is, in their principal assets. "Monetary expansion" relates to an increase in the nation's money supply, usually defined to include demand deposits of banks and currency in circulation. Technically speaking, the terms differ in that "bank credit expansion" approaches the problem from the bank asset side, while "monetary expansion" approaches it from the bank liability side. Since demand deposits are at the same time the major component of the money supply and the main, although not the sole, offsetting liability to bank assets, bank credit expansion and monetary expansion are essentially two sides of the same coin.

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2. What is the reason for including the limitation in various directives restricting changes in security holdings of the System to $1 billion or later to $1.5 billion: Have these limitations at any time during the past year restricted or controlled the actions taken?

The dollar limitation contained in the directive issued to the Federal Reserve Bank of New York by the Federal Open Market Committee is intended simply to set a ceiling on the total change that may be made between meetings in System Account holdings of Government securities without further consideration by the Committee. The limitation did not preclude operations in pursuit of the Committee's policy objectives at any time during the past year.

The usual limitation of $1 billion is high enough to cover any normal variations in the System portfolio required over the usual three-week period between meetings. On occasion estimates may indicate that an exceptionally large absorption, or release, of reserves from the operation of other factors may require a larger change in the System portfolio in order to meet Committee objectives. On such occasions, the Manager of the System Open Market Account or any member of the Committee may request that the limit be changed. This was the case at the meeting of October 25, 1960. At that time estimates of factors affecting member bank reserves over the succeeding weeks indicated that changes in float and currency circulation alone would absorb about $3/4 billion bank reserves before November 10 and suggested that implementation of the Committee's directive to conduct open market operations with a view "to encouraging monetary expansion"

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might require a change in the System's security holdings of more than $1 billion. Accordingly, the Manager of the System Open Market Account requested that the limit be raised to $1.5 billion and the Committee granted this request. As it turned out, the change in System outright holdings of securities over the period amounted to $991 million. During the period, reserves supplied temporarily by the acquisition of Government securities under repurchase agreement amounted, however, to as much as $640.5 million, although the net change in securities held under repurchase agreement for the whole period was only $80 million. It might be noted that the limitation does not apply to such repurchase agreements, which are made for the account of the Federal Reserve Bank of New York and which provide reserves on a temporary basis, nor does it apply to purchases and sales of bankers' acceptances.

The limitation stipulated in the directive did not inhibit the Manager in the conduct of operations during 1960, and it remains a useful device, since it ensures that a decision of the full Committee, which can be obtained on short notice through a telephone meeting if necessary, must be made if unexpected developments in the money or securities market suddenly require open market operations in excess of the limitation.

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3. What significance did you expect the Manager or the Congress, in later reading of directives, to attach to the phrase in the August 16 meeting "to take into account even more than usual the tone of the market rather than statistical measures"? What statistical measures were referred to and why were they to be downgraded in importance?

In providing that operations for the System Account during the period immediately following the August 16 meeting should "take into account, even more than usual, the tone of the market rather than statistical measures," the Committee expected the Manager to rely to greater degree than customarily would be the case on his intimate knowledge of current money market conditions, as a basis for his judgment of the degree of ease actually prevailing from day to day and of the transactions to be effected in pursuit of the Committee's objective of encouraging monetary expansion. In line with regular Committee procedure, this particular authorization applied only to the period until the next meeting of the Committee, when the directive would again be reviewed and reconsidered.

In the ordinary course and as part of his job, the Manager of the Account is expected to use his special and expert knowledge of market conditions, along with statistical estimates or projections of available reserves and information regarding the distribution of such reserves, in measuring the prevailing tone of the market. His judgment on this point is, of course, of key importance in combination with statistics in arriving at a determination of the particular transactions needed on any given day in order to attain the Committee's objective. Among the most pertinent statistics he examines are daily projections

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of total reserves, excess reserves, and borrowings, in the aggregate and by class of bank. He also has available figures on current positions and financing needs of Government securities dealers and the flow of securities through the market, as well as market prices and yields on U. S. Government securities, the prevailing rate on Federal funds, and a variety of other money market data.

By his examination of such statistics and by observing current market developments, the Manager of the Account is aided in determining the actions needed to maintain or bring about the objectives indicated by the Committee's directive and policy consensus. However, there is no single statistical measure that states or reflects precisely the degree of ease or tightness prevailing in the market at any given time, or the change in the degree of ease or tightness that would be produced by the injection or withdrawal of a given amount of additional reserves. One of the functions of the Account Manager is to interpret the available statistical data in the light of his expert judgment, and thus to initiate operations that will attain the Committee's objective.

At the August 16 meeting, the Committee felt it desirable to place relatively greater emphasis than usual on the Manager's evaluation of the tone and feel of the market. This was because the customary statistical indicators were likely to provide less precise guidance as to the degree of ease or tightness prevailing in the market during the next few weeks as a result of uncertainty regarding member bank response to the actions taken by the Board of Governors

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of the Federal Reserve System on August 8, 1960. Those actions made additional reserves available through (1) authorizing the counting of vault cash by banks in meeting their reserve requirements effective August 25 and September 1, and (2) reducing reserve requirements for central reserve city banks effective September 1.

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4. Assuming that the System Manager is, as is apparently the case, expected and allowed to translate "shades of opinion" into operational dollar terms, do you feel that this is an adequate explanation to the Congress of the "determination of open market policies and the reasons underlying the action," as required by statute?

The policy actions of the Federal Open Market Committee and the reasons underlying such actions are, it is believed, adequately explained in the Annual Report of the Board of Governors. The directive and the accompanying entry that appears in the Annual Report covering each policy action provide Congress with an explanation of the "determination of open market policies and the reasons underlying the action," as required by statute. This material is supplemented by the general analytical text covering the events of the year as presented on pages 1-33 of the Annual Report for 1960.

Significant shades of opinion regarding policy that emerge in the course of Committee discussions are reflected in the Committee consensus and are recorded in the entries for the policy record, later published in the Annual Report. The bearing that such observations have upon the policy actions taken by the Committee thereby becomes part of the public record.

Additional comment on the use of shades of opinion by the management of the System Open Market Account appears in the answer to Question 5.

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5. In translating these "shades of opinion," is the Manager expected to consider the number of members voting for or against the directive and assign different weights to the opinions of different members, depending upon what seems to him to have been the most persuasive and best articulated reasons?

The Manager of the System Open Market Account is expected and instructed by the Federal Open Market Committee to pursue operations that will attain the objectives specified by the directive issued by the Committee at any given meeting. He is not expected or authorized to "assign different weights to the opinions of different members, depending upon what seems to him to have been the most persuasive and best articulated reasons."

To assist him in carrying out the necessary operations, the Manager has the benefit of the full discussion at the meeting at which a policy decision is reached. The "shades of opinion" expressed by members at a meeting are not necessarily related to the number voting for or against a directive: such shades of opinion exist when a vote is unanimous, as is often the case, and they may relate to a variety of factors such as timing of operations or emphasis upon one or more of a series of statistical indicators.

In fact, the term "shades of opinion," as used in the introduction to the Record of Policy Actions of the Federal Open Market Committee appearing on page 34 of the Board's Annual Report for 1960, applies to all the Committee discussion, particularly those significant portions that are set forth in the subsequent entries appearing on pages 35-74 covering individual policy decisions. The

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purpose of the introductory general comment on this point was to indicate to the Congress and others that the Manager, by attendance at the meetings, is in a position to know immediately the full background of discussion leading to the wording of the directive and to the additional substantive instructions given by the Committee at the meeting, as set forth in the Record of Policy Actions.

Many examples of these shades of opinion are contained in the entries covering individual policy decisions. For example, several shades of opinion are reported at the January 12, 1960, meeting in the paragraph at the top of page 37, and in the second paragraph on that page a minority vote and the reasons given in support thereof are presented. The Management of the Account had the benefit of this full discussion in pursuing the directive calling for "operations with a view to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding opportunities." He was bound by the directive and consensus, however, which was for no change in the degree of restraint that prevailed at the time the meeting convened; and the Manager would not consciously have taken a move to change the situation without further instruction from the Committee.

At the January 26 meeting, the Committee decided to continue substantially the same degree of restraint on credit expansion but, to illustrate again the shades of opinion that existed, several members would have preferred to move slightly in the direction of reducing the degree of pressure on bank reserve positions if a large

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Treasury financing had not been imminent. It was clear that no member then favored increasing the degree of restraint, and one again voted against the directive because he continued to feel that less restraint should be applied.

At the February 9 meeting, the shades of opinion expressed included (a) the unanimous view that any tightening in the degree of restraint should be avoided, (b) the views of several who leaned toward less restraint, and (c) a rather general view that a moderate increase in the money supply would be desirable. However, the majority action, and the wording of the directive issued, was for no change in the existing policy on the grounds that a basic shift in open market policy was not called for at the time.

At the next meeting, March 1, the directive and the accompanying consensus set forth in the policy record were changed by unanimous vote to wording that called clearly for moderately less restraint. Taking the period January 12 to March 1 as a whole, although the wording of the directive did not change, the shades of opinion recorded in the policy record entries for several meetings made clear that any doubts as to the effect of transactions in the System Account should be resolved on the side of no more restraint, rather than on the side of an increase in pressures on reserve positions of banks.

In sum, whether arrived at by a small or large majority or by unanimous vote, the Committee instruction as to policy and operation of the Account is the basic guide that the management of the Account is obligated to follow. The directive represents a general statement

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of Committee policy objectives, which is supplemented by the consensus that emerges from each meeting and forms the basis for the record of the policy decision. Thus, the policy record entry that appears in the Annual Report is a more complete spelling out of the Committee's instructions and reasoning than is the directive taken alone. Within the framework of the directive, however, the Manager of the System Account may be expected to derive assistance in understanding the intent of the Committee in issuing its instruction because of his knowledge of the views expressed in the process of arriving at the Committee's decision.

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6. In purchasing or selling securities, do you ever expect or direct the Account to take an active forceful role by purchasing securities above or below the current price for the purpose of changing the level of interest rates? If this is never done, is not the role of the System reduced to that of a follower rather than a leader?

The Federal Open Market Committee does not direct the Account Management to make purchases above current prices, or to make sales below current prices, in carrying out transactions for the System Account. Transactions for the Account, rather, are made on a "best price" basis, that is, purchases are made at the lowest prices offered, and sales at the highest prices bid at the time the transactions are effected. This procedure is utilized in order to avoid arbitrary discrimination among dealers and disruptive market effects. Nevertheless, it permits the Federal Reserve to assume an active, forceful role in influencing conditions in the money and credit markets when this is deemed desirable. Such influence is exercised primarily through changes in the supply of bank reserves, although interest rate considerations may at times be of importance.

The System is a large participant in the Government securities market and its operations affect the expectations of other participants in that market as well as general expectations regarding money conditions. System transactions in Government securities consequently have an immediate effect on prices and yields, as do the large transactions of any other market participant. The magnitude of this effect, in the case of purchases, depends primarily on the size of the operation relative to the volume of securities available in the market, including

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those in dealers' positions as well as those flowing into the market from customers, at prices that are at, or close to, those currently being quoted. Similarly, the immediate impact of System sales will depend on the strength of bids for securities in the market, including those by dealers for positioning and for filling orders for customers. By operating on a "best price" basis, the System permits the market to adjust continuously to the volume of transactions actually effected. To operate otherwise would tend to weaken the value of the knowledge that a free market, where the individual decisions of buyers and sellers are worked out, can provide.

The immediate focus of System open market operations is to regulate the reserve positions of banks and in this way to make possible a flow of bank credit and money adjusted to the needs of the economy. The bulk of operations are designed to offset undesired short-term variations in other factors affecting bank reserves and to provide for seasonal and other temporary needs for reserves. Open market policy thus helps to dampen the very wide short-term variations in securities prices and yields which would tend to occur in the absence of System actions. From the standpoint of such day-to-day operations, therefore, the question of "leading" or "following" the market does not arise.

Contracyclical monetary policy is carried out simultaneously with operations conducted to provide for seasonal and other short-term reserve needs and in practice the two sets of operations cannot be separated. The extent to which factors making for temporary changes

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in reserves are in fact offset--or, occasionally, reinforced--by System operations depends on the direction in which monetary policy is moving in its economic stabilization function. It is in carrying out its continuing contracyclical function that the Federal Reserve may be said to have an active, leadership influence on money and credit flows and thereby on market interest rates.

Through influence on market expectations, bank credit and monetary policy also have effects on interest rates in addition to, or even prior to, those resulting from changes in bank reserve positions and in market supplies of securities. Expectational responses to System actions, by accelerating market adjustments in prices and yields of securities to cyclical movements in the economy, give monetary policy an additional leverage in its efforts to counter economic instability. At the same time, the risk that the response of market psychology may be excessive requires that the authorities be careful in undertaking actions or operations that might appear to signal an abrupt change in prevailing credit conditions.

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7. Reference is made on several occasions to "relating the supply of money in the market to the needs of commerce and business." What significance has this statement in a policy directive unless related to some equilibrium level of interest rates?

Clause (1)(a) of the directive of the Committee has specifically provided for operations of the System Open Market Account to be undertaken with a view, among other objectives, to relating the supply of funds in the market to the needs of commerce and business. This is one method by which the Committee keeps clearly before its operating officials the responsibilities for accommodating commerce and business as established under Section 12A of the Federal Reserve Act.

This statement in the policy directive relates mainly to the function of the Federal Reserve System in offsetting seasonal, regional and random flows of funds that might suddenly cause undue stringency in bank reserve positions and in the money market. Prior to the establishment of the Federal Reserve System, such flows of funds at times aggravated, or even caused, serious financial and economic disturbances. The statement therefore refers to the more routine functions of the Federal Reserve System involved in preventing temporary distortions in money flows from having a disturbing effect on the economy. The policy instructions of the Committee are contained elsewhere (Clause (1)(b)) in the directive to the New York Bank.

