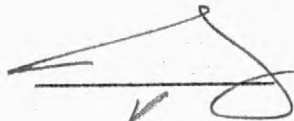



The attached minutes of the meeting of the Board of Governors of the Federal Reserve System and the Federal Advisory Council on September 19, 1961, which you have previously initialed, have been amended at the request of Mr. Livingston to revise the first paragraph on page 16.

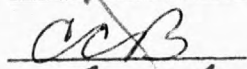
Governor Mills



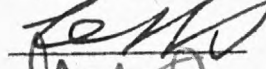
Governor Robertson



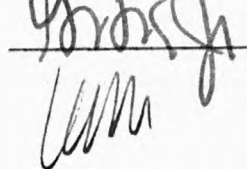
Governor Balderston



Governor Shepardson



Governor King



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Minutes for September 19, 1961

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date. 1/

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin

(M)

Gov. Mills

[Signature]

Gov. Robertson

[Signature]

Gov. Balderston

CCB

Gov. Shepardson

[Signature]

Gov. King

[Signature]

Gov. Mitchell

[Signature]

1/ Meeting with the Federal Advisory Council

A meeting of the Board of Governors of the Federal Reserve System and the Federal Advisory Council was held in the Board Room of the Federal Reserve Building in Washington, D. C., on Tuesday, September 19, 1961, at 10:30 a.m.

PRESENT: Mr. Balderston, Vice Chairman
Mr. Robertson
Mr. Shepardson
Mr. King
Mr. Mitchell

Mr. Sherman, Secretary
Mr. Kenyon, Assistant Secretary

Messrs. Enders, Murphy, Petersen, Hays, Hobbs, Persons, Livingston, Murray, McClintock, Betts, and Frankland, Members of the Federal Advisory Council from the First, Second, Third, Fourth, Fifth, Sixth, Seventh, Ninth, Tenth, Eleventh, and Twelfth Federal Reserve Districts, respectively

Mr. Allen Morgan, President, The First National Bank of Memphis, Memphis, Tennessee

Mr. Prochnow, Secretary of the Federal Advisory Council
Mr. Korsvik, Assistant Secretary of the Federal Advisory Council

In the absence of Mr. Turner, Member of the Federal Advisory Council from the Eighth Federal Reserve District, Mr. Morgan represented the District at this meeting.

There had been distributed before this meeting a memorandum from the Council listing the topics suggested for discussion. The topics, the statement of the Council with respect to each, and the discussion at this meeting were as follows:

1. What are the views of the Council concerning the current business situation and prospects for the remainder of 1961

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and early 1962? Is rapid expansion in activity likely to continue without interruption for another six months, as it did after the autumn of 1958? How does the demand situation at present compare with the situation at that time?

The Council believes that the over-all level of business is good and that there will be further expansion in activity in the remaining months of 1961 and early 1962. The members of the Council expect the expansion in activity to continue without interruption for another six months, but they do not anticipate it will reach boom proportions. The Council believes that the present demand situation is not as strong as it was in the autumn of 1958.

At the instance of the Board, there was a general discussion of the sluggishness of retail sales and the reasons that might be assigned. In this connection Vice Chairman Balderston noted that the Board's index of industrial production had moved from 102 to 113 over a period of six months. In 1958 the improvement over a like number of months was 9.1 per cent so the recovery, as far as industrial production was concerned, had been fully as rapid as in 1958. However, the failure of consumer spending to increase in the same proportions was rather perplexing.

President Livingston indicated that the Council also was perplexed. The level of consumer income and the available accumulation of liquid assets would suggest that consumer spending should be more brisk than at present. This question had also come up yesterday at the Council's meeting with members of the Board's staff, and the staff likewise apparently was searching for an answer. At the meeting of the Council, there had been speculation on various factors that might have a bearing on the situation. For example, the thought was expressed that the recent recession and the continuation of relatively large-scale unemployment might

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have produced apprehensions about job security. Also, it was suggested that mounting international tensions might for some reason be causing the consumer to be less willing to buy. However, the Council did not pretend to know exactly why the phenomenon of a reticence on the part of the consumer to spend more freely existed. Perhaps the consumer actually had fairly well caught up on his basic needs and preferred to husband his resources for the time being. At any rate, if the consumer should start to buy with the briskness that one might expect at this stage of the cycle, the resurgence of the recovery would assume large proportions.

