

FEDERAL RESERVE BANK OF NEW YORK



MONTHLY REVIEW

JULY 1961

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Foreign Exchange Markets, January-June 1961

The heavy flow of short-term capital between major financial centers highlighted developments affecting the foreign exchange markets during the first six months of 1961—particularly in the period immediately following the March revaluations of the German mark and the Dutch guilder. Although relatively unrestricted international short-term capital movements have been possible since the adoption of external convertibility for the leading currencies at the end of 1958, the magnitude of the problems that they could pose has only become fully evident in the last year or so. In the latter part of 1960 there was a substantial outflow from the United States, as shifts of short-term capital undertaken to realize maximum interest earnings were reinforced by speculative movements. In the first half of 1961, speculative considerations appear to have been of major importance in generating additional heavy short-term international capital movements. Under these conditions, prompt, decisive, and cooperative action has become necessary to sustain stable and orderly exchange markets.

In the turbulent period following the March revaluations, unequivocal declarations by national and international authorities that parity values would be maintained, and actions undertaken both cooperatively and unilaterally by the major countries, tended to calm the exchange markets.¹ While the sharp break in the exchange value of the Canadian dollar late in June introduced some new uncertainty into the markets, ground had nevertheless been gained by midyear toward restoring more orderly conditions.

International efforts to deal effectively with speculative short-term capital movements are, of course, of interest to the United States, which has also undertaken certain exchange stabilization operations to protect the United States dollar. In mid-June, leading United States officials submitted statements to the Subcommittee on International Exchange and Payments of the Joint Economic Committee of Congress, which referred to these efforts and operations.² Secretary of the Treasury Dillon noted in his statement that the Administration supports central

bank cooperation as a device that could be of substantial assistance in dealing with short-term capital movements. He also suggested that the International Monetary Fund might serve, where necessary, as a source of longer term financing of credits that might arise in central bank operations, and lent his support to an appropriate expansion of the Fund's resources. With respect to exchange stabilization operations by the United States, Secretary Dillon stated:

We have . . . initiated a number of measures designed to diminish the likelihood that speculation against the dollar might recur. Our decision to undertake limited operations in forward exchange markets represents one step in this direction.

The impact of the currency speculation during March did not confine itself to the markets for spot exchange. In the case of the German mark, for example, the premium on the forward mark rose to very high levels immediately following the revaluation. Had this premium been allowed to rise unchecked, it might well have aggravated the speculative conditions prevailing in the market. However, arrangements were worked out between the United States and Germany whereby a stabilizing influence could be exerted on the market. It is our intention to conduct similar operations in other major currencies whenever such action appears appropriate and useful. . . .

Aside from these operations in the forward market, the Treasury, through the facilities of the Federal Reserve System, and in cooperation with authorities abroad, has begun to acquire modest holdings of foreign exchange which could be sold in the spot market should the dollar again come under pressure. You will recall, for example, that we requested Germany to make some marks available to us temporarily at the time they agreed to prepay \$587 million of their official debt to the United States. The Treasury has also taken advantage of opportunities to acquire certain other convertible currencies in relatively small amounts during recent months.

The expressed determination of the United States authorities to defend the current gold value of the dollar, the cooperative international efforts to mitigate disruptive short-term capital flows, and the relatively strong

¹ International cooperation at this time was discussed in "International Economic and Financial Developments" in the *Monthly Review* for June 1961, pp. 102-4.