The needs of commerce and business are of course accommodated by a relatively stable reserve base, and the System's marginal operations referred to above must be related to these needs. Widely varying needs

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for funds are generated in the regular course of business activity. Holidays such as the Fourth of July and the Christmas season, for example, produce sharp increases in currency used by the public which, unless offset by Federal Reserve action, would produce strong temporary pressures upon bank reserve positions. Needs for credit accommodation are also associated with such seasonal developments as quarterly tax payments and the harvesting and processing of agricultural commodities. Variations in credit needs of a longer run nature accompany cyclical business expansions and the underlying trend of economic growth.

Some of these types of shifting credit needs are sufficiently repetitive to be projected in advance on the basis of historical patterns. Other needs, less amenable to regular projection, may sometime be forecast or perceived soon after their inception. The Manager of the System Open Market Account has prepared daily estimates of aggregate reserve sources and uses for a number of days ahead which embody adjustments for many of these developments. In his operations, the Manager makes such allowance for these market developments as appears practicable within the degree of general monetary ease or restraint which the Federal Open Market Committee has directed to be maintained. In terms of volume, the open market operations undertaken by the Account to offset or compensate for market factors affecting reserves far overshadow the volume of operations necessary in order to achieve such changes in general reserve availability as are called for by the Committee.

The kinds of demands for funds outlined above interact in varying degrees with the prevailing state of credit availability and interest rates. Some repetitive needs for funds are sufficiently

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insensitive to interest rate changes to produce substantial upward fluctuations in market interest rates in the absence of offsetting reserve provisions. Such a pattern often materialized near the end of each year prior to the establishment of the Federal Reserve System, as the market worked to equilibrate insistent seasonal demands for funds with an inelastic supply. Federal Reserve operations, by providing appropriate adjustments in the credit base, aim to minimize the degree to which the onset of seasonal and other pressures can produce departures from the conditions of general credit availability being sought by over-all monetary policy.

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8. In connection with the indications that the Board considers the growth of time deposits in commercial banks as having expansionary effects, precisely what is the Federal Reserve policy with respect to time deposits during periods of inflationary pressures or during periods when stimulation of general economic activity is desired?

Because of the diverse effects of the savings and liquidity aspects of time deposits in commercial banks on spending and economic activity, an appraisal of the significance of their growth must be based on constant study of the various forces underlying such growth. Over the long run, increases in time deposits in commercial banks as well as in other forms of savings facilitate investment and contribute to economic development. Over the economic cycle Federal Reserve policies tend to encourage bank credit and deposit expansion at times when stimulation of general economic activity is desired, and to restrain them during periods of inflationary pressures. Growth in time rather than demand deposits is preferable during periods of inflationary pressures since they are less liquid, but the form of deposits in which holders wish to keep their funds is mainly a function of the needs and desires of holders rather than the actions of the Federal Reserve. Thus, the amount of demand deposit expansion appropriate for any particular economic situation is affected to some extent by the concurrent rise in time deposits as well as in other forms of liquidity.

Time deposits in commercial banks are at the same time a form of savings and a reservoir of liquidity. They are a highly liquid form of asset and are readily convertible into cash, with no fluctuation in capital value, although some sacrifice of interest is usually involved.

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As a form of both savings and liquidity, time deposits in commercial banks have some influence on the volume and timing of consumption and investment, and hence the course of activity over the economic cycle as well as in the longer run. Current additions to time deposits, in turn, also reflect the economy's decisions to spend or save. For example, when spending tends to diminish, consumers or businesses may add part of the additional unspent income to time deposits. Thus, movements of these deposits are, like many other facets of economic activity, both cause and effect of such activity.

Time deposits differ from many other forms of savings in that they are subject to more public regulation. Since most time deposits in commercial banks are liabilities of member banks of the Federal Reserve System, they are subject to legal reserve requirements and maximum interest rate regulation. Reserve requirements against time deposits limit the degree of multiple bank credit expansion that can be built up on the basis of a given amount of reserves in case some of the bank funds made available are held in the form of time deposits. Federal Reserve policy takes account of both the savings and liquidity aspects of time deposit growth at commercial banks.

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9. Does the size of the Open Market Committee have anything to do with the vague and very general wording of the policy directives?

The size of the Federal Open Market Committee has little, if anything, to do with the wording of the policy directive, once the Committee has decided by unanimous vote or otherwise what its policy goal is to be.

Clause (b) of the first paragraph of the directive specifies the economic goal or objective of current policy. This is a statement that must guide operations over a period of several weeks and, appropriately, is in rather broad terms, irrespective of the size of the Committee. A distinction should be made between this policy goal statement and the detailed operating procedures or techniques to be followed in attaining such goal. This distinction--not the size of the Committee--is the determining factor in the type of wording used in the Committee's directive, when the policy decision has been arrived at.

As an example, the wording of the directive adopted at the last meeting in 1960 provided that open market operations be with a view "to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments." This language set out in concise and definite terms the policy objectives of the Committee at that particular phase of the business cycle. It was not designed to provide detailed instructions for day-to-day operations of the System Account in pursuit of the goal, but it was designed to make

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clear the Committee's purpose that should guide the Manager of the System Account in executing transactions. Such a guide would be necessary, regardless of the size of the Committee. Also, regardless of the size of the Committee, more detailed guidance may be given within the framework of the directive. In practice, such guidance to the Manager is contained in the consensus that is reached at each meeting of the Committee, as set forth in the Record of Policy Actions.

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10. Among several references noting that the money supply had failed to respond as anticipated, the September 13 summary refers to the change as "disappointing." Is it your contention that the Federal Reserve is sometimes frustrated in its attempt to increase the money supply and, if so, how and why?

The particular variable over which the System exercises major influence is the total of commercial bank reserves. Through its influence over reserves the System is able to have a significant effect on total loans and investments and total deposits of banks, and through these variables some effect on the volume of spending, investment and saving by the public in general.

It is never possible to predict exactly the expansion of bank credit and money which will result from a given addition to total reserves. Depending on the strength of public and private credit demands, the liquidity of banks and their willingness to borrow, and many other factors, the supply of reserves made available by open market operations or reserve requirement adjustments may be used in many ways. Banks may accumulate excess reserves, repay indebtedness, or utilize the reserves as a basis for deposit expansion. Typically, some part is likely to be employed in each of these ways. At times the bulk, if not all, of the reserves provided may flow into one use rather than another.

The quoted observation in the policy record for September 13 related to the fact that, despite the substantially larger than seasonal increase in total reserves since May, the increase in the seasonally adjusted money supply through August had been very moderate. In this

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sense the Federal Reserve may be "frustrated" at times in endeavoring to foster an increase in the money supply, because the monetary expansion resulting from its actions to supply reserves is less than was anticipated on the basis of previous experience. Responses of less than anticipated dimensions can be, and are, taken into account in subsequent policy formulation, as is demonstrated by the policy record cited in this question.

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11. Does the Board take into account or attempt to estimate the member banks demand for free reserves or liquidity as well as the supply of these reserves? Is the rate of interest on Federal funds an important indicator influencing the direction and extent of open market operations?

The Federal Reserve does take into account the member banks demand for reserves in its actions to affect the supply of reserves through monetary policy. It does this both in the short run to allow banks to meet the seasonal and other temporary demands for financing on the part of the Government and private borrowers, and in the longer run to contribute most effectively to sustainable economic growth.

The significance of the level of free reserves or net borrowed reserves in the banking system as a factor tending to encourage or restrain bank credit and monetary expansion depends, among other factors, on the demand for reserves. The demand for reserves, in turn, depends on the vigor of actual current demands for bank credit, the existing level of over-all bank liquidity, shifts between types of deposits, and the variation among the different classes and groups of banks with respect to these factors.

If the Federal Reserve responds fully to demands for reserves by supplying them through open market operations, member bank borrowings are unlikely to rise and excess reserves unlikely to fall. If, however, the Federal Reserve judges that some restraint on bank credit and monetary expansion is appropriate, it will supply through open market operations a smaller volume of reserves than is being demanded. As a result, there is likely to be an increase in the level of member bank

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borrowings or a reduction in excess reserves. In these circumstances, banks tend to moderate their credit expansion.

At other times, when economic activity is slack and when credit demands are light or banks prefer to increase their liquidity rather than to expand their loans, it is appropriate for the Federal Reserve to supply banks with more excess reserves in order to encourage bank credit and monetary expansion. Thus, in providing an appropriate supply of reserves, the Federal Reserve takes into account (1) the demand for them, (2) the desirability of encouraging or restraining bank credit and monetary expansion, (3) the desire of banks for liquidity, and (4) the willingness of banks to borrow in order to obtain reserves.

The rate of interest on Federal funds is an important indicator, but only one of several important indicators, that is used to evaluate current conditions in the money markets and thus to determine whether action by the Manager of the Federal Open Market Account is necessary or desirable in order to carry out the current directive of the Federal Open Market Committee. The Federal funds rate indicates mainly supply and demand relationships in one segment of the money market, namely, the market for one-day bank funds. It reflects particularly short-term variations in the reserve needs of individual banks and their efforts to balance their reserve positions or to put excess reserves to use within the period they are permitted to use for reserve computation purposes.

The spread between the Federal funds rate and the discount rate reflects rather accurately day-to-day changes in the distribution of

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reserves among larger banks, and hence their short-run lending and investing ability. This is especially true in periods of credit ease. The general state of credit markets even in the short run, however, is more accurately reflected in money market rates other than the Federal funds rate, particularly those for Treasury bills.

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12. For each of the five or six changes in key words of the policy directives do you feel that a reporting of this change in language meets the requirements of a full disclosure to the Congress of the actions taken and the reasons underlying the action?

Changes in the language of the general policy directive of the Committee were made at the Committee's meetings of March 1, May 24, August 16, and October 25, 1960. The underlying reasons for these changes are set forth at pages 43, 55, 63, and 70, respectively, of the Board's 1960 Annual Report. In addition, the policy record entry for each of the Committee's meetings contains a summary of the consensus of the Committee reached at that meeting, spelling out Committee objectives in more detail than in the broad policy directive. The Record of Policy Actions is supplemented by an integrated analysis appearing on pages 1-33 of the Report with respect to general economic and financial developments during the year.

It is believed, therefore, that the Board's 1960 Annual Report clearly meets the requirements of the law for full disclosure to the Congress of the policy actions of the Committee and of the reasons underlying such actions.

July 7, 1961

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WM. SUMMERS JOHNSON,
EXECUTIVE DIRECTOR

Congress of the United States

JOINT ECONOMIC COMMITTEE

(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)

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JACOB K. JAVITS, N.Y.

JOHN W. LEHMAN, DEPUTY EXECUTIVE
DIRECTOR AND CLERK

June 14, 1961

The Honorable
William Mc C. Martin
Chairman, Board of Governors
The Federal Reserve System
Washington, D. C.

Dear Mr. Martin:

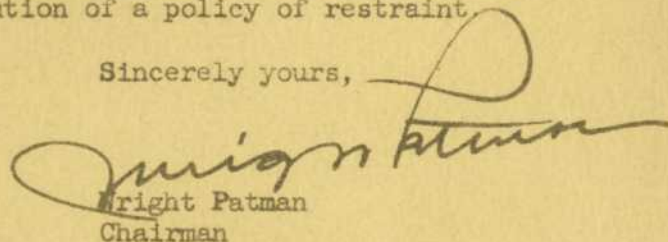
The purpose of this letter is to make clear the requests made of you and Mr. Rouse, concerning records of considerations and decisions of the Federal Open Market Committee, during the hearings of this Committee on June 1 and 2. The records requested are of three types, as follows:

First, the verbatim record of the Open Market Committee meetings, or the full minutes of the Committee meetings, or both, if both verbatim records and minutes were made during the year 1960. (This request was made at page 242 of the transcript of June 2.)

Second, all interpretative memoranda and all notes taken or prepared by Mr. Rouse or any other members of the staff of the Board or the New York Reserve Bank concerning the deliberations and policy decisions of the Open Market Committee, plus copies of the wires from the Board to Mr. Hays and Mr. Rouse (referred to by Mr. Rouse at page 57 of the transcript for June 1). This request is also made for records pertaining to the calendar year 1960. (This request was made of Mr. Rouse at various pages of the transcript for June 1, especially at page 77.)

Third, a description of all the factors which the Open Market Committee took into account on the last occasion when it instituted a policy of restraint, and a description of the factors which it took into account on the occasion of the immediately preceding meeting, prior to institution of a policy of restraint.

Sincerely yours,



Wright Patman
Chairman

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Article Title: "On open market operations "Don't Nudge too far, Fed warns Kennedy" William McC. Martin and other Fed officials tell Congress they must reserve independence of action despite Administration ideas about level of interest rates

Journal Title: Business Week pgs 28-29

Date: June 10, 1961

Pages: 28-29

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Author: Nossiter, Bernard D.

Article Title: Reserve Head Balks at Low Rates: Kennedy-Martin Feud Over Interest Breaks Into Open

Journal Title: Washington Post

Date: June 3, 1961

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Johnson - 5171

FOR IMMEDIATE RELEASE
WEDNESDAY, MAY 24, 1961

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

JOINT ECONOMIC COMMITTEE TO REVIEW
OPERATIONS OF FEDERAL RESERVE BOARD AND
FEDERAL OPEN MARKET COMMITTEE

Rep. Wright Patman (D-Tex.), Chairman of the Joint Economic Committee today announced hearings to be held June 1 and 2.