Question was raised as to whether there were indications of greater discrimination and selectivity in consumer buying, in response to which two members of the Council cited evidence that had come to their attention which indicated that the consumer was searching for quality products, with price perhaps only a secondary factor. In one instance, a lower-priced line introduced by a manufacturer had been withdrawn from the market due to lack of consumer acceptance. A member of the Board expressed the view that disappointment with the serviceability of new products may have created consumer resistance, with the result that products were being retained longer and more of the consumer dollar was going into maintenance and repair costs.

It was noted that smaller appliances appeared to be moving better than larger items, which might indicate that consumers were relatively well supplied with larger appliances of longer useful life. Many such items, it was pointed out, had been acquired as part of the furnishings of new homes in recent years.

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There was general agreement that as yet little if any evidence had been seen of an accumulation of goods in the face of the critical international situation, and one explanation suggested was to the effect that the magnitude of any potential calamity may have produced a rather fatalistic attitude. Likewise, while the sluggishness of consumer spending might seem to suggest that the consumer was not particularly apprehensive about inflationary potentialities, the thought was expressed that other factors might have a more direct bearing upon spending decisions, particularly in the case of relatively minor objects of expenditure.

With respect to the relationship of the unemployment problem to consumer attitudes, one Council member pointed out that his bank had extended many notes during the period of major unemployment that extended into the second quarter of this year and that these obligations were only now in the process of being paid off. Thus, in some instances consumers might not yet have built up a sufficient cushion to warrant the resumption of active spending. In this connection, however, question was raised whether a substantial proportion of those who had been unemployed were not in the category where buying was limited principally to necessities. This question suggested that the return of such persons to the ranks of the employed might not create any substantial buying potential. At the same time, current statistics showed high levels of employment and of personal income, which would seem to indicate that enlarged consumer spending might have been expected.

One Council member reported conversations with persons in retailing which suggested a surge in consumer buying very recently. His comments

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also led into a general discussion of the increasingly important role of the discount houses in the retail trade picture, with many top-line manufacturers now offering their products through such houses, servicing of products sold becoming more available from the discount houses, and other outlets having to consider competitive steps in terms of price and reduction of overhead. The volume of business of the discount houses was believed to have become so important that the omission of such firms from the Federal Reserve department store sales series seriously weakened the value of those figures for purposes of analyzing retail sales of consumer durables.

Governor Mitchell inquired whether it would be fair to say, by way of interpretation of the Council's statement on this topic, that the Council was not too bullish about business prospects, that it was quite cautious in its appraisal of the outlook, that although the Council looked for some further increases in the index of industrial production and in gross national product, it would expect a moderation of the rate of increase of the past several months, and that the attitude of consumers introduced some uncertainty into the future trend of the recovery.

Comments by President Livingston and other members of the Council indicated general agreement with Governor Mitchell's summarization. The discussion concluded with an observation by Mr. Murphy to the effect that a much faster rate of advance could create problems, whereas the current and prospective rate of progress, which could be characterized as a healthy recovery, would appear to be sustainable over a longer period of time.

2. Are there indications that increased international tension and the increase in the defense program are

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having any effect on business buying or on consumer buying? Has there been any shift in recent weeks in business views as to prospects for commodity prices? Is there any concrete evidence that inflationary expectations are developing?

The members of the Council have seen no evidence that increased international tension and the increase in the defense program have had any important effect on business or consumer buying. The Council discerns no shift in recent weeks in business views as to the prospects for commodity prices. There is little concrete evidence at this time that inflationary expectations are developing, but the members of the Council believe that underlying, long-term inflationary factors are still present.

President Livingston noted that these questions had been touched upon to some extent in the discussion of the preceding topic. In response to a comment by Governor Robertson that he was glad the Council had seen fit to include in its statement the reference to underlying, long-term inflationary factors, President Livingston said he regarded this as one of the most serious problems facing the country. All of the movement seemed to be in one direction, and things happening now would tend in time to accentuate the problem.