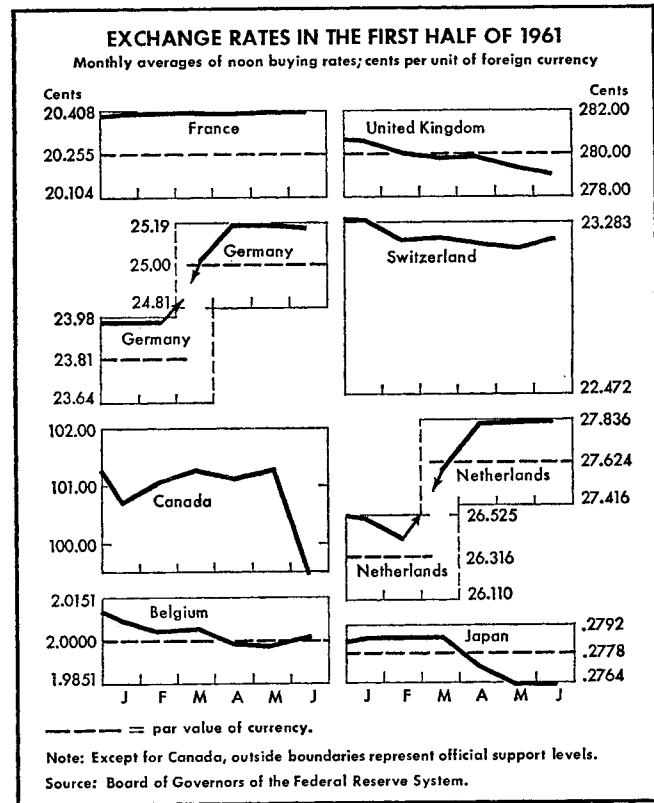
² The statement by Alfred Hayes, President of the Federal Reserve Bank of New York, is given in full beginning on p. 120 of this *Monthly Review*.

underlying balance of payments of the United States all served to reduce the pressure on the dollar during the first half of 1961. The United States trade surplus in the first four months of 1961 reached a seasonally adjusted annual rate of nearly \$7 billion. This was close to the record achieved during the first half of 1957 and almost twice the rate during the corresponding 1960 period. In addition, there was a reduction in the short-term capital outflow which had been responsible for much of the selling pressure on the dollar in the last half of 1960.³

Interest incentives to move funds from the United States on a covered basis were reduced or eliminated as short-term interest rates abroad declined relative to rates in the United States and as, in some instances, forward exchange rates moved in our favor. Since the third quarter of 1960, yields on short-term Government securities in the United States have tended to hold within the range of 2¼ to 2½ per cent. Meanwhile, foreign monetary authorities acted to reduce short-term rates in order to help curtail short-term international capital flows. As one example of the trend in interest arbitrage incentives, it may be noted that in the case of three months' Treasury bills the covered interest arbitrage differential, which in mid-1960 had approached 1.5 per cent per annum in favor of London, gave way to substantial differentials in favor of New York by mid-1961. This development reflected both the narrowing of interest rate disparities and the recent widening of forward sterling discounts.

The accompanying chart, which presents market quotations for the dollar against major currencies in cents per unit, shows some strengthening of dollar quotations over the first half of 1961, although it also makes it evident that the dollar's gains were limited. In particular, the dollar has remained at, or close to, official intervention

³ Short-term capital movements and exchange rates in 1960 were discussed in the *Monthly Review* for January 1961, pp. 9-10.



levels in relation to the French franc and the Dutch guilder.⁴ In addition, the German mark generally remained at its upper limit, despite the 5 per cent revalua-

⁴ The central banks of the signatories of the European Monetary Agreement have agreed to buy or sell dollars whenever necessary to keep their exchange rates within specified margins of parity with the dollar. Most have set these margins at ¼ per cent of parity. Selling pressure has forced the dollar's quotation vis-à-vis some of these currencies to the point where the central banks in question are sometimes required to purchase dollars from the market in order to prevent any further increase in their own currency's value.

Statements before Congressional Committees

At a hearing held in late June before the Subcommittee on International Exchange and Payments of the Joint Economic Committee of the Congress, Mr. Alfred Hayes, President of the Federal Reserve Bank of New York, filed a statement appraising the recent performance of the international financial system and commenting on current issues of international financial policy. Because of the widespread public interest in these subjects, the statement is reprinted in full in the present issue of the *Review*. We are also including statements made in early June by Mr. Hayes and Mr. Robert G. Rouse, Vice President of the Federal Reserve Bank of New York and Manager of the System Open Market Account, during testimony before the Joint Economic Committee. These statements provide insights into the background for monetary policy decisions and the processes by which such decisions are formulated and carried out. The full text of their testimony at the hearings in early June will be published by the Committee.

tion on March 6, until late in the period, when there appeared to be a growing conviction that further revaluation was not in prospect and when certain technical conditions, arising out of official operations in the forward exchange market, led to some searching in the market for dollars.⁵