First witness will be Mr. Robert G. Rouse, Manager of the Federal Reserve System's Open Market Account. He will be followed by Mr. Alfred Hayes, President, Federal Reserve Bank of New York and Vice Chairman of the Open Market Committee, and, finally, by Mr. William McChesney Martin, Jr., Chairman of the Board of Governors and also Chairman of the Open Market Committee.

Mr. Patman said that the hearings will focus mainly on the Board's Annual Report. He said the Committee will consider such questions as:

"How adequate is the information made public by the Board's Annual Report to Congress? Does it give the public a clear understanding of the actions and policies of the Board and the Open Market Committee, and the reason for these actions and changes in policy? How well and how timely have the policies described in the Board's report been implemented?

"Whether or not monetary policy can be determined for longer periods in advance, and made public, in the same way that the annual Economic Report of the President makes public the Federal Government's fiscal

-more-

1961-13

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policies for the coming year. When the Open Market Committee meets each three weeks and adopts a credit policy for the three weeks ahead, would it not be better to make a prompt announcement of the policy, rather than have the financial community and the general public learn only gradually what the policy is."

In explaining the role of the witnesses in the Federal Reserve System, Mr. Patman said:

"The Open Market Committee, made up of the 7 Board members, plus 5 Federal Reserve Bank presidents, determines over-all money and credit policy for the country. The Federal Reserve Bank of New York is agent for the Open Market Committee, and the System Open Market Account, located in the New York bank, makes money and credit 'tight' or 'easy,' according to policy instructions from the Open Market Committee."

Members of the Joint Economic Committee are:

Wright Patman, Representative, Texas, Chairman
Paul H. Douglas, Senator, Illinois, Vice-Chairman

House of Representatives

Richard Bolling, Missouri
Hale Boggs, Louisiana
Henry S. Reuss, Wisconsin
Martha W. Griffiths, Michigan
Thomas B. Curtis, Missouri
Clarence E. Kilburn, New York
William B. Widnall, New Jersey

Senate

John Sparkman, Alabama
J. W. Fulbright, Arkansas
William Proxmire, Wisconsin
Claiborne Pell, Rhode Island
Prescott Bush, Connecticut
John Marshall Butler, Maryland
Jacob K. Javits, New York

HEARINGS WILL BE IN ROOM 1304, NEW HOUSE OFFICE BUILDING, 10 a.m., THURSDAY, JUNE 1, and 10 a.m. and 2 p.m., FRIDAY, JUNE 2.

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Chairman Martin

The following has been excerpted from the unedited copy of the Report of Proceedings of Hearing held before the Joint Economic Committee, on Friday, June 2, 1961, concerning "Recent Policies and Actions of the Federal Reserve System"

* * * *

(The questions referred to follow:)

1. In framing its directive to the Manager of the Account and reporting to the Congress, what, if any, difference is there in the terms "credit expansion" as in the revision of May 24, and "monetary expansion" as in the revision of August 16? Are we to understand these terms to apply to an expansion of total loans and investments, of demand deposits, of demand deposits plus time deposits, or currency in circulation plus demand deposits?

2. What is the reason for including the limitation in various directives restricting changes in security holdings of the System to $1 billion or later to $1.5 billion: Have these limitations at any time during the past year restricted or controlled the actions taken?

3. What significance did you expect the Manager or the Congress, in later reading of directives, to attach to the phrase in the August 16 meeting "to take into account even more than usual the tone of the market rather than statistical measures?" What statistical measures were referred to and why were they to be downgraded in importance?

4. Assuming that the System Manager is, as is apparently the case, expected and allowed to translate "shades of opinion" into operational dollar terms, do you feel that this is an adequate explanation to the Congress of the "determination of open market policies and the reasons underlying the action," as required by statute?

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5. In translating these "shades of opinion," is the Manager expected to consider the number of members voting for or against the directive and assign different weights to the opinions of different members, depending upon what seems to him to have been the most persuasive and best articulated reasons?

6. In purchasing or selling securities, do you ever expect or direct the Account to take an active forceful role by purchasing securities above or below the current price for the purpose of changing the level of interest rates? If this is never done, is not the role of the System reduced to that of a follower rather than a leader?

7. Reference is made on several occasions to "relating the supply of money in the market to the needs of commerce and business." What significance has this statement in a policy directive unless related to some equilibrium level of interest rates?

8. In connection with the indications that the Board considers the growth of time deposits in commercial banks as having expansionary effects, precisely what is the Federal Reserve policy with respect to time deposits during periods of inflationary pressures or during periods when stimulation of general economic activity is desired?

9. Does the size of the Open Market Committee have anything to do with the vague and very general wording of the policy directives?

10. Among several references noting that the money supply had failed to respond as anticipated, the September 13 summary refers to the change as "disappointing". Is it your contention that the Federal Reserve is sometimes frustrated in its attempt to increase the money supply and, if so, how and why?

11. Does the Board take into account or attempt to estimate the member banks demand for free reserves or liquidity as well as the supply of these reserves? Is

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the rate of interest on Federal funds an important indicator influencing the direction and extent of open market operations?

12. For each of the five or six changes in key words of the policy directives do you feel that a reporting of this change in language meets the requirements of a full disclosure to the Congress of the actions taken and the reasons underlying the action?

13. For each of these actions (1) what combination of economic indicators prompted the action, (2) what evidence is there of market response, and (3) did the response match, fall short of, or surpass expectations or aims?

(The answers referred to follow:)

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Excerpts from Chairman Martin's testimony
before Joint Economic Committee, June 2, 1961

(From unedited transcript of testimony)

* * * * * * * * *

Senator Bush. Governor Martin, I think you know, and the Committee knows, that I am one who believes very much in the independence of the Federal Reserve System and its responsibility to the Congress, and it is a creature of the Congress, so to speak, and I approach this question in that point of view, as one who respects the independence of the Federal Reserve Board very much, and believes it is very important.

But in President Kennedy's recent message in connection with our urgent national needs, and those three words are from his address, he made this statement, and I will read it:

"The full financial influence of Government must continue to be exerted in the direction of general credit ease and further monetary growth while the economy is recovering. Some further downward adjustments in interest rates, particularly those which have been slow to adjust in the recent recession, are clearly desirable, and certainly to increase them would choke off recovery."

The President has also indicated that he thinks that we are definitely moving out of the recession, and other statements which he has made indicate that the Administration believes that the gross national product will be attaining new high levels toward the end of this year, and maybe substantially higher than were attained last year.

And so confident are they in that belief that this is at least a partial justification in their minds for some largely increased spending

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programs which, it is said, would result in increasing tax income to the government and, therefore, we can go ahead with these larger spending programs because of not being fearful of the deficit, because the increase in gross national product will produce greater earnings and we will not have a deficit. That is the general idea.

Now, he says, "The full financial influence of government must continue to be exerted in the direction of general credit ease and further monetary growth while the economy is recovering."

I do not know how long he means, whether to the very end of the recovery, but it is a statement that disturbs me somewhat, feeling as I do that monetary policy should be used with great restraint, if any, in respect of stimulating a recovery that already appears to be well under way, and gives promise of going quite far in a favorable direction.

I wonder whether you would care to comment on that from the point of view of the Federal Reserve Board, and especially whether you feel that some further downward adjustment in interest rates, particularly those which have been slow to adjust in the recent recession "are clearly desirable and certainly to increase them would choke off recovery," would you care to comment on this, sir?

Mr. Martin. Yes, I will be glad to comment on it.

In the first place, the Open Market Committee and the Federal Reserve Bd will carefully consider anything that the President of the United States says at any time, and we welcome his views.

Now, when it comes to this matter of forecasting the future --

Senator Bush. The what?

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Mr. Martin. When it comes to the matter of forecasting the future, you have got a great many imponderables that nobody can state precisely.

Now, our interest rates, as I have stated a great number of times, our role in the Federal Reserve -- and he is talking there about the full financial resources of the government, which there are many resources outside the Federal Reserve -- take the home credit field, for example, on various things -- but the Federal Reserve has the obligation to supply reserves to the economy, not to fix any levels of interest rates but to supply reserves to the economy, in such a way as to help the economy have stability and growth.

Whatever level of reserves in the judgment of the Federal Reserve Board is appropriate to that, that is what we should seek.

Now, you cannot have high or low interest rates per se without relating them to the flow of funds, and when you talk about interest rates in this sense, levels of interest rates, you have got to relate them to the flow of funds.

I have used the word picture of a stream. If you pump money into the money stream faster than it can dig a river bed to contain it, then that money stream overflows its banks and floods the river on either side, and I think that creates inflationary pressures.

Likewise, if you want to create artificially high interest rates you just starve the economy for money, and you will get artificially higher rates.

But what we have been trying to do here is to adapt this flow of money to produce the dual operation of encouraging the flow of capital for private domestic expansion where it is called for in this country and, at

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the same time, to minimize the outflow of capital abroad, and I want to reiterate here what has been the Federal Reserve Board's position and what I understand to be the position of those in the Administration that I have consulted with on this also, that we do not intend to peg interest rates. At no time have we intended to peg interest rates.

Now, I cannot forecast what the future is going to be. But, generally speaking, against this background, if business continues to rise, and it may not continue to rise, I am not forecasting it will here, interest rates will tend to rise.

We can, perhaps, moderate them, but we cannot control them. If business stays about where it is under present conditions, interest rates will stay about where they are.

If business declines, interest rates will decline. That is the best I can do with the --

Senator Bush. And, conversely, if business improves interest rates should improve; is that right?

Mr. Martin. Yes, somewhat.

Senator Bush. Yes.

I do not want to be too persistent on this, but the President speaks of in spite of the recovery that he mentions, of the desirability, clearly desirable, it is clearly desirable that some further downward adjustment in interest rates take place -- this would not seem to me to fit in with the statement you have just made.

Mr. Martin. I think it depends entirely on what happens in the business picture, and I think that -- I want to make my position on interest rates clear again, as I have many times, I have repeatedly stated, that

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I would like to see as low interest rates as you can have without producing inflationary pressures.

But I do not think the Federal Reserve Board ought to be asked to force interest rates or to peg interest rates. It is self-defeating and does not help in putting unemployed back to work.

Senator Bush. That is a very satisfactory answer to this question. I am very glad to hear you say that, and I certainly agree you have been consistent in this position over the years that you have been coming before these committees.

I have no other questions, Mr. Chairman.

Chairman Patman. I would like to pursue that for just a little, Mr. Martin.

I read this statement this morning to Mr. Hayes, and Mr. Hayes' answer was that although the members of the Federal Open Market Committee are all aware of this statement, it has not been taken up, although he said he was not speaking for the Open Market Committee, had not been taken up with the committee, and I did not press him for what the Open Market Committee would probably do, because you were coming on this afternoon, and since you are the chairman, I would like to ask you what you propose to do about this.

Will you ask the Open Market Committee to take into consideration this statement of the President's?

Mr. Martin. I will be very glad to see that every member of the Open Market Committee has a copy of the statement.

Chairman Patman. I know; it was delivered to the Congress. It was important enough to where the President of the United States came before

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a Joint Session of Congress and delivered a message, the title of which was "Urgent National Needs," and among the urgent national needs he said:

"The full financial influence of government must continue to be exerted in the direction of general credit ease and further monetary growth while the economy is recovering. Some further downward adjustment in interest rates, particularly those which have been slow to adjust in the recent recession, are clearly desirable, and certainly to increase them would choke off recovery."

That is the President of the United States.

In other words, if I understand that correctly, he is saying to you and everyone else connected with monetary policy or monetary affairs to adjust your business so there will be some easing of interest rates.

Now, will the Federal Reserve respect that in any way, I mean the Open Market Committee of the Federal Reserve Board, in an attempt to carry out his objective here?

Mr. Martin. The Federal Reserve will consider that, Mr. Patman, as I have answered Senator Bush here in the light of all of the circumstances.

The President followed that with an announcement of a reduction in FHA rates to 5-1/4 per cent. That is well within his prerogative and his program and, of course, there is a difference between clearly desirable at a given time and whether it actually will come about or is needed.

Now, I would like to see, as I reiterate, as low interest rates as we can have, without producing inflationary pressures.

But I do not want to see pegging develop, and I do not want to see artificially low interest rates.

I want interest rates to be related to the flow of money into the economy; that is what it is. It is an equilibrating factor.

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Chairman Patman. Let me ask you this then: I understood from Mr. Rouse's testimony yesterday that your February 20th announcement was misunderstood, and that, in truth, the Open Market Committee has not made any decision to try to reduce long-term interest rates; is that correct?

Mr. Martin. Mr. Patman, I made a very full statement on that when I was up here on March 7 -- I recall that to you -- I think, in answer to a question that you put to me.

We have made a bona fide effort to endeavor to bring about a meaningful decline, although I pointed out how difficult it is to bring about a meaningful decline in long-term interest rates and, at the same time, to maintain the short rate in view of the balance of payments difficulty that we had, and I pointed out at some length in the statement that I made on March 7 what the difficulties and problems were. And we have made a conscientious, sincere, earnest and continuing effort to carry out both the spirit and intention of that February 20 statement.

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Chairman Patman. Mr. Martin, we were asking Mr. Hayes some questions this morning about how these policy statements of the Federal Open Market Committee were interpreted, and I will ask you, you take, for instance, the statement by the Open Market Committee on March 1, 1960, where it said:

"The directive that had been in effect since May 26, 1959, calling for operations with a view 'to restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities was changed to read to fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion."

How do you expect the manager of the account in New York to take this statement here alone and interpret it just from this statement? Would you expect him to do?

Mr. Martin. Yes, I would, if he is the competent man I think he is; I think that that gives him adequate information.

Chairman Patman. Well, of course, he testified that he had written notes himself at the meeting of the Federal Open Market Committee when this was agreed upon, and he used those notes.

