Heller Papers Box 19
Mon. Policy
Letter to Gov. Mitchell before he went to BoG

July 18, 1961

Dear George:

I enclose--strictly for your personal information--copies of some memos and letters we have written about monetary policy since January. These will give you a general idea of our approach to the problem. Of course each of these is colored by the specific situation of the moment, but I think they follow a consistent line. I could summarize our feelings about current policy, as follows:

a) So long as we are short of reasonably full employment, and inflationary pressures are minimal, overall government policy should be expansionary.

b) Expansionary policy requires active moves, because an upswing has built-in "stabilizing" tendencies which tighten both the Budget and the credit markets.

c) The Budget is quite tight (like it or not), and this leaves considerable room for monetary ease. This mixture of policies has advantages for economic growth, if we succeed in achieving full recovery.

d) We do not underestimate the importance of the balance-of-payments constraint. The U.S. must aim at a basic balance. At the same time, we at the Council are much interested in international monetary reforms which would free our hands somewhat and give countries breathing spells in which to adjust. The present Fed is <u>very</u> conservative on this subject.

e) The international constraint on U.S. interest rates is adequately satisfied now by bill rates between 2 and 2-1/4 percent.

f) Monetary ease at the moment, we would judge, means keeping net free reserves plentiful enough to keep the FF rate below the discount rate and, if the bill rate tends to rise above 2-1/4 percent, below the bill rate. This criterion should take precedence over a numerical target for free reserves.

g) Reserves needed to accomplish such monetary ease should be injected by purchases of "longs." The problem that gave rise to the Feb. 20 policy is still with us. It is especially important to keep long rates down, and even possibly to reduce them, because we see evidence that our efforts to reduce mortgage rates are now running into the floor set by basic rates.

h) In general, there is no reason to return to "bills only." Long operations can be conducted without danger of "pegging." Although a great deal of the criticism of "bills only" was exaggerated, there is some marginal advantage in operating clear across the maturity spectrum, and in a number of circumstances monetary objectives may not be achievable without doing so.

i) A small decline in the discount rate at the present time would facilitate a policy of ease, and might even be appropriate internationally, in view of the UK problem. But there are many ways to skin a cat, and if the Fed wants to do it by bigger open-market purchases, that is certainly o.k.

j) In general, we wouldn't like to see further reductions of reserve requirements. We think, as one of the memos indicates, that the Fed should choose its tools so as to give some attention to the taxpayers' costs when this can be done without compromising its monetary objectives.

k) We believe in a flexible policy, and if the economy is suffering from excess demand and serious inflationary pressures occur, we would expect the Fed to move vigorously to restrictive policy. But we don't think monetary restriction is the way to solve the problem of gradual wage-price creep. We hope the Fed won't slam the brakes on too soon in this upswing. We're very much concerned to keep it going when inventory building starts to peter out.

By and large, even though there might be some minor differences in interpretation and intent, the above represents the general line the President has been taking. Also, let me add that our personal relations with Martin have always been cordial and friendly, and at the moment there is little difference between us on current policy. Some of his public statements have disturbed us, and some of ours have disturbed him. But private agreement is greater than these statements indicated.

We look forward to talking these matters over with you in the coming months and years. We're mighty glad you are coming on the Board.

Sincerely,

Walter

Walter W. Heller

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