Sterling, which had remained relatively firm during 1960, dropped to \$2.7929 in the wake of the March revaluations, but recovered with the central bankers' March 12 declaration of mutual support. Subsequently, however, the rate again gradually drifted lower, reaching \$2.7868 in early June, as Britain's trade returns proved somewhat disappointing. That sterling will be vigorously defended at its current parity has been made abundantly clear by the British authorities, who have stated that there will be no delay in mobilizing, as required, all available resources, including Britain's large drawing rights at the IMF. As regards forward sterling, the market was generally quiet despite a rather wide range in the discounts for three and six months' deliveries during the period. Quoted early in February at discounts of about 0.8 per cent and 0.6 per cent for three and six months, respectively, the discounts gradually widened to about 3.5 per cent and 2.9 per cent at the end of June.

The quotation for the Canadian dollar remained quite steady through the first five months of 1961, ranging from

⁵ See "The German and Dutch Revaluations" in the *Monthly Review* for April 1961, pp. 62-4.

U.S.\$1.00²¹/₆₄ to U.S.\$1.01²⁵/₃₂. In mid-June, however, the rate dropped to under U.S.\$1.00, for the first time since December 1955, as the government publicly called for the resignation of the governor of the Bank of Canada in a policy conflict. Subsequently, the rate broke sharply to about U.S.\$0.97—the lowest quotation since November 1951—in an uneasy and sometimes erratic market following the June 20 Canadian budget message in which the Minister of Finance stated the intention of the government to bring the Canadian dollar to a discount vis-à-vis the United States dollar. This exchange rate policy, it was stated, is designed to improve Canada's trade balance and to reduce Canadian borrowing in the United States.

As regards other currencies, the Japanese yen came under some pressure and tended to weaken with Japan's continued heavy trade deficits and the accompanying reduced short-term capital inflows. South Africa, on February 14, replaced the pound with the rand (equal to U.S.\$1.40, or one half the value of the former pound) as its basic currency unit. In the market, the exchange value of the South African currency has continued to weaken, mainly owing to persistent outflows of capital from that country. Many primary-producing countries, including Brazil, Venezuela, Ecuador, Indonesia, and South Korea, took important steps during the past six months toward more realistic exchange values for their currencies or toward simplification of their exchange rate structures, or both.