Governor Shepardson noted that although the defense program was showing the usual lag in terms of actual expenditures, there was the prospect of a considerable bulge in expenditures in the relatively near future, and the comments made in response by President Livingston were in agreement with this observation. President Livingston went on to say that the Council was in rather complete agreement that expectations of inflation were the basic answer to the behavior of the stock market in recent months and to the lack of interest generally in fixed-income obligations.

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3. Is the recent shift from inventory liquidation to accumulation likely to be followed by still more rapid accumulation?

Most members of the Council do not anticipate in the months immediately ahead a more rapid accumulation of inventories than occurred during the first half of 1961.

President Livingston commented that the Council had experienced some difficulty in phrasing its answer to this question in view of the significant shift from inventory shrinkage to inventory accumulation within the first half of this year. For further comment on this point he turned to Mr. Prochnow, who cited statistics indicative of the contrast between the situation in the first quarter of the year and in the second quarter. It was the feeling of the Council that this shift was of a greater magnitude than was apt to be found in succeeding quarters.

Governor Mitchell inquired whether the Council members detected any tendency on the part of businessmen to expand their inventories substantially beyond present levels, and the responses were generally to the effect that evidence of such a trend was not seen. Mr. Hays reported, however, a good deal of conversation regarding the possibility of accumulation of metal inventories in the first and second quarters of 1962 in anticipation of a strike in the steel industry upon the expiration of the current labor contract about midyear.

Governor Shepardson inquired whether the Council foresaw a general trend toward lower inventory levels because of improved inventory control procedures, and President Livingston replied that somewhat differing opinions on that point existed within the Council. In his own opinion,

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however, the improvement in control techniques was not so important a factor as to account for changes in basic inventory trends.

Governor Balderston inquired whether the Council saw any evidence as yet of the accumulation of inventories for speculative reasons, and the response was in the negative.

4. Are businesses changing their plans for plant and equipment expenditures in response to the recent increase in business activity and profits? Are funds readily available from internal sources or from the capital markets to finance larger capital outlays?

The members of the Council do not believe that businessmen are changing their plans for plant and equipment expenditures in response to the recent increase in business activity and profits. In general, the Council anticipates that while such expenditures will rise in the latter part of the year, total expenditures for 1961 will be somewhat below outlays last year. Internal sources supplemented by funds from capital markets are likely to be adequate to finance the anticipated increase in investment.

The Council's statement was noted, and there was no further discussion of this topic.

5. Are consumers likely to continue to buy goods and services in only moderate volume, considering current income levels, or will they tend to borrow more and accumulate liquid assets less rapidly than in the recent past? With the more liberal financing terms provided by new legislation, mortgage rates down from earlier highs, and disposable incomes up, is there evidence of strengthening in demand for residential properties?

The members of the Council expect consumers to spend and borrow more in the months ahead than in the recent past. Although the demand for residential properties, as indicated by housing starts, applications for FHA commitments, and requests for VA appraisals, is above the low point of December 1960, there is little indication of any important strengthening in this demand.

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With respect to residential construction, President Livingston said he continued to feel--and he thought this was the general feeling of the Council--that the absence of greater vigor was not due to any lack of financing at satisfactory terms, but rather to the fact that there were enough houses available for those who wanted them. While there might be some areas where this was not the case, the situation that he had mentioned prevailed generally in the Seventh District and apparently in other parts of the country as well.

6. Are demands for bank credit developing more or less actively than usual for this season of the year? In what areas is loan demand most active? Does the Council's experience confirm the observation that the slower rate of loan expansion thus far in this recovery period has been due to a heavy volume of loan repayment from the proceeds of security issues rather than a lag in the demand for new loans?

The over-all demands for bank credit are developing less actively than usual for this season of the year and do not yet reflect the increase in business activity. Although business loans of weekly reporting member banks are still (as of the close of August) somewhat below their 1960 year-end level, further inventory accumulation and the anticipated expansion in business should increase the demand for bank loans. With the exception of certain types of construction loans in some districts, the members of the Council do not find any areas of loan demand significantly more active than others. The Council's experience does not confirm the observation that the slower rate of loan expansion thus far in this recovery has been due to a heavy volume of loan repayment from the proceeds of security issues rather than a lag in the demand for new loans. A heavy volume of loan repayment from the proceeds of security issues is only one factor in the slower rate of loan expansion in this recovery period.