Mr. Martin. Well, we have had him participate in the meetings of the Committee because I think that is helpful to him.

Chairman Patman. Yes, sir; I am sure it is.

Mr. Martin. But I am sure, as a specialist in this field, that this language means something to him.

Chairman Patman. But an outsider could not take this language and interpret it without that, could he?

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Mr. Martin. Well, it is not that -- outsiders are not the ones who are concerned with that particular point, and I think you are dealing here with the specialist, and it is very difficult to write --

Chairman Patman. Maybe I should not have used the word "outsider," but if he had not had other information than just the directive itself, it would be difficult of interpretation, would it not?

Mr. Martin. If he took over in a vacuum, yes.

Chairman Patman. That is right. In other words, as a stranger, he came in and took charge of the desk, he would have difficulty interpreting this, if that was all the information he had, the language itself.

Mr. Martin. Standing on its own, yes. But I think that it is a --

Chairman Patman. Therefore, he is necessarily dependent upon his notes that he made at the meeting partly, and also doesn't he have the benefit and advantage of the minutes made for the Federal Open Market Committee at the meeting?

Mr. Martin. Well, we have minutes of these meetings, Mr. Patman.

Chairman Patman. That is what I mean, and you make those minutes, one of the purposes being to give it to the manager of your accounts so as to help him in interpreting what you mean by this language, is it not?

Mr. Martin. Not only the manager of the account but every member of the Committee.

Chairman Patman. I know, but he is the one who carries it into execution, as I understand it, and he is the person who actually takes action, and he is the only one who actually takes action, isn't that right?

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Mr. Martin. Well, we are working constantly, and I welcome your raising it, to try to get a directive which is more informative to outsiders as well as insiders, but I can assure you that the language is --

Chairman Patman. That is the point I am getting, Mr. Martin. I have considered this language, I have read these directives you have gotten up, and I am not expected to be able to interpret them myself, but I do not see how the ordinary, average person could possibly interpret what the language means. It is really, and I say this respectfully, it is gobbledygook, you just cannot tell what it is, and I do not believe you could tell if you just had this alone unless you had the minutes of Federal Reserve Open Market Committee.

Mr. Martin. Well, we will certainly try to improve on any gobbledygook we have.

Chairman Patman. I am sincere about that. I have read them, and the testimony here seems to be very plain that you have a language in the Street or in the financial community or in the Federal Reserve that means a lot to the Federal Reserve like this language, and you understand it after attending the meeting of the Federal Reserve Open Market Committee and making your own notes and having the minutes of the meeting.

But people generally cannot understand it. But the traders, these sophisticated people, the dealers, they immediately, when you go into action on this, know exactly what you are doing, and they can profit from it, as they should, because of their knowledge.

But people generally do not understand it, and cannot participate in anything that is done that would be helpful by reason of this directive.

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The point is, don't you think that language should be plain enough for anybody to understand, and not restricted to people who are specialists in the market?

Mr. Martin. Well, I would like to see the language, and we are glad to get suggestions -- that is one of the benefits of this hearing -- I would like to see the language as clear as it can be.

So far as it meaning more to sophisticates or to those who are experts than it does to a farmer, let us say, in Nebraska, I think that applies to anybody who reads the baseball box scores or anything else.

Chairman Patman. That is quite different, Mr. Martin.

Mr. Martin. A man absorbed in baseball can get anything out of the box score, more so than somebody who is not.

Chairman Patman. Well, you voluntarily go into this sport. You are in this, whether you want to be or not. This affects everybody.

Mr. Martin. All right. I asked for it.

Chairman Patman. These minutes, you could understand this a lot better if you had those minutes, couldn't you, of the Federal Reserve Open Market Committee?

Mr. Martin. You mean the general public?

Chairman Patman. This committee, for instance, we can understand it better if we had your minutes, the Open Market Committee minutes. Where are those minutes, Mr. Martin?

Mr. Martin. Those minutes are in the custody of the Open Market Committee.

Chairman Patman. Are you willing to give us the minutes for last year, 1960, so that we can use them in connection with these directives and see whether or not we can suggest improvements on the language?

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Mr. Martin. Well, Mr. Patman, if your committee, if you want to write me and request those, I will put it before the Open Market Committee, and I will certainly do it in the most sympathetic way. I want to -- and I have no -- listen, I have never withheld anything from you, as you know.

Chairman Patman. No, sir; you have been --

Mr. Martin. I have rolled up five years of audits.

Chairman Patman. You have been very good, and I am not going to write you any letter, Mr. Martin, but I am asking you now to let us have the minutes for 1960.

Mr. Martin. I think an orderly procedure -- it is not that I in any way distrust you, Mr. Patman -- but in orderly procedure, that I have to put this to the Committee because what is involved here --

Chairman Patman. This transcript will be available.

Mr. Martin. It is in the public interest.

Chairman Patman. I am asking you now to furnish us the minutes for 1960. That is long behind us, it certainly cannot be current information, and it could not be dangerous or harmful, and I am asking you now to furnish us the minutes for 1960. When can you let us know about that?

Mr. Martin. I cannot let you know about that until after the Open Market Committee meeting next week.

Chairman Patman. When does it meet?

Mr. Martin. It meets June 6.

Chairman Patman. June 6. All right, sir, I shall not press it until after June 6. Will you let me know then?

Mr. Martin. I will be glad to let you know.

Chairman Patman. All right, fine.

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Background
Not submitted

June 2, 1961

The Board's Annual Report serves several important purposes. Perhaps most important is to inform the Congress and the public of the policy actions taken by the Board and the Federal Open Market Committee during the year covered. In the official policy record of the Report, we attempt to set forth as accurately and succinctly as we can the economic and financial developments taken into account in arriving at each policy decision, together with the reasons for the policy action taken and the reasons for any dissents to the action which individual members may have expressed. A policy record is prepared and reviewed promptly after each meeting in which a policy decision is reached. Thus, these records do not benefit or suffer from hindsight.

Under our established procedures, a first draft summary report of a policy proceeding is prepared by a competent and experienced secretary. It is then carefully reviewed without delay by every member who participated in the policy decision. Any proposed revisions or other suggestions are submitted for comment to the other members, and finally, after this process is completed, the revised draft is circulated for final approval.

As I am sure is the case in the deliberations of legislative committees on which you all serve, it is not easy in every case to express concisely the reasons why a group of highly qualified and expert men took a particular action at a particular time. In any group some members will express their thinking in more detail and at greater length than others. It does not follow that the less expressive or even silent members hold less firmly to their opinions or have less compelling reasons for holding them.

Accordingly, the policy record is, and will remain, an imperfect account of all the considerations weighed in reaching a particular decision.

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It is doubtful, moreover, that it could be made more accurate either by lengthening it or by trying to specify its content more rigidly. Endeavors to force the rationale of decisions into a mold that might obscure the reasoning actually employed in specific cases could hardly serve a public interest.

Beyond providing a vehicle for publication of the policy record, the Annual Report performs a number of other functions. It contains a very carefully drawn review of the economic developments and flows of credit funds during the year, with special reference to money and bank credit. From time to time some supplementary discussion has focused on the use of one or another of the instruments of policy for the purpose of making clear to interested persons the System's own interpretation of the role performed by that tool in the execution of policy.

The Report is also an avenue for reporting to the Congress on actions taken by the Board of Governors under various authorities that Congress has assigned to it. Examples are its actions under the Bank Holding Company Act and its operations in the field of bank supervision.

The Report further contains information with respect to the Board's internal administration and the operations of the Federal Reserve Banks. Finally, it presents some 20 statistical tables which summarize in figures the System's operations during the year.

A virtue of the Report, in my judgment, is that it has, in appropriate circumstances, contained recommendations for new legislation, discussion of the role of the System in current economic and financial developments, or explanations of the mechanism of its major policy instruments. There has been no feeling of compulsion, however, to extend the Report to these areas in every year.

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The Board has viewed the Report as a useful means for recording its actions and the reasons for them, for accounting to the Congress and the public for its performance of the responsibilities assigned to it, and for calling attention, when the occasion demanded or seemed appropriate, to desirable changes in the law.

As you know, the Board's Annual Report is only one of a number of media of communication of the System with the Congress and the public. Our prepared testimony before your Committee and others on various matters is another important medium. Then there are the weekly statements of condition of the Federal Reserve Banks, the Federal Reserve Bulletin and the monthly economic letters of the Federal Reserve Banks. From time to time, too, the staffs of the Board and the Banks engage in special studies in response to Congressional or other requests and the reports presenting the result of these studies are means of communicating with you. Lastly, the Board makes available for the information of the Congress and the public a booklet which endeavors to explain simply and yet adequately the purposes and functions of the Federal Reserve System as well as other informational publications on various phases of Federal Reserve activities, such as the one issued by the New York Federal Reserve Bank on "Federal Reserve Operations in the Money and Government Securities Market."

As a concluding point, I may recall for you the view expressed by the Board in 1952 to the Subcommittee of the Joint Economic Committee of which you were Chairman, concerned with Monetary Policy and Management of the Public Debt. The Board commented on a question directed to this point as follows:

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"The guiding view of the Board of Governors and the Federal Reserve Banks in reports and information made available to the public is that an adequate and critical public understanding contributes to an intelligent credit and monetary policy designed to foster stable economic progress. Accordingly, the System is actively interested in disseminating factual and explanatory information on general economic conditions and on credit and monetary policies. Such is deemed to be the System's responsibility since the preservation of democratic institutions depends on an informed public opinion."

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June 1, 1961

To Chairman Martin Subject: Rouse testimony before

From Jerome W. Shay Joint Economic Committee

This will confirm and amplify my report to you earlier today concerning the testimony of Mr. Rouse before the Joint Economic Committee this morning.

Members of the Committee present were Chairman Patman, Mrs. Griffiths, and Messrs. Sparkman, Reuss, and Pell (Democrats) and Messrs. Bush and Widnall (Republicans). Set forth below are significant or principal lines of questioning that developed during the morning. It seemed clear that there was no real plan or organization behind the questioning, which seemed to be pretty much on a random basis.

One of Mr. Patman's questions was whether there was any reason why the Government security dealers must all be located in New York (or Chicago). This was followed with the question as to why the Federal Reserve Banks could not act as dealers. Briefly, Mr. Rouse's reply to the first question was that New York is where the market is made, and his reply to the second question was that the Reserve Banks are customers and that, in any event, for the Reserve Banks to try to replace dealers would change the situation entirely.

Mr. Patman also asked concerning attendance at meetings of the Open Market Committee (i.e., who attended in addition to the 12 members of the Open Market Committee). His position, in effect, was that by having <u>all</u> presidents of Federal Reserve Banks present at FOMC meetings the law has been disregarded and the meetings have been "loaded" in favor of the "private" interests (representatives of commercial banks) as against the seven "public" members (members of the Board).

The next line of questioning pursued by Mr. Patman, in effect, was why open market operations and policy decisions could not be announced promptly, as is the case with changes in discount rates and reserve requirements. Mr. Rouse's answer to this was that to do so might create expectations in the market that would not in fact be borne out or which might possibly benefit speculators. Mr. Patman's position on this, however, was that the present system benefits the "sophisticated" people, who can rather easily determine what open market policy is even though there has been no public announcement of it and that this, of course, discriminates against the "little fellow".

Some of Mr. Patman's other questions were such as to suggest the possibility of "leaks" of open market information and the possibility of Federal Reserve personnel trading in the market on the basis of "inside" information. You will recognize this as a line of questioning which Mr. Patman frequently engages in and, as he has done in the past, he emphasized that there is no law or regulation against purchases of marketable securities by Federal Reserve or Open Market Committee personnel.

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Pursuing a disclosure by Mr. Rouse that either he or one of his assistants took notes during Open Market Committee meetings, Mr. Patman, in effect, asked Mr. Rouse to supply these notes for 1960 to the Committee. Mr. Patman also indicated in this connection that he would ask you to supply Open Market Committee minutes for 1960 to the Committee. Mr. Rouse, in effect, said that he could not supply anything of this nature to the Committee without the consent of the Open Market Committee. There were indications by both Mr. Reuss and Senator Bush that undoubtedly the Open Market Committee would supply the Committee minutes upon a proper request. Mr. Patman made it plain, however, that he was not pushing Mr. Rouse, and it seemed abundantly clear that Mr. Rouse has nothing further to do in the matter at this time.

Senator Bush wanted to know whether the "nudging operation" undertaken in February had resulted in any easing of long-term interest rates. Mr. Rouse replied it had had some effect. In this connection, however, Mr. Rouse referred to your speech on April 11 at Boca Raton, Florida, and read therefrom the passages that, in effect, stated that the Federal Reserve was not seeking to set any particular levels of rate for either long or short-term securities and that the best guages of its operations were whether the outflow of funds to foreign centers was being stemmed and whether the flow of capital into productive investment activities was being facilitated. Mr. Rouse also emphasized that the basic purpose of the System was to affect the supply of bank reserves and that, while its operations had some effect on interest rates, this was not a primary objective for consideration.

Senator Bush was interested also in whether the System might encounter difficulty in disposing of any long-term bonds it might acquire. To this, Mr. Rouse replied that the market is a good market and that such bonds can be sold just as the long-term bonds acquired during the war had been sold.

Senator Sparkman's principal inquiry concerned the change in policy announced on February 20. In this connection, he referred to the Report of the Joint Economic Committee of May 2, 1961, on the Economic Report of the President, which rather clearly suggests that the System's transactions in the long end of the market had been inconsequential. Senator Sparkman's comments clearly indicated his belief that what the System had set out to do was to reduce long-term interest rates. Here, again, Mr. Rouse emphasized that the basic reasons for the System's operations was to affect bank reserves, and he referred again to your Boca Raton speech.