President Livingston said the one area where the members of the Council were able to identify a significant increase in the demand for bank credit was in connection with certain types of construction loans.

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However, the total involved would not be so large as to be indicative of any general trend in construction activity.

Speaking further to this point, Mr. Murphy reported evidence of a pick-up recently at banks throughout the New York City area in lending for general construction purposes, including the construction of apartment houses, shopping centers, and office buildings. There appeared to be considerable underlying strength, and insurance companies were willing to make the necessary commitments for long-term mortgages. As to office buildings, a question might be raised as to when the saturation point would be reached. However, all of the new buildings seemed to be filled before completion. One expert in the field was inclined to feel that the construction of such buildings could go on indefinitely, due to the tendency for new buildings to render the older ones obsolete. It was now becoming difficult to lease space in buildings not equipped with air conditioning, and it is almost prohibitively expensive to air condition some of the older buildings.

Mr. Murphy also reported some indication of a little more activity recently in the field of loans to commodity dealers. He went on to say that a check around the Second District on the strength of loan demand revealed mixed reactions, three respondents advising that the demand was strong, three stating that it was light, and two reporting a more or less sideways movement.

Mr. Frankland commented that in the Twelfth District it was necessary to take into account a sizeable volume of loans coming into existence as the result of Housing and Home Finance Agency programs; for

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example, the construction of school dormitories. For the District as a whole, the total of such programs was quite substantial.

President Livingston then referred to the Council's statement on the last of the three questions presented under this topic. As indicated thereby, he said, the Council felt that the volume of security flotations had been a factor contributing to the slower rate of loan expansion thus far in the recovery. However, the Council felt that it should not be construed as the dominant factor. In any event, the usual seasonal increase in commercial loans had not yet been experienced. The Council was still hopeful that the seasonal demand would appear, but time was running out.

Governor Mitchell inquired what the experience had been over the mid-September tax date, and the replies indicated that the experience might be classified as about typical or as slightly disappointing.

Governor Balderston commented on the steady rise from year to year in the availability of internal funds, and President Livingston agreed that the increase over a period of time had been large. While he did not think the trend had reached a point such as to suggest that the usual seasonal rise in the demand for credit should not be expected in the latter part of the year, nevertheless the growth of internal funds was continuing.

7. What does available information concerning particular products suggest as to the course of exports? Will exports generally remain close to the advanced level reached early this year or will they show important changes in one direction or another? Is increased production in this country leading to increased imports?

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Available information concerning particular products provides little or no guidance as to the probable course of exports. The Council anticipates that the volume of exports will be down moderately from the advanced level reached early this year. Although the volume of imports is somewhat below last year, increased production in this country should lead to increased imports.

President Livingston commented on the difficulty encountered by the Council in arriving at any responsive statement. Generally, the Council believed that with the expansion of production in this country the importation of a good many parts and basic materials would necessarily increase, but the Council found it difficult to measure the significance of any such development.

Mr. Petersen said he thought it was hard to measure export and import trends according to particular product areas. He gathered the Board was seeking some kind of estimate from the Council on the course of the trade balance, but he did not think such an estimate could be obtained from a group such as the Council.

Governor Shepardson inquired whether the Council sensed any serious trend toward protectionism, in response to which President Livingston said he continued to feel that the movement of national sentiment, to the extent it existed, was in the direction of increasing tariffs rather than toward liberalization. While he deplored this trend, he felt that probably it was natural when a recessionary period had occurred.

General Persons expressed agreement with President Livingston's appraisal of the trend of national sentiment. Relating this to the southern part of the country, he described the activities of textile and pig iron manufacturers in recent years on behalf of measures to discourage competitive

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imports. He sensed growing apprehension, particularly among the laboring class, that jobs would be lost because of the import of various products into this country. A similar appraisal of the trend of public sentiment was expressed by Mr. Murray.