Mr. Widnall's only question was whether money could be expected to go into the short-term market if long-term rates were reduced. To this, Mr. Rouse replied affirmatively.

Mr. Reuss started his questioning by asking for definitions of short, intermediate and long-term securities. Mr. Rouse's response was that short-term included anything up to five-year maturities, that intermediate covered from five to 10-year maturities, and that anything over

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10 years was a long-term security. This reply created some excitement, inasmuch as Mr. Reuss clearly expected Mr. Rouse to say that short-term securities were those with maturities not exceeding 15 months. Thereafter, there was some tracing of the history of the directives of the Open Market Committee from 1953 to the change in the directive on March 1, 1960, and also the change in the directive on October 25, 1960, and the purposes behind these changes. Mr. Reuss seemed to think that sometime during 1960 maturities of up to four years had been purchased, but Mr. Rouse said that nothing greater than 15 months had been acquired and that this had taken place subsequent to the October 25 change in the directive.

Mrs. Griffiths asked a series of questions with respect to technical aspects of Open Market Committee meetings and communications. These questions, for example, included whether the OMC minutes and the daily 11 o'clock market 'phone calls are stenographically transcribed. This line of questioning was such as to suggest that communications between the Committee and the Account Manager and the trading desk were too vague for adequate guidance and control of actual operations.

Another inquiry from Mrs. Griffiths was when during the last five years the System applied a policy of restraint and the exact economic factors that influenced the System in applying such policy. Mr. Rouse's reply was that he would try to supply this for the record, pointing out, however, that policy was a matter for the Committee, rather than the Manager of the Account.

Senator Pell's questions were such as to indicate agreement with Mr. Rouse that a stenographic transcript of minutes of the Open Market Committee would not be of real help in day-to-day operations and that the minutes as presently prepared might be more conductive to helpful discussion at Committee meetings and, in the end, serve as better guide lines to the manager and the desk.

cc: Each Board Member
Messrs. Thomas, Young, Knipe, Molony, Fauver, Alderfer,
Sherman, and Noyes

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Excerpt from Board's Reply to Questions Submitted to the Subcommittee on Economic Stabilization (Chairman, Sen. Flanders) of the Joint Committee on the Economic Report, Nov. 26, 1954, pp. 24-25

Conclusion

The formulation of appropriate credit and monetary policy is, at best, difficult. It requires, first, painstaking search for all the relevant facts that may bear on the economic and financial outlook; second, all the wisdom and insight that experience and operating contacts can bring to the interpretation of those facts, and, finally, and perhaps most important, humility with respect to any emerging situation. There are relatively few occasions when the meaning of developing events is so clear that the monetary authorities can say, "As of today, our policy should be changed from restraint to ease." A shift in policy emphasis more typically emerges from a succession of market developments and administrative decisions in which the range for variation needed in pursuit of any particular policy gradually shifts from the side of ease to the side of restraint or vice versa.

The various factors that exert an impact on bank reserve positions are at best difficult to forecast in advance. There is a considerable margin of uncertainty in any forecast of factors absorbing or supplying reserves. Yet these forecasts or projections must be made in planning open-market operations. In consequence, there is frequently much discussion, when prospective purchases or sales are authorized, of whether it would be wiser to deal with the area of uncertainty in the forecast in the direction of restraint or in the direction of ease. These changing shifts in emphasis do not necessarily mean that a new policy direction is emerging. Usually, however, by the time the facts of the economic situation are sufficiently clear to lead to the adoption of a changed policy directive, it will be found that these day-to-day allowances for uncertainties in the forecasts of reserve availabilities have begun to be increasingly resolved on the side later indicated by the new policy directive.

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Excerpt from Riefler Answer to Questions Submitted by
the Committee on the Working of the Monetary System
(Chairman, Lord Radcliffe), June 1958, pg. 306

168.

The guiding view in making information available to the public was stated several years ago, in a statement to a Joint Committee of the Congress, as follows:1/

> From its beginning the Federal Reserve System has departed from the older view prevalent in other countries that the reasons for central banking moves to tighten or relax credit and monetary conditions should be inferred solely from the nature of the actions taken. The course pioneered by the Federal Reserve System is that explanations of policy actions and factual information which guide them should be made available to the public.

A decade after the System's founding, this view was expressed in the Board's Annual Report, as follows:2/

> "The more fully the public understand what the function of the Federal reserve system is and on what grounds and on what indications its policies and actions are based, the simpler and easier will be the problems of credit administration in the United States. For this reason it has been the policy of the Board to inform the public, either through its official monthly publication or by statements to the press, on matters in which the public has an interest and to which its attention should be drawn. By this means the Board presents to the public a statement of the problems confronting the system and of the attitude of the Board toward current banking and credit developments. The public is a partner in the Federal reserve system. The co-operation of the public based upon an understanding of the broad outlines of Federal reserve credit policy is of the greatest advantage to a good functioning of the system."

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1. U. S. Congress, Joint Committee on the Economic Report, Monetary Policy and the Management of the Public Debt, 82nd Congress, 2nd Sess., Doc. No. 123, Pt. 1, p. 321.

2. Annual Report of the Federal Reserve Board for 1923, p. 38.

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The dominant place which the Federal Government has come to occupy in the functioning of the economy has made increasingly necessary a widening public knowledge and understanding of national purposes and policies. In a democracy, the best and fundamentally the only way to make wise public measures prevail, and to avoid unwise ones, is to expose them fully and fairly to public scrutiny. This continuing task imposes on public servants a clear responsibility for the fullest possible disclosure of accurate and unbiased information. It calls for discriminating judgment not only to prevent distortion or unwarranted withholding of factual material but also to present and interpret it intelligently. Such factual material and interpretation need also to be readily and widely disseminated within the bounds set by prudent expenditure of funds for this purpose.

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Excerpt from Riefler Testimony before the Committee on the Working of the Monetary System (Chairman, Lord Radcliffe), June 19, 1958, p. 623.

9554.

What about other publications? -- Our balance sheet is published as of every Wednesday. As I said in the memorandum, great care is taken to make it a revealing balance sheet. In the United States, banks are allowed to average their reserves, over a week for city banks and over half a month if they are country banks. Figures as of a given Wednesday, consequently, do not really tell the story because they may be quite far from the mean, so weekly average figures have been developed to reveal what the actual balances were that affected the money market. Then, efforts have been made to clean up the concepts. Some of the items on the weekly statement were fuzzy, for example, loans used to lump together both loans to member banks and loans to foreign banks. That has been changed. The result is that anybody who is in the market and wants to analyze what has actually been done, gets the applicable information sometimes as fast as we do. There are many other regular releases, of course, than the weekly statement. In addition, all policy actions are announced immediately. So much for information covering actual operations; on the other side, the System tries to educate the public with respect to the philosophy that governs its actions. It publishes Purposes and Functions, an elaborate advanced-level textbook on money and banking. It also has many publications of a more popular type as well as those for a pretty sophisticated audience. Each tries to convey the same story and reach the same type of understanding in groups at the different levels. In that way, an effort is made to reach everyone so far as it is possible. In so far as actual future operations are concerned, we say nothing, but we do have a detailed discussion of past operations in the Annual Report which comes out some time after the end of the year. The interval is long enough so that people cannot interpret from the explanation of an action taken, say, in December, the logical succeeding action that would have to be taken, say, in February. If the reasons for an action were published immediately, a very clever operator might have a basis to forecast future action. We think we escape that hazard by publishing only once a year. Maybe we are wrong in this attitude toward publication. In any case, it is consistent with what the law requires.

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Federal Reserve System

Monetary Policy Directives and Changes, 1960
As Reported in
"Record of Policy Actions"
Annual Report, 1960

A. March 1, 1960, Open Market Committee
Directive in effect from May 26, 1959, "...restraining inflationary credit expansion in order to foster sustainable economic growth and expanding employment opportunities" changed to read "...fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion." (page 41)

B. May 24, 1960, Open Market Committee
"...fostering sustainable growth in economic activity and employment by providing reserves needed for moderate bank credit expansion." (page 54)

C. June 2, 1960, Board of Governors
Approved reduction in discount rate 1/2 percentage point from 4% to 3-1/2%. (page 80)

D. July 28, 1960, Board of Governors
Reduced margin requirement for purchase or carrying registered stocks from 90% to 70%. (page 81)

E. August 11, 1960, Board of Governors
Approved reduction in discount rate 1/2 percentage point from 3-1/2% to 3%. (page 85)

F. August 16, 1960, Open Market Committee
"...encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment." (page 61)

G. August 25, 1960, Board of Governors
Pursuant to action announced August 8, 1960, permitted member banks not classified as central reserve city or reserve city banks to count vault cash in excess of 2-1/2% (rather than 4%) of net demand deposits as part of required reserves, and effective September 1, permitted central reserve city and reserve city banks similarly to count vault cash in excess of 1% (rather than 2%) of net demand deposits. Effective September 1 reduced reserve requirements of central reserve city banks from 18% to 17-1/2%. (page 83)

H. October 25, 1960, Open Market Committee
Amended August 16 directive to add the words "while taking into consideration current international developments." (page 67)

I. November 24, 1960, Board of Governors
Pursuant to action announced October 26, 1960, permitted banks to count all bulk cash as part of required reserves; increased reserve requirements at central reserve or reserve city banks from 11% to 12%; and effective December 1, reduced reserve requirements of central reserve city banks gainst demand deposits from 17-1/2% to 16-1/2%. (page 87)

Note: Underlining added by JEC staff.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

June 1, 1961

To: Mr. Martin

From: Guy E. Noyes

Attached is a brief statement on Recent Economic Developments, which should provide the background for any questions in this area.

G.E.N.

Attachment.

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June 1, 1961

Recent Economic Developments

Economic activity reached its low for this cycle in late winter and has been recovering since then. The low was reached somewhat earlier and the recovery so far has been more rapid than had been expected by many observers. In the three months since February, the index of industrial production has recovered more than half of the 7 per cent decline that occurred from July last year to February. By April, the index had risen from its low of 102 per cent of the 1957 average to 105 and a further rise is indicated in May.

Gross national product reached its low in the first quarter at an annual rate of $500 billion. In the current quarter, GNP is expected to show a substantial rise. Inventory liquidation, which had been at an annual rate of $4-1/2 billion in the first quarter, appears to have ended and for the second quarter as a whole there may be some net accumulation of inventories.

This inventory shift has been stimulated to an important extent by a pick-up in consumer buying of durable goods which had been weak at the beginning of the year. Moreover, consumer purchases of nondurable goods, which leveled off during the recession, appear to be rising again. Consumer outlays on services and State and local government and Federal Government outlays for goods and services are continuing to expand further.

Total construction activity, including public as well as private, increased in May to the highest level since August 1959. Housing starts, although still well below the highs of early 1959, have shown considerable improvement from their reduced levels of last winter.

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Expansion in general activity has been supported and reinforced by increasing personal income. Personal income declined little during the recession and recently has been rising again, reaching a new high level in April.

Recovery in general activity has been accompanied by improvement in the labor market. Recent gains in nonfarm employment, in average weekly hours worked at factories, and in total labor income, together with stability in the unemployment rate so far this year compare favorably with experience in the early months of previous postwar periods of cyclical recovery.

It is unlikely that the unemployment rate this year will reach the high level touched in the 1958 period. At that time, the unemployment rate rose from 4 per cent of the labor force to 7-1/2 per cent. In the latest period, unemployment, although starting from a higher level, has risen much less sharply, from 5 per cent to 7 per cent. As economic activity continues to expand, unemployment should begin to show some decline. The reduction, however, may not come quickly enough or go far enough to bring the number of unemployed down to the low levels desired.

Average prices of commodities at both wholesale and retail have been relatively stable for some time. As is typical for periods of cyclical recovery, however, average prices of sensitive industrial materials have risen from their recession low last winter.

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In the financial area, the flow of new long-term funds to corporations and State and local governments has increased substantially. The second quarter will show an unusually large volume of corporate financing even aside from the large AT&T financing. State and local government borrowing, which had declined in late 1960, increased sharply in the first quarter of the year and this increased volume appears likely to be maintained in the second quarter.

Yields on corporate bonds have fluctuated in a narrow range this year, declining to March, then firming a little since then. Yields on State and local securities have fluctuated in a range above their lows of last September. Mortgage yields have continued to decline steadily and the average yield on FHA mortgages at the end of April was about 1/2 per cent below the January 1960 high. Mortgage rates at saving and loan associations are reported to have continued to decline in May.

Yields on U. S. Government securities have continued this year in the broad range reached in the second half of 1960 following sharp declines from their highs earlier in that year. The short-term bill rate has tended this year to stay within a narrow range of 2-1/4 to 2-1/2 per cent as compared with a high last year of over 4-1/2 per cent. Intermediate- and long-term securities have shown no persistent trend this year at levels considerably below their highs last year. Although yields on such securities recently have risen somewhat from their lows in early May, they have continued below their levels earlier in the year.

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The over-all monetary situation is one of continuing ease. From the last half of December through the first half of May, the seasonally adjusted money supply rose at an annual rate of almost 3 per cent and time deposits continued to expand rapidly. Free reserves of member banks have remained relatively high.

Credit advanced by commercial banks, which usually declines over the first four months of the year, declined much less this year than last. Business loan demand, however, has been generally sluggish this spring, following the pattern of the two previous recovery periods beginning in 1954 and 1958, when business loans lagged the upturn in economic activity by several months.

Stock market prices rose sharply since last October and in early May reached a new peak 29 per cent above the 1960 low. More recently, prices have moved down a little. Customer credit in the stock market rose sharply to a new record level in April.