Mr. Petersen also reported evidence of a considerable rise in protectionist sentiment that he thought it would be difficult to counter-balance. As to the trade account, he noted that the United States balance of payments was favorable; this was one good aspect of the balance of payments figures. The problems in this area were, he felt, difficult of solution. In textiles, for example, competitive imports were coming not only from Japan but a number of other countries. At the same time, United States exports were fully as great as the imports, but they were in different categories. Further, in the case of Japan, that country had its own problems. It was running a large trade deficit and losing reserves, and it was one of the best customers of the United States. In fact, most of its unfavorable balance could be accounted for by its trade with the United States. Similar examples could be cited involving other products and other foreign countries. In an effort to obtain protection, resort was being had increasingly, with Governmental sanction, to what might be called "international cartel arrangements". These had been developed, for instance, in textiles, lead, zinc, and crude oil. In the political sense, such arrangements might have the effect of diminishing the force of the tariff argument, but in the longer run he felt that the trend toward the use of such agreements was deplorable. The greatest problem this country was facing in the

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international trade field, Mr. Petersen felt, was the growth of the common market, which was essentially a form of discrimination against the United States. Unless this problem could be dealt with effectively, the economic growth of this country could be injured.

Governor Balderston commented that for over a year the formulation of System policy had had to take seriously into account balance of payments factors as well as domestic objectives. At present, the System had to remind itself constantly that the improvement in the gold outflow since last fall might be only temporary. The situation had been smoothed over for a time due to circumstances that were fortunate for this country, although perhaps unfortunate for other countries. The trade advantage between exports at an annual rate of \$19 billion and imports at an annual rate of \$13.5 billion that opened up in the second quarter of this year could be explained largely by the boom conditions in Europe and Japan, and those conditions could not be expected to last indefinitely. Further, the rate of imports seemed likely to rise. In short, one might suppose that the trade balance would tend to diminish as the boom abroad receded and the business expansion in this country led to an increase in imports. This brought closer to the System the same type of problem with which it struggled in the second half of 1960; namely, to try to keep the Treasury bill rate high enough to discourage an exodus of gold and short-term capital, and at the same time low enough to encourage expansion of business in this country.

8. Does the Council care to make any comments on the apparently growing tendency to use drafts, some with documents, as cash items in lieu of checks?

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The use of drafts, some with documents attached, as cash items in lieu of checks, is presently not of large volume. However, it does represent some abuse of the banking system, and it would be unfortunate if this practice accelerated and became widespread. Furthermore, the expanded use of drafts might hamper the encoding and mechanical handling of these items.

President Livingston said that while the members of the Council deplored this practice and their banks had tried to resist it, the problem did not appear as yet to be sufficiently important to require that specific steps be taken. If the problem should assume more importance, all of the members of the Council felt that something would have to be done about it. From a rather careful canvass among the Council members, it appeared that the volume of drafts was a little less than popularly supposed. The practice had existed for a long time, had spread somewhat, and a recent article in the Wall Street Journal attracted attention to it. A problem did exist, and the banks were watching it closely. However, contrary to the impression created by the article that almost a free service on the part of the banks was involved, the discussion of the matter by the Council indicated that in most instances commensurate balances were maintained. In summary, the practice was not believed to be large enough at the present time to constitute a severe problem, but it must be watched closely.

9. What have been the effects of extension of Federal Reserve operations this year to other than short-term Governments?

It is extremely difficult to evaluate with assurance the effects or desirability of the extension of Federal Reserve operations this year to other than short-term Governments. The short-term market has tended to be relatively stable and above 2 per cent, but the change in operations may have introduced some uncertainty into the long-term Government bond market.

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In introductory comments, President Livingston said the Council was mindful that total System purchases of longer-term securities in the period until August were in the neighborhood of \$2.2 billion, of which purchases of about \$1.45 billion were in the one-to-five year category. At the same time, purchases in the over-10-year maturities totalled about \$80 million. One thing, he noted, was rather obvious. Whereas some had thought that the result of the Federal Reserve operations would be to hold down long-term interest rates, this had not happened. Such rates were now higher than when the System operations began, and about seven issues were now yielding more than 4 per cent. This comment was made as a factual observation and not in condemnation of the System's effort.

President Livingston went on to say that he interpreted what the System had done as an effort at experimentation in an area where no one was sure of the answer. In other words, it appeared to him to have been an effort to accommodate, without risking serious danger, the actions of the System to the beliefs of those who felt that operations in all maturities would be desirable. From his own point of view, he did not think this was a good thing. In effect, the Federal Reserve was pegging the market, and this was basically wrong no matter how small the transaction figures might be. Thus far, as he saw it, the System operations had not been of consequence in accomplishing the objective that apparently had been sought.

Mr. Murphy commented that it was rather difficult to know what the situation would have been like if the System operations had not occurred. The short-term market had been quite satisfactory, and the movement was

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more orderly from a cyclical standpoint than in 1958 as far as interest rates were concerned. Thus, the effects that had been seen had been satisfactory. While not too much had happened in the long-term area, there was some concern about the character of the long-term Government bond market. If a holder of long-term securities tried to sell today, it was difficult, without the Federal Reserve support in the background, to find a buyer. It was almost impossible to know today what the market for long-term Governments was, and most market participants would be happier if the law of supply and demand was at work. Nevertheless, he considered the System operations a worthwhile experiment. To have denied the advocates of such operations a fair trial would not have been right. It would take more time to determine the full effect of the experiment with certainty.

Governor King referred to the two parts of the second sentence of the Council's statement and inquired whether the Council regarded the introduction of some uncertainty into the long-term Government bond market as a more important development than the fact that the short-term market had tended to be relatively stable.

President Livingston replied that it was difficult to analyze just what had happened, and what would have happened if the change in System procedure had not occurred. He did not hold the view that the Council's statement might seem to imply that the relative stability in the short-term market was attributable to the change in Federal Reserve practice. Based on the experience of his own bank, and of other large city banks, it could be said that a rather peculiar thing had occurred. The banks

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anticipated a seasonal increase in loans in the latter part of this year, which was a normal expectation. They also realized that a substantial percentage of their deposits was already invested in loans, and therefore they were concerned about the impact on their reserve positions and on their liquidity of the superimposition of the anticipated increase in loan volume. Accordingly, they traded in Federal funds rather than acquiring bills, hoping thereby to be ready immediately to take care of additional borrowing requirements. This circumstance, in his opinion, was more responsible for the maintenance of the bill rate than anything the Federal Open Market Committee had done policywise. In retrospect, it would have been wiser for the large banks to go into bills, and that would have had quite an effect on the yield.

Turning to the second part of Governor King's question, relating to the long-term area of the market, President Livingston said he had some difficulty in analyzing the matter. According to his understanding of the background of the operations in longer-term securities, the Administration was concerned about the fact that interest rates on money borrowed for a long term of years were relatively high. The theory was that if the rate were lower, people could borrow more freely to buy homes and for similar purposes, and this would be helpful to the economy. The objective, therefore, was to bring down long-term interest rates, and a policy was devised toward that end. During the period of the operations in longer-term securities, numerous factors had exerted a bearing on the rate structure. Arithmetically speaking, however, the effort had failed because long-term

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rates, rather than going down, had gone up beyond the levels prevailing in February.

Governor King inquired whether, going back several months, the banking behavior that President Livingston had outlined could have been forecast, and the latter replied that he did not think so. In the light of developments, the banks had been wrong in not acquiring more bills because they could have had better earnings. Governor King then inquired whether it would be fair to say that the behavior of the banks and the Federal Reserve operations both were factors contributing to the relative stability of short-term rates, and President Livingston replied that probably this could be said.

Governor Robertson inquired whether, assuming that the Federal Reserve operations were an experiment designed to push down long-term rates, it was felt that the amount of Federal Reserve buying was sufficient to test whether the experiment could or could not succeed, and President Livingston replied that he thought the answer would be in the negative.

Governor Robertson then presented the question whether any critically adverse factors involved in the experiment could be determined until the time arrived when the Treasury wanted to extend the maturity of the public debt portfolio. His opinion was that the test would come at that time.

President Livingston replied that he thought this was true. Even prior to the System operations, he noted, the long-term market was extremely thin, and System operations had added another element to the picture. He did not think anyone could tell what rate of interest a 30-year bond should

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bear as long as this element was a part of the market picture. It was not possible to make an objective determination.