The international balance of payments of the United States continues to be a problem requiring long-term attention and vigilance. In recent months there has been some drop in the outflows of volatile funds from the United States to other countries, but there are still sizeable flows both of bank loans abroad and of some other types of capital. The reduction in the capital outflow has been an important factor in reducing the over-all deficit--measured by increases in foreign holdings of dollars and of gold bought from the United States--which has been much smaller than it was last year. Among the underlying accounts of the balance of payments, exports have been holding

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up at a high level, and they should continue to do at least that well with demand abroad as strong as it now is. Imports fell off in the latter part of 1960, but should tend to rise as recovery goes ahead in this country.

In summary, the vigor of this cyclical recovery compares favorably with the early months of previous postwar recovery periods. Moreover, this recovery has followed the mildest recession since the mid-1920's. It seems reasonable to expect that the forces of recovery which are now underway will carry further and that by year-end over-all activity will be at a level substantially above the 1960 peak.

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FRIDAY TESTIMONY

A.

Treasury report of its operations, due about now, won't reveal much buying of 10 year and over Governments during February.

--next to last week   200,000 per day avg.
--next to last week 1,800,000 per day avg

Heavy buying was in March and April.

Query: Brunt of questioning as to amount of intermediate and long-term buying will fall on Bob Rouse as the first witness.

B.

Where does nudging end and pegging start?

Answer will be revealing both to market and to critics:

Possible posture.
Distinction turns primarily on expectations of market as to whether price and rate levels will be allowed to fluctuate.

Nudging must be kept within "composite" range of prices quoted if buying is to be kept confined to loose offerings and not to have effect of increasing the supply that would be in the market anyhow and thus building-up expectations of price support, perhaps at prices not sustainable by market forces.

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May 31, 1961

To Chairman Martin Subject: Hearing on June 2

From Jerome W. Shay

Attached are some materials you may wish to review before the hearing on June 2 before the Joint Economic Committee.

1. Charts covering 1959 and 1960.- The first of these materials is a group of six charts, accompanied by an explanatory key, covering 1959 and 1960. The lines A through I on each chart represent the monetary policy directives and changes during 1960, which are described in the key.

These charts have been distributed by the staff of the Committee to each member of the Committee in preparation for the hearing. Unless some Committee member mentions the charts during the hearing, I would suggest that you not refer to them.

2. Monthly Review of Atlanta Reserve Bank.- The second item is the Monthly Review of the Atlanta Federal Reserve Bank of May 1961, the lead article of which is "Managing the System Open Market Account". You may get a question concerning the chart on page 3 of the Review. The question would be based on the chart and would, in effect, suggest that our dealings in Treasury bills have not been as important as our dealings in certificates and notes.

3. Open market operations during late 1960.- The third set of data includes a confidential memo of May 31, 1961, prepared by Mr. Yager, on "Federal Reserve Transactions in U. S. Government Securities Other Than Bills in Late 1960". The memo was marked "CONFIDENTIAL" because of the third paragraph on page 1; but by now confidential treatment may not be necessary.

There have been indications of interest in to what extent we may have departed from "bills only" during 1960 and the facts and figures of such operations, if any.

You will note that Mr. Yager has attached a supporting chart to his memo, and also copies of the relevant Weekly Statements of Condition for late 1960.

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4. <u>Open market operations during 1961.</u>- The fourth set of materials consists of the confidential tables which I believe are distributed to each Board Member in connection with the weekly review of the money market. There have been indications that you might find it useful to have in mind especially Tables VII and IX, particularly with respect to the extent of Treasury purchases.

5. <u>Statutory policy directions to the Federal Reserve.</u>- The fifth item is an excerpt of a statement supplied to the Senate Finance Committee in 1957 concerning the mandate given to the FRSystem in the law. As you will recall, Mr. Patman strongly suggests that we have no directive to work for sustained economic growth and a stable dollar. It may be useful to have the attached except for insertion in the record if, as is not unlikely, the question is raised again on June 2.

Attachments

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CONFIDENTIAL (FR) May 31, 1961

(3)

Federal Reserve Transactions in U. S. Government Securities Other Than Bills in Late 1960

In late October 1960, the System Open Market Committee authorized the manager of the System Open Market Account to purchase short-term Treasury issues other than Treasury bills in order to help supply needed reserves to the market while minimizing downward pressure on the key 3-months bill rate which threatened to fall below 2 per cent. Details on these operations are shown in the attached Table 1.

In pursuing this policy, the manager of the System Open Market Account made outright purchases of eight short-term coupon issues totaling $315 million during three weeks in November. Of this amount, $9 million were bought from foreign and international accounts and the remaining $306 million were bought from Government securities dealers in the open market. The longest term issue purchased was the 3-1/4 per cent note of February 15, 1962, which at the time of the purchase had a maturity just short of 15 months. Ninety-seven per cent of total purchases, however, consisted of certificates, notes and bonds maturing within 13 months.

The System in this period sold short-term coupon issues during only two weeks--those ending December 7 and December 21. These sales totaled $232 million, of which $169 million were to the International Monetary Fund and foreign accounts, and $63 million to dealers in the open market. Sales to the IMF and other foreign accounts were made in order to keep the purchases of these customers out of the market at a time when reserve factors were supplying large additional reserves to the banking system and putting downward pressure on bill rates. Sales of coupon issues to these accounts were

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accompanied by even larger sales of Treasury bills.

Information on transactions available to the public. While details concerning the specific issues bought and sold by the System have not been released, the amounts, types, and approximate maturities of securities transactions are published each week in the Board's H.4.1 release. On page 2 of this release are tables showing net changes in System holdings by type of issue (i.e., bills, certificates, notes, and bonds) and by maturity category (within 15 days, 16 days to 90 days, 91 days to 1 year, and over 1 year to 5 years, etc.). In addition, the explanatory text which precedes the statistical tables generally indicates the extent to which changes in the System's portfolio represented exchanges of securities in connection with Treasury financing operations. Thus in the release for the week ending November 16, 1960, it was pointed out that a decrease of $5 billion in certificates and an increase of $5 billion in notes reflected the exchange of securities maturing on November 15 for new 3-1/4 per cent notes.

In each of the weeks in which the System made market purchases or sales of coupon issues, the public was informed of the maximum maturity range of the operations. Thus, in the first operation--for the week ending November 2--it was pointed out that "the longest maturities among the securities purchased were 2-1/2 per cent bonds maturing November 15, 1961." Similarly in the release showing figures for the November 9 week, it was announced that the securities purchased in that week had maturities of less than 13 months; and in the weeks of November 25, December 8, and December 22, the release indicated that all securities bought or sold had maturities of less than 15 months.

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TABLE 1.

Outright System Operations in Short-term Securities
Other Than Treasury Bills in Late 1960 1/
(In millions of dollars)

Issues bought or sold	Total operations over period:			Statement week ending:				
	Net purchases or sales (-)	Gross purchases	Gross sales	Nov. 2	Nov. 9	Nov. 23	Dec. 7	Dec. 21
4 7/8 C/I 2/15/61	76.0	116.0	- 40.0	5.0	98.0	13.0	--	- 40.0
4 3/8 C/I 5/15/61	34.5	34.5	--	7.0	11.0	16.5	--	--
3 5/8 N 5/15/61	-42.0	--	- 42.0	--	--	--	--	- 42.0
3 1/8 C/I 8/ 1/61	-57.8	15.2	- 73.0	--	14.2	1.0	-14.0	- 59.0
4 N 8/ 1/61	15.0	15.0	--	5.0	10.0	--	--	--
2 3/4 B 9/15/61	16.5	16.5	--	7.0	8.5	1.0	--	--
1 1/2 N 10/ 1/61	5.0	5.0	--	--	5.0	--	--	--
2 1/2 B 11/15/61	42.8	105.8	- 63.0	49.5	56.3	--	-11.0	- 52.0
3 1/4 N 2/15/62	- 7.0	7.0	- 14.0	--	--	7.0	- 5.0	- 9.0
All issues other than bills	83.0	315.0	-232.0	73.5	203.0	38.5	-30.0	-202.0

1/ Delivered basis.

May 31, 1961

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HEARINGS BEFORE SENATE FINANCE COMMITTEE

August 1957, Part 3, page 1518

The Federal Reserve Act does not contain any provision specifically stating that the objective of the Federal Reserve System is to promote conditions that will foster sustained economic growth and stability in the value of the dollar. However, this objective is implicit in the title of the act and in policy directives contained in various provisions of the act; and, taking such directives together with the declaration of policy contained in the Employment Act of 1946, it is clear that the promotion of credit conditions conducive to economic growth and the maintenance of the stability of the dollar is one of the most important objectives of the Federal Reserve System.

The Federal Reserve Act is entitled "An act to provide for the establishment of Federal Reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

The law provides that discount rates shall be established by the Federal Reserve banks, subject to review and determination by the Board of Governors, "with a view of accommodating commerce and business" (12 U.S.C. 357).

The Board is authorized to change reserve requirements of member banks "in order to prevent injurious credit expansion or contraction" (12 U.S.C. 462b).

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The operations of the Federal Open Market Committee are subject to provisions of the law which require that the time, character, and volume of all purchases and sales in the open market "shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country" (12 U.S.C. 263).

The board of directors of each Federal Reserve bank, in extending credit to member banks, is enjoined to consider "the maintenance of sound credit conditions, and the accommodation of commerce, industry, and agriculture"; and each Reserve bank is required to keep itself informed of the general character and amount of the loans and investments of its member banks "with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions" (12 U.S.C. 301).

In prescribing margin requirements for purchasing and carrying securities, the Board is required by the Securities Exchange Act of 1934 to consider whether such requirements are "necessary or appropriate for the accommodation of commerce and industry, having due regard to the general credit situation of the country" (15 U.S.C. 78g).

The various policy directives which have been given by Congress to the Board, the Open Market Committee, and the Federal

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Reserve banks are more fully discussed in Chairman Martin's replies to the 1952 questionnaire of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report. These directives, as previously indicated, implicitly place upon the Federal Reserve System a responsibility for promoting monetary and credit conditions conducive to economic growth and maintenance of stability of the value of the dollar. That objective is supported by the declaration of policy contained in section 2 of the Employment Act of 1946, which reads as follows:

"SEC. 2. The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power" (15 U.S.C. 1021).

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DRAFT
5-31-61
GEN/RAY:ajm

Mr. Chairman:

I welcome today's opportunity to respond to whatever questions you and your colleagues may wish to ask concerning the operations of the Board of Governors of the Federal Reserve System during 1960 as recorded in the Board's Annual Report. Before beginning the question and answer part of the hearing, there are a few remarks that I should like to make concerning the role and purposes of our Annual Report to the Congress.

The Board's Annual Report serves several important purposes. Perhaps most important is to inform the Congress and the public of the policy actions taken by the Board and the Federal Open Market Committee during the year covered. In the official policy record of the report, we attempt to set forth as accurately and succinctly as we can the economic and financial developments taken into account in arriving at each policy decision together with the reasons for the policy action taken and the reasons for any dissents to the action which individual members may have expressed. A policy record is prepared and reviewed promptly after each meeting in which a policy decision is reached. Thus, these records do not benefit or suffer from hindsight.

Under our established procedures, a first draft summary report of a policy proceeding is prepared by a competent and experienced secretary. It is then carefully reviewed without delay by every member who participated in the policy decision. Any proposed revisions or other suggestions are submitted for comment to the other members, and finally, after this process is completed, the revised draft is presented for approval at a regular meeting of the Board or Federal Open Market Committee.

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As I am sure is the case in the deliberations of legislative committees on which you allserve, it is not easy in every case to express concisely the reasons why a group of men took a particular action at a particular time. In any group some members will express their thinking in more detail and at greater length than others. It does not follow that the less expressive or even silent members hold less firmly to their opinions or have less compelling reasons for holding them.

It is also clear that the men who serve on the Board and the FOMC are influenced in their judgments by the total experience they have had as Federal Reserve officials and the kind of experience they carry forward into their Federal Reserve work from the varied private and public activities in which they previously engaged. In other words, they are influenced by more than the developments and technical considerations brought out at a single meeting.

Accordingly, the policy record is, and will remain, an imperfect account of all the considerations weighed in reaching a particular decision. It is doubtful, moreover, that it could be made more accurate either by lengthening it or by specifying its content more rigidly. Endeavors to force the rationale of decisions into a mold that might obscure the reasoning actually employed in specific cases could hardly serve a public interest.

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Beyond providing a vehicle for publication of the policy record, the Annual Report performs a number of other functions. It contains a very carefully drawn review of the economic developments and flows of credit funds during the year, with special reference to money and bank credit. From time to time some supplementary discussion has focused on the use of one or another of the instruments of policy for the purpose of making clear to interested persons the System's own interpretation of the role performed by that tool in the execution of policy.

The Report is also an avenue for reporting to the Congress on actions taken by the Board of Governors under certain special authorities that Congress has assigned to it. Examples are its actions under the Bank Holding Company Act and its operations in the field of bank supervision.

The Report further contains information with respect to the Board's internal administration and the operations of the Federal Reserve Banks. Finally, it presents some 20 statistical tables which summarize in figures the System's operations during the year.

A virtue of the Report, in my judgment, is that it has, in appropriate circumstances, contained recommendations for new legislation, discussion of the role of the System in current economic and financial developments, or explanations of the mechanism of its major policy instruments. There has been no feeling of compulsion, however, to extend the Report to these areas in every year.

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The Board has viewed the Report as a useful means for recording its actions and the reasons for them, for accounting to the Congress and the public for its performance of the responsibilities assigned to it, and for calling attention, when the occasion demanded or seemed appropriate, to desirable changes in the law.

As you know, the Board's Annual Report is only one of a number of media of communication of the System with the Congress and the public. Our prepared testimony before your Committee and others on various matters is another important medium. Then there are the Federal Reserve Bulletin and the monthly economic letters of the Federal Reserve Banks. From time to time, too, the staffs of the Board and the Banks engage in special studies in response to Congressional or other requests and the reports presenting the result of these studies are means of communicating with you. Lastly, the Board makes available for the information of the Congress and the public a booklet which endeavors to explain simply and yet adequately the purposes and functions of the Federal Reserve System as well as other informational publications on various phases of Federal Reserve activities, such as the one issue by the New York Federal Reserve Bank on "Federal Reserve Operations in the Money and Government Securities Market."

In conclusion, it is appropriate to recall the viewpoint that the Board expressed in 1952 to the Subcommittee of the Joint Economic Committee of which you were Chairman, concerned with Monetary Policy and Management of the Public Debt. In its written reply to a question

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put by your Subcommittee on practices in public information, the Board stated:

> "The guiding view of the Board of Governors and the Federal Reserve Banks in reports and information made available to the public is that an adequate and critical public understanding contributes to an intelligent credit and monetary policy designed to foster stable economic progress. Accordingly, the System is actively interested in disseminating factual and explanatory information on general economic conditions and on credit and monetary policies. Such is deemed to be the System's responsibility since the preservation of democratic institutions depends on an informed public opinion."

This continues to be the guiding view of the Board and the Reserve Banks.

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

May 24, 1961

Mr. Martin:

On the basis of a telephone call I had yesterday afternoon from John Clarke at the New York Reserve Bank, I would judge that Mr. Rouse and Mr. Hayes intend to accept invitations to testify on the morning of June 1 and the morning of June 2, respectively. I say this because the whole purpose of Clarke's telephone call was to get from me background information for Messrs. Hayes and Rouse in connection with the hearings planned by the Committee and there was not the slightest indication that Messrs. Hayes and Rouse were thinking of trying to avoid testifying on June 1 and 2.

JWS

P.S. I told Bill Johnson that you had to catch a plane at 5:15 on the afternoon of the 2nd, but he indicated no feeling that this would interfere with your appearance at 2:00 p.m. that afternoon.

P.S.S. (from Miss Muehlhaus)--There is a plane at 5:50, arriving Atlanta 7:15. It's nonstop also. The 5:15 nonstop arrives at 6:36.

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M'ss Muehlhaus

May 24, 1961

The Honorable Wright Patman,
Chairman, Joint Economic Committee,
Congress of the United States,
Washington 25, D. C.

Dear Mr. Chairman:

In reply to your letter of May 22, I will be glad to appear as the final witness at the hearings scheduled by your Committee for June 1 and 2 on the Board's Annual Report for 1960. It is understood that my appearance on June 2 is to be at 2:00 p.m.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

JWS:ac

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EXECUTIVE DIRECTOR

Congress of the United States

JOINT ECONOMIC COMMITTEE

(CREATED PURSUANT TO SEC. 5(a) OF PUBLIC LAW 304, 79TH CONGRESS)

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DIRECTOR AND CLERK

May 22, 1961

Honorable William McC. Martin, Jr.
Chairman, Board of Governors
Federal Reserve System
Federal Reserve Building
Washington, D. C.

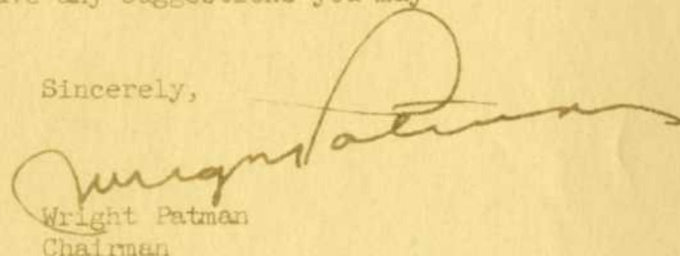
Dear Chairman Martin:

The Committee has scheduled hearings on the Board's Annual Report for 1960 for June 1 and 2.

If it suits your convenience, we would like you to be the final witness and, accordingly, are reserving the afternoon meeting for Friday, June 2, for your appearance.

Please let me know if this suggestion meets with your convenience and, further, let me have any suggestions you may have to offer.

Sincerely,



Wright Patman
Chairman

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For release on delivery -
not before 10 a.m. on
Thursday, June 1, 1961.

STATEMENT
BY
ROBERT G. ROUSE,
MANAGER, SYSTEM OPEN MARKET ACCOUNT,
BEFORE
JOINT ECONOMIC COMMITTEE

JUNE 1, 1961

Mr. Chairman and Members of the Committee:

My name is Robert G. Rouse. I am Manager of the Federal Reserve System's Open Market Account, and I am also a Vice President of the Federal Reserve Bank of New York. You have asked me to appear before you as a witness in this hearing, which, I understand, is to focus mainly on questions suggested by the record of policy actions of the Federal Open Market Committee contained in the Annual Report of the Board of Governors of the Federal Reserve System covering operations for the year 1960.

Before turning to a description of the process by which the policies established by the Federal Open Market Committee are translated into action by the management of the System Open Market Account at the Federal Reserve Bank of New York, it might be of interest to the Joint Economic Committee to hear about one or two of the special developments in the Government securities market since my last testimony before your Committee in August 1959. First of all, I am pleased to report that the program for regular statistical reporting by the Government securities dealers that arose out of the Treasury-Federal Reserve Study of the Government securities market, and which was encouraged by your Committee, has become a reality, with publication of the first data at the end of March. The collection and dissemination of these statistics is now working quite smoothly. Many of the dealers, despite some initial doubts, are finding that the statistics are useful to them. The general public interest in these statistics is illustrated by the fact that we have had requests from about 1,400 individuals and organizations to be put on the regular mailing list to receive them. I am also pleased to report that there has been an addition of one firm to the number of Government securities dealers with which the Desk does business. This brings the total number of such dealers to 18, and there are good prospects that we may see two more organizations develop into full-fledged Government securities dealers in the near future. As I indicated to you in 1959, we welcome additions to the list of primary dealers; we hope that there will be more in the future.

I should also like to compliment your Committee on the excellent study prepared under the direction of its staff and written by Professors Meltzer and von der Linde of Carnegie Institute of Technology. This study was a significant contribution to public knowledge of the Government securities market.

Much of what I have to say regarding the implementation of the policies of the Federal Open Market Committee is probably already familiar to you, since a great deal has already been written and said on this subject. In his appearance before the Joint Economic Committee in December 1956, Mr. Hayes, President of the Federal Reserve Bank of New York, described in some detail how the Federal Open Market Committee reaches its policy decisions

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and how these decisions are implemented by the Federal Reserve Bank of New York; and my own statement at that time also commented on the role of the Manager of the Account in this respect. In addition, there is the booklet prepared by Robert Roosa, entitled "Federal Reserve Operations in the Money and Government Securities Markets", which has been widely circulated among the public. This booklet was prepared by Mr. Roosa while he was associated with me in the management of the Account as assistant vice president in the Securities Department of the New York Bank. We believe it important that the interested public know as much as may properly be disclosed of how the System operates in the money and Government securities markets. Despite the fact that there is much that is already known, I thought it might be of some interest to the Committee to review briefly my personal experience as an individual in the front line of System operations that are designed to carry out System policies.

Open market policy is determined by the Federal Open Market Committee, which meets regularly at approximately three week intervals in Washington. These determinations are based on a broad and careful analysis of all aspects of the current state of business, credit conditions, international developments, and related matters. The Federal Reserve Bank of New York has been designated by the Committee as the institution in the System that conducts actual operations, on behalf of all twelve Federal Reserve Banks, to put the Federal Open Market Committee's policy into operation.

As Manager of the System Open Market Account, it is my responsibility to supervise the execution of all open market transactions carried on in accordance with the Committee's policy decisions. In view of my position as Manager of the System Account, I attend the meetings of the Open Market Committee. At each of these meetings, I make a report of System operations and stand prepared to answer any questions that any member of the Committee may care to raise on the manner in which the Committee's directions have been carried out. My attendance at the meetings gives me an opportunity to hear at first hand what the Federal Open Market Committee has in mind as to policy for the succeeding period as developed in the meeting. As you know from the record of policy actions contained in the Annual Report of the Board of Governors, the Federal Open Market Committee at each meeting issues a directive to the Federal Reserve Bank of New York setting forth the Committee's policy in broad terms. In addition, the Committee arrives at a consensus during the course of each meeting, which tends to specify in somewhat more concrete terms, but still in a relatively general way, a series of guidelines for the Manager of the Account. It is my duty as Manager of the Account to make sure that the intentions of the Federal Open Market Committee as to the management of the Account during the period between meetings of the Federal Open Market Committee are clear to me. My presence at those meetings affords me an opportunity of raising any questions that I may have at that time. In addition to the directive and the consensus laid down by the Committee, I have the benefit of hearing all the detailed statements by the several members of the Committee and by the other Presidents of the Reserve Banks who are not currently serving on the Committee. The views expressed in these statements serve as an important supplement to the more formal statement of the directive and the consensus, and furnish a number of additional guideposts for day-to-day operations.

A great deal remains to be said about the process by which day-to-day decisions to buy or sell Government securities are made on the basis of the Committee's policy intentions, and about the process by which the day-to-day activity of the Account is reviewed by the Committee on a current basis.

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I hope that in trying to be brief I will not leave out any essential elements of the story, and I shall, of course, be glad to answer any questions to fill in any gaps that you may feel exist in it.

First of all, it should be remembered that the Committee's decisions do not take place in a vacuum, but are made against the background of recent experience in the money and credit markets. I should like to emphasize this ever-present element of continuity. Quite often policy can be summarized in terms of creating somewhat more or somewhat less pressure in the money market and on member bank reserve positions, or in terms of maintaining about the same conditions that prevailed in an earlier period. In moving from a policy decision to day-to-day operations, the first question for determination is the effect of the natural influences in the market on bank reserves and on the degree of tightness or ease in the money markets. It may be, for example, that in the period immediately ahead, float, or a return flow of currency from circulation, or an inflow of gold, may be reasonably counted on to supply reserves to the market. If the Committee has decided upon a policy of ease, this natural flow of funds through the market may do a great part of the Manager's job for him. If, on the other hand, the Committee is pursuing a policy of restraint, an increase in bank reserves through such natural factors will require offsetting operations and thus will tend to make the Manager's problem more complicated.

In order to keep abreast of the very latest developments in all the factors affecting member bank reserve positions and the money market, the Federal Reserve has developed an elaborate system for collecting information, designed to feed into the Manager's hands all the latest data pertaining to bank reserve positions and the various factors that may be affecting these positions. On each morning, for example, we have on hand a complete nationwide picture of the reserve positions of member banks as of the close of business the night before, including full information on the distribution of reserves as between the money market banks, reserve city banks, and country banks. In addition to up-to-the-minute information on past developments, we have a number of specialists who forecast changes in factors affecting bank reserves for the period immediately ahead. These estimates are revised each day for the next succeeding three- or four-week period.

But it is clear that cold statistics do not provide sufficient basis for the conduct of day-to-day operations. We also rely heavily on the specialists who work on our Trading Desk, which serves as the listening post of the Federal Reserve System on the nation's money and securities markets. Located as we are in the heart of the country's financial center, and with direct communication with the Government securities dealers and the money market banks, we have a unique opportunity to follow developments in the market as they are occurring.

Part of our job is to disseminate this information on current developments throughout the System, and to the Treasury for which we execute transactions as fiscal agent of the United States. But in addition, hour-by-hour developments, particularly those in the Federal funds market, in the Government securities market, in the progress of Government securities dealers in finding the financing required to carry their portfolios of Government securities, provide the Manager of the Account with information which gives him an informed judgment of the degree of ease or tightness in the market--sometimes referred to as the "feel" of the market. The Federal

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funds rate tells us something about the availability of excess reserves in the banking system, with a rising rate indicative of somewhat greater pressure and a falling rate indicative of declining pressure on bank reserve positions. Similarly, if Government securities dealers--who scour the country each day in search of funds from banks, corporations, and State and municipal bodies--are having an easy time finding funds to finance their portfolios at relatively low rates, we know that there is a ready availability of short-term funds throughout the country. Movements in Treasury bill rates, too, may at times be indicative of nonbank liquidity as well as bank liquidity, and may be an important part of the information we use in reaching decisions on operations. Current trends in the capital markets are also taken into consideration in viewing the mix of pertinent factors.

The Manager of the Account is also directly concerned with activity by foreign central banks, monetary authorities and international institutions in our money market. Developments in our balance of payments and in the international position of the dollar are of course taken into consideration by the Federal Open Market Committee in its policy deliberations. But as Vice President in charge of the Securities Department of the New York Bank, I have a direct and immediate technical interest in these operations, since foreign central banks hold and invest so large a part of their dollar reserves through the Federal Reserve Bank of New York. Transactions for foreign accounts affect member bank reserves and thus must be taken into account when operations for System Account are being considered. The gold outflow in 1960, for example, was one of the major factors affecting member bank reserves with which we had to deal. The fact that the Federal Reserve Bank of New York has close institutional relationships with foreign central banks and performs so large a percentage of transactions for their account in the money market enables us to have first-hand information concerning the timing and the potential market impact of these transactions. At times the coordination of these foreign operations in the Government securities market with Federal Reserve open market operations can become a particularly important undertaking. Transactions for foreign accounts in the market on occasion may make the job of the Manager of the System Account somewhat easier; on other occasions, they may complicate it. At times, for example, it is possible for us to avoid an undesirable market impact of foreign account transactions by arranging transactions among these accounts or directly with the System Open Market Account. In any event, the fact that we have knowledge of such foreign transactions permits us to integrate them with System operations.