Governor Mitchell said he did not think it was fair to say that the policy had failed simply because long-term rates were higher at present than in February. Rather, one must consider what they might have been. In view of interim developments, including the large volume of State and corporate financing, there was no question in his mind but that the rate pattern would have been quite different without the participation of the Federal Reserve in the longer-term market.

Governor Mitchell went on to say that he was not quite sure what the Council thought about the long-term market. The Council's statement indicated that the change in System operations might have introduced some uncertainty into the long-term Government bond market, and he gathered that perhaps the Council was not prepared to go beyond that point at this time. He would like to know, however, whether the Council felt that the consequences of these System operations would, over the long range, be regarded as uncertain, or whether they were regarded as certain to be bad.

President Livingston replied that he would like to say the former, but he believed the latter.

Governor Balderston said he was one who believed that transactions in the short-term area were the most convenient and practical method of conducting System open market operations. Nevertheless, he had come to feel in the fall of 1960 that in view of the international situation, and particularly the gold outflow, the System must protect the bill rate against

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a decline such as occurred in the spring of 1958. Also, he realized that the academic fraternity, perhaps through the failure of the System to teach and convert, was almost unanimously against the bills preferably policy. While arguments existed that were plausible to the Federal Reserve staff, the System had not experimented in order to develop the facts. In the latter half of 1960, the System became confronted with a situation that had to be met, and it tried to keep the bill rate from declining severely by using other instruments of policy such as reserve requirements. Looking back on the period of System operations in longer-term securities, he found himself unable to make the point convincingly that monetary policy was too much different no matter whether System operations were confined to the short-term area or whether they were conducted across the whole spectrum of the market. By this, he referred to the effect of putting in reserves at one point or the other. However, when the argument turned to the operation of the market, he had more concern.

To him, Governor Balderston said, the critical point was whether the game was worth the candle. The question, in other words, was whether, considering the inconvenience and the possible damage to the breadth, depth, and resiliency of the market, the risk was worth taking. Looking at the results thus far, he could not see that effects were as yet visible that would demonstrate the incorrectness of operating in longer-term securities as well as short-term. He had been waiting to see the evil effects of such operations in terms of the intermediate and long-term areas of the market, but the evidence did not convince him that the case had yet been proved.

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Following a reference to the apparent success of the Treasury's current advance refunding offer, Governor Robertson said that he did not consider the advance refunding a real test. As he had said previously, the test would come when the Treasury wanted to extend the maturity of its portfolio by offering long-term bonds. Without question, the long-term market was extremely thin today, and the volume of transactions was dwindling.

Governor Balderston commented that this again raised the question as to what the long-term market would have been like anyway. He noted that the Federal Reserve operations had not been large, and President Livingston inquired whether it could not be said that a miniature pegging operation was involved.

Governor King expressed doubt that it was fair to say that a pegging operation was involved. If it were, he suggested, the changes in rates that had taken place would not have occurred. In a further comment on rate developments, he called attention to the changes in bill rates during the 1958 period and referred to them as a manifestation of uncertainty that had not occurred in recent months. Therefore, when mention was made of uncertainty in the long-term market, he thought it was well also to keep in mind the relative stability of the short-term sector. Relating this relative stability to the outflow of gold and short-term capital, he added that the Federal Reserve probably could not by itself stop such an outflow. However, it seemed desirable to avoid the charge of aggravating the outflow or of having done nothing, although actually other factors had brought the outflow into being.

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Governor Shepardson referred to the earlier observation about the criticism of the bills preferably policy on the part of academicians and persons in Governmental circles. With this in mind, he inquired how the Federal Reserve System and the banking system could have been more effective in stating the rationale of the former policy.

President Livingston replied that he did not know how the argument might have been presented more effectively. As for himself, he held to the view that a free market should set the price of securities, as well as other prices, and on this theory the entry of the Federal Reserve into the longer-term Government securities market was basically undesirable. However, he felt that it was hard to present the argument effectively to the public. As to what had happened thus far as the result of System intervention in the longer-term area, he did not think that anything consequential had occurred except in terms of the uncertainty that had entered into the expectations of those trading and investing in Government securities. The amount purchased by the System in the long-term area had been minimal, and he saw nothing irreparable or too serious from that standpoint. The question of expectations, however, was more serious.