To sum up, then, we start from a policy decision of the Committee as to the degree of pressure or ease desired, and on the basis of our knowledge of the present and prospective influences on bank reserves as a result of the operation of natural factors, together with the information that is fed to us on a current basis by the money and securities markets themselves, a decision whether to supply reserves to the market or absorb reserves through open market operations is arrived at. This is a decision that has to be reached each day in the light of all of the factors that I have mentioned before. Our estimates and forecasts of bank reserve positions are subject to wide fluctuations as a result of any number of factors that can only be imperfectly predicted, and I might add that a decision not to undertake open market operations is as difficult as a decision to buy or sell. I should emphasize here that, while the management of the System Open Market Account is in constant touch with the market, the Account does not necessarily operate in the market every minute, every hour, or even every day or week.

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I think it is obvious that a considerable amount of judgment is required as to the nature, the timing and the exact amount of any given open market operation. The very nature of open market operations means that they must be approximate and directional in nature, rather than precise, and it is only by a constant review of the impact of our operations on the money market and on bank reserve positions that we can answer the question of how much we should do and when we should do it.

Although the Federal Open Market Committee meets periodically, open market operations must be conducted on a day-to-day basis. While the Open Market Committee lays down a number of guidelines for the Manager of the Account, the nature and complexity of our financial structure precludes the Committee from setting forth a precise schedule of purchases and sales of Government securities that the Manager should follow on each day. This should not be taken to indicate, however, that the Manager operates solely on his own initiative between meetings of the Committee, and hence has an opportunity to determine policy on his own account. I shall not attempt to go into the many advantages that stem from the regional character of the Federal Reserve System. The fact that we do have a regional system, however, and the fact that the Board of Governors is located in Washington while operations are, of necessity, conducted in New York, does require a highly developed system of communications within the System to insure that each member of the Board of Governors and each President of a Federal Reserve Bank is kept fully informed of the Manager's operation of the System Account on a day-to-day basis.

To start with, each morning there is a conference call at 11:00 o'clock, at which time the Account Management talks by telephone with a representative of the Board of Governors and one of the Presidents of a Reserve Bank who is currently serving on the Committee. Quite often, Mr. Hayes, the Vice Chairman of the Committee, and his alternate on the Committee, Mr. Treiber, the First Vice President of the New York Bank, sit in with my associates and myself on this call, and one or more of the Governors of the Board may sit in at the Washington end. After a summary of conditions in the money and capital markets as they have developed during the first hour of trading in the morning, a summary of the reports received from dealers as to the volume of trading in Government securities and their positions at the close of business on the preceding day, a review of the country-wide reserve positions, with special attention to the reserve position of the New York and Chicago money market banks, a review of developments expected for the day in the Treasury balance and other information that may appear pertinent, the Account Management outlines the approach it proposes to take with respect to operations during that day. (This review of our intentions is, of course, based on our assessment of conditions as they exist at 11:00 o'clock or thereabouts, and is subject to change should there be a significant change in the market atmosphere.) The other participants in the call may choose to comment on the course of action outlined by the Manager and may review any other developments that appear to them to be pertinent in this respect. A rather detailed summary of this call is prepared at the Board of Governors and placed before each member of the Board within a short time after the completion of the call. The same information is transmitted by telegram to the Presidents of all the other Reserve Banks, so that within a very short time the entire System has been alerted to the morning's developments and to the course of action that the Manager deems appropriate to implement the policy laid down by the Committee. This rapid dissemination of this information permits each member of the Committee to assess the desirability of the action contemplated by the Manager, and to make comments and suggestions if he believes it desirable to do so.

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I might add that, while the final responsibility for determining day-to-day operations rests with me, I rely heavily upon the staff work of specialists, traders, statisticians, economists, and others who devote so much of their time to the conduct of our System operations. I am, of course, able to discuss at any time problems that may arise with the Vice Chairman of the Committee or his alternate on the Committee, and if there are particularly troublesome problems, I may consult directly with Chairman Martin or request a telephone conference of the full Open Market Committee.

In addition to this daily call, a written report is submitted daily to the Board of Governors and to interested officers of other Reserve Banks, and at the end of each statement week, a full written report of Account operations as well as developments in bank reserve positions, the money, Government securities and capital markets is submitted by me to the members of the Open Market Committee and to the other Presidents. Similar reports are prepared to cover developments between meetings of the Open Market Committee, including a report which covers developments and Account operations up to the close of business on the Monday night preceding a meeting. Thus, when the Committee convenes on a Tuesday morning, it has a full written record of all the activity conducted for the Account, as well as a description of the background against which these operations were conducted.

And this is not all. During the course of the day, we submit hourly reports to the Board of Governors on prices and interest rates on Government securities, and indicate on an hourly basis, the operations that have been undertaken by the Account Management. In addition, a summary of the day's developments is also transmitted by telephone to a member of the staff of the Board of Governors by the Trading Desk after the close of the market at 3:30 p.m., and a summary of this information is prepared for distribution to members of the Board.

In addition to these informational activities, the System has devised, as part of its Emergency Planning Procedures, a program whereby certain officers and staff members of the other Reserve Banks and of the Board of Governors spend two to three weeks with us at the Trading Desk in New York. While this program was devised mainly to provide some measure of continuity in System operations in case of a national emergency, it has served to provide key people in the System with a broad understanding of the scope of, and the problems involved in, day-to-day open market operations.

All in all, while this program of information and training takes great time and effort, we feel that it is absolutely essential and that it has been quite effective in keeping the entire System up-to-date on operations undertaken on behalf of the Open Market Committee. The completeness of the information provided, and its current nature, permits each member of the Committee to be fully informed of the operations undertaken, and provides each member of the Committee an opportunity for continuous review of, and comment concerning, the manner in which the Manager is carrying out the instructions he received at the meeting of the full Committee.

I have come to the end of my prepared statement, Mr. Chairman; and I shall now be happy to answer any questions I can that the members of this Committee may have, relating either to matters that I have covered, or to any other matters that are within the scope of the Committee's announced interest.

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For release on delivery--
not before 10 a.m.,
Friday, June 2, 1961.

STATEMENT
BY
ALFRED HAYES,
PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK
BEFORE
JOINT ECONOMIC COMMITTEE

JUNE 2, 1961

Mr. Chairman and Members of the Committee:

My name is Alfred Hayes. I am the President of the Federal Reserve Bank of New York, and a member and the vice chairman of the Federal Open Market Committee. You have asked me to appear before you as a witness in this hearing, which I understand is to focus mainly on questions suggested by the record of policy actions of the Federal Open Market Committee contained in the Annual Report of the Board of Governors of the Federal Reserve System covering operations for the year 1960. I am glad to have this opportunity to appear before the Committee to discuss some of these points, and possibly to assist the Committee in respect of particular matters that concern it.

As Mr. Rouse stated when he appeared before you yesterday, the Federal Open Market Committee has selected the Federal Reserve Bank of New York to carry out all transactions in U. S. Government securities for the account of the twelve Federal Reserve Banks. The selection of the Federal Reserve Bank of New York is the logical consequence of its physical location in the nation's money market center, where the great bulk of all transactions in Government securities, and in other money market instruments, actually takes place. The securities acquired pursuant to such operations are held in a "System Open Market Account" in which the twelve Reserve Banks participate.

The general position of the Federal Open Market Committee as to credit policy is set forth in the directive it issues to the Federal Reserve Bank of New York at each meeting. Each directive is amplified by the statement of the consensus of the Committee and by the full discussion of the participants in the meeting, all of which are noted in the minutes of the meeting.

The primary responsibility for the conduct of day-to-day open market operations rests with the Federal Reserve Bank of New York, acting in accordance with the directions of the Federal Open Market Committee, whose members are kept currently informed of these operations. Within the Bank, this responsibility is centered in the Manager of the System Open Market Account. The Manager has the advantage of frequent consultation with the President of the Bank, who is a member of the Committee, with the First Vice President of the Bank, who is an alternate member of the Committee, and with a staff in constant touch with the market. All of them have an incentive to keep continuously informed and to be readily available for consultation because of the institutional responsibility which they share. This sharing of responsibility has the additional advantage of permitting an internal arrangement whereby, in the absence of the Manager, the First Vice President acts as his alternate in respect of open market operations.

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In his statement yesterday Mr. Rouse referred to the fact that the Federal Reserve Bank of New York, as fiscal agent of the United States, executes transactions in Government securities for the Treasury Department and that the Bank also conducts similar transactions in behalf of foreign central banks and certain international organizations. These transactions, which are conducted under the general supervision of Mr. Rouse in his capacity as Vice President of the Federal Reserve Bank of New York, affect member bank reserves and thus are relevant to, and must be closely coordinated with, System policy. The conduct of such Treasury and foreign transactions by the New York Bank enables the Manager and his staff to be informed as to their potential market impact and thereby to achieve, where desirable and possible, a closer integration of such transactions with the aims of System Open Market operations. As Mr. Rouse mentioned, it is at times possible for us to avoid an undesirable market impact of foreign account transactions by arranging transactions among those accounts or directly with the System Open Market Account. The fact that the Federal Reserve Bank of New York, as an institution, acts as fiscal agent of the United States, and serves as correspondent bank for foreign central banks, monetary authorities, and international organizations greatly facilitates the carrying out of the objectives of the Federal Open Market Committee.

I understand that you are particularly interested in the subject of the adequacy of the information provided by the Federal Reserve System, especially with reference to the record of policy actions taken by the Federal Open Market Committee. I assume that you would like me to comment first on the adequacy of the information in the Annual Report of the Board of Governors that pertains to the record of policy actions of the Open Market Committee.

The policy record of the Federal Open Market Committee, which is published each year as part of the Annual Report of the Board of Governors records all formal actions taken at each meeting of the Committee. The directive to the Federal Reserve Bank of New York is given in full, together with the names of all members voting for or against its continuation or change, as the case may be, at each meeting. Furthermore, the consensus arrived at is recorded, and the considerations leading to it are summarized in some detail.

When decisions are not unanimous, the views of the minority are presented and occasionally it is also indicated what changes in the text of the resolutions adopted would have made it possible for the minority to vote for them. The secretary circulates the draft of the policy record to all members of the Committee in order to assure the presentation of a comprehensive and fair picture of our deliberations.

I believe that the Board's report, including the Federal Open Market Committee policy record, presents in an effective manner a comprehensive record of steps taken as well as a review of the underlying rationale. Students of monetary affairs have found this to be a valuable report.

The policy record is published once a year in the Board's Annual Report, as required by law. It has been suggested that the policy record be published more frequently. It has been pointed out that under present practice the record of the last meeting of any year becomes available with a delay of only about three months, while about fifteen months elapse between the first meeting of any year and the publication of the record of that meeting in the Annual Report; and it has been suggested that the policy record could perhaps be published quarterly,

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with an appropriate lag. This possibility has been raised within the System. While I can see merit in the suggestion for quarterly publication under some circumstances, I would emphasize that the Federal Open Market Committee has not yet considered the matter in detail. I am sure that the Federal Open Market Committee would wish to avoid any hasty conclusions on this matter, in view of its importance.

I should not like to leave this subject without pointing out that students of monetary matters, and all those who must make decisions in credit and capital markets, follow closely the wide range of weekly and other periodic banking statistics published by the System, including the recently inaugurated release of data on United States Government securities markets, a matter concerning which your Committee has shown great interest. A timely and comprehensive review of business and credit conditions is available in the various monthly publications of the Federal Reserve System, including our Bank's Monthly Review, which carries each month a very detailed analysis of the credit and securities markets with particular attention given to United States Government securities and to Treasury financing operations. In addition to this material, which is written for those who closely follow current financial developments, we make an effort to provide less technical material, dealing with System functions, operations and policies, designed to be of interest to a much wider segment of the public.

I should like to address myself now to the first of two related questions in which I understand the Committee is interested, that is, whether monetary policy can be determined for longer periods in advance, and made public. It must be understood in this connection that an effective monetary policy requires a continuous review and reassessment of the evolving business and credit situation, both domestic and international, in which there must be a prompt and sensitive reaction to the interplay of factors affecting the development of policy. As you know, the Federal Open Market Committee generally meets every three weeks for a full scale review of these matters, and special meetings can be called on short notice. Monetary policy has the major advantage of a high degree of flexibility--an advantage that would be lost if it became a practice to determine and announce policy intentions for long periods in advance. Fiscal policy does not, generally speaking, enjoy the same degree of flexibility. There would clearly be no wisdom in reducing the flexibility of over-all economic policy by making monetary policy less sensitive and less adaptable to changes in the business and credit situation.

The second related question in which this Committee has evidenced an interest is whether it would be advisable to make a prompt announcement of policy decisions. In response to this question, I could say that theoretically it would be possible for the Federal Open Market Committee to make an immediate announcement following each meeting as to the policy it had adopted. In practice, however, such public announcements would seriously interfere with the effectiveness of monetary policy. For example, business and credit conditions may at times be so clouded that the Federal Open Market Committee may wish to undertake a modest shift in the extent or direction of its operations and then evaluate the effect on credit conditions and on the money market. Depending upon the results, this shift might develop into a full-fledged move, or might be quickly reversed. The usefulness of such operations would be destroyed if the market were informed as to what was being attempted. Moreover, an announced shift in System policy might set off a wave of optimism (or pessimism) which, in turn, might result in substantial changes in security prices and yields. If somewhat later the System found it

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appropriate to reverse policy and made a public announcement to this effect, an opposite swing in market sentiment would be quite likely. In other words, a policy of prompt announcement might subject financial markets to disruptive swings in prices and yields that would serve no useful function. Conceivably such a policy might introduce an unnecessary and unwarranted degree of rigidity into System actions for fear of the very swings just mentioned.

I have now come to the end of my prepared statement, Mr. Chairman, and I shall be happy to answer any questions I can that the members of this Committee may have relating either to matters that I have covered or to any other matters with which this Committee is now concerned.

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