Governor King said that in his own mind--and he believed the thinking of others also--a pegging of rates was not the intent of the Federal Reserve operations. Instead, the operations had been undertaken largely in an attempt to avoid aggravating the outflow of gold and short-term funds. The apparent alternative was to see the bill rate drop considerably, and this was something that he had not wanted to see happen.

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He had been willing to try some other approach rather than to risk that development.

10. What are the views of the Council regarding current monetary and credit policy?

Current monetary and credit policy has effectively contributed to the recovery of the economy. The Council believes the continuation of current monetary and credit policy would seem desirable until considerably stronger credit demands appear.

President Livingston said that while the Council was pleased with the degree of recovery of the economy, it would like to see more concrete evidence of the durability of the recovery than it saw at the moment. Therefore, the Council would recommend no change in the present degree of ease until various factors that were not now discernible became discernible.

Governor Balderston commented on the degree of liquidity in the economy. The banks had more short-term securities in their portfolios than in 1958, and corporations were more liquid. If and when the Federal Reserve had to return to a policy of restraint, it would find water in the brakes.

Governor Shepardson noted the concern expressed in some places from time to time about the lack of growth of the money supply, narrowly defined to include demand deposits adjusted and currency. On the other hand, he pointed out, there had been a significant growth in so-called near money substitutes. He inquired whether there was any feeling of concern on the part of the Council about the lack of growth in the money supply, narrowly defined.

President Livingston replied that he had no feeling of concern, and that he saw no problem at the present time. No different view was expressed by other members of the Council.

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This concluded the discussion of the subjects that had been included on the agenda for this meeting.

President Livingston inquired whether the Board had any developments to report with respect to the maximum rates of interest permitted to be paid on time and savings deposits under Regulation Q, Payment of Interest on Deposits, and Governor Balderston replied that the Board continued to discuss the subject frequently. He asked whether the Council had any advice, and President Livingston replied in the negative. He added, however, that, without suggesting what should be done on the matter, this was a subject that perhaps should be included on the agenda for the next meeting of the Board and the Council, particularly since many views were being expressed.

Mr. Murphy noted that there was considerable concern on the part of New York City banks with respect to the negotiable time certificates of deposit. In the opinion of the banks, these had served a real purpose, but the banks did not know how long the funds would remain with them. At present, something over \$1 billion had been written by the New York City banks, and perhaps \$2 billion altogether. Therefore, when the problem of the certificates was added to the problem of foreign time deposits and was tied into a 3 per cent interest rate ceiling, it was one to which real attention must be given. If short-term rates should rise above the 3 per cent ceiling, the time certificates and the foreign time deposits could leave the banks quickly to seek other avenues of investment.

In further comments, Mr. Murphy said there were still some corporate treasurers who favored the use of bills, but he thought that feeling would break down. As to the attitude of the banking fraternity toward the ceiling

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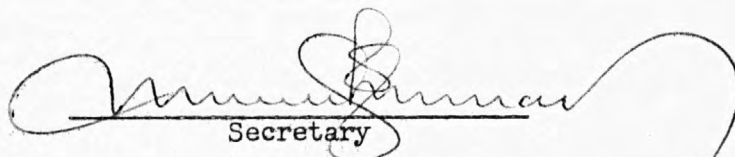
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interest rates, he noted that in any group of bankers there were bound to be conflicting opinions. However, it would be unfortunate in his opinion if some solution could not be devised that would meet with the approval of the various segments of the banking community. As he saw it, the negotiable time certificates were a helpful development from the standpoint of the banking community. Funds that had gone elsewhere were now back in the banking stream. Nevertheless, as he had said, these certificates and a large part of the foreign time deposits could be pulled out again within a period of months. If that should happen, it would reflect a situation in which loan demand was heavy, and that was the point of concern to the banks.

In reply to a question, Mr. Murphy indicated that the problem focused on the 3 per cent interest ceiling for time deposits with a maturity of six months or more, rather than on the maximum rates on shorter maturities.

It was agreed that the next meeting of the Federal Advisory Council would be held on Monday, November 20, 1961, with a joint meeting of the Board and the Council the following day.

The meeting then adjourned.


Secretary