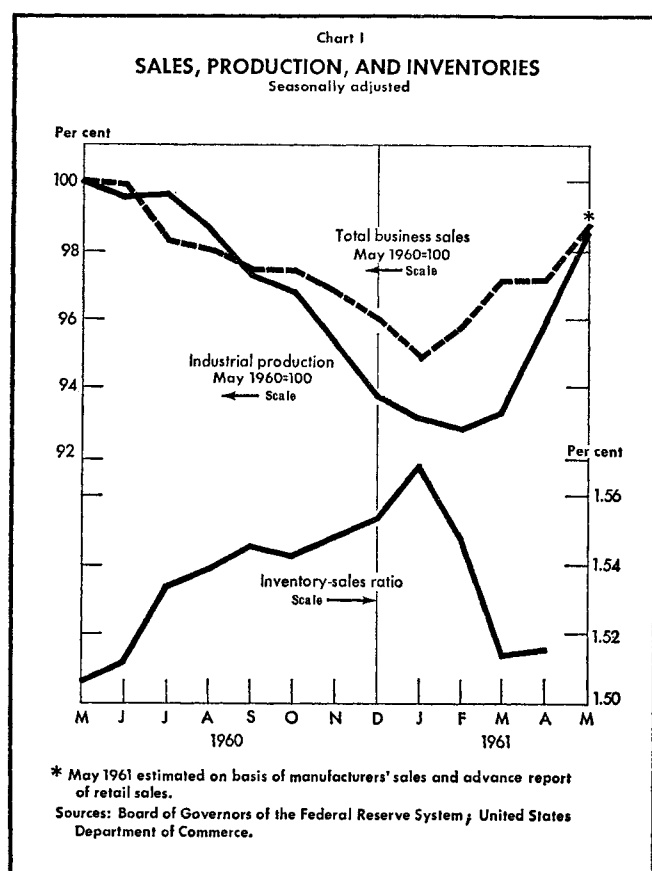
The Business Situation

The recovery in economic activity continues to be evident in a wide range of current indicators. Industrial production, in particular, scored sharp gains in April and May, responding to the significant impetus from a cessation of inventory liquidation—and possibly some incipient inventory rebuilding—as well as to gains in final demand. At the same time, scattered reports of price shadings for several types of industrial materials reflect in the main competitive pressures in an economy with ample capacity and subject to price competition from foreign suppliers. Seasonal factors, moreover, are causing some slackening in steel output which is likely to continue and to be paralleled in other major industries during the summer months; output in the automobile industry, in particular, will be affected by an early model change-over. These

seasonal influences may, but need not, affect business sentiment and expectations and should not interfere with further solid expansion in over-all activity so long as prospects for growth in final demand remain favorable. At the present time, it is virtually certain that Government spending will continue to exert an important upward thrust; there has been further confirmation of an imminent, but moderate, expansion in capital spending; and consumer outlays appear to be making some new gains, although no real buoyancy has yet appeared.

INVENTORIES AND PRODUCTION

Investment in inventories was about unchanged in April and May after having moved generally downward for more than a year. Although businessmen had been cutting stocks



continuously during the seven months ended in January, sales had fallen even more rapidly, causing a rise in the inventory-sales ratio. In February and March an upturn in sales and continued inventory liquidation combined to push the stock-sales ratio down; by the end of the first quarter, it had reached the lowest level since last June. The slight upturn in inventories and the further decline in the inventory-sales ratio in April and May suggest that stocks are approaching a better relationship to current and expected sales. Trade sources report that businessmen now intend to hold the inventory-sales ratio near its present level or to allow it to fall slightly further as sales move up.

As the downward push from inventory liquidation abated in the second quarter, industrial production expanded more strongly than total business sales (see Chart I) after having declined more rapidly during most of the recession. In May, the industrial production index (seasonally adjusted) scored a second consecutive monthly gain of almost 3 per cent, as output of consumer goods, business equipment, and materials all increased. Iron and steel led the advance, rising by more than 10 per cent in response to improved demand from metal-using industries. New orders received in May by manufacturers of durable

goods rose by 3 per cent, suggesting that activity in metal-using industries may continue to expand on a seasonally adjusted basis. Steel ingot production, however, appears to have declined slightly more than normally in June, and may fall off about seasonally during the summer as the auto industry cuts back assemblies in preparation for the introduction of new models.

While industrial production rose approximately 6 per cent from the low point in February, manufacturing employment has registered an increase of only 2 per cent. Three quarters of this rise occurred in May, and helped to push up total payroll employment (seasonally adjusted) by 200,000 persons to 52.7 million, according to the mid-month survey of the Bureau of Labor Statistics. The smaller increase in manufacturing employment relative to output reflects the continued lengthening of the average workweek and the expansion in productivity which usually occur in the early phase of a cyclical recovery. A similar pattern held in construction, where employment actually moved downward despite a 1 per cent rise in outlays. Other types of nonagricultural employment, however, showed at least small gains in May. According to more recent information from the Census Bureau, total non-agricultural employment rose $\frac{7}{10}$ of 1 per cent in June after seasonal adjustment. The seasonally adjusted unemployment rate, on the other hand, changed imperceptibly from 6.9 to 6.8 per cent, staying in the narrow range within which it has moved since the beginning of the year.

FINAL DEMAND AND CAPITAL SPENDING

A key determinant of the pace of economic recovery in the months ahead will be the volume of spending for fixed investment. The second-quarter survey of plant and equipment outlays, taken by the Commerce Department and Securities and Exchange Commission, shows that business firms plan a gradual increase in such spending in the second half of this year (see Chart II). Actual outlays of \$33.9 billion (seasonally adjusted annual rate) in the first quarter were \$1.7 billion below the preceding quarter, constituting a sharper drop in spending than had previously been estimated. Plans for the second quarter, however, call for outlays to remain at about the first-quarter rate, and planned outlays of \$34.6 billion for the third quarter mark the beginning of the upturn in spending. The estimated annual rate of spending indicates a continued advance in the final quarter of the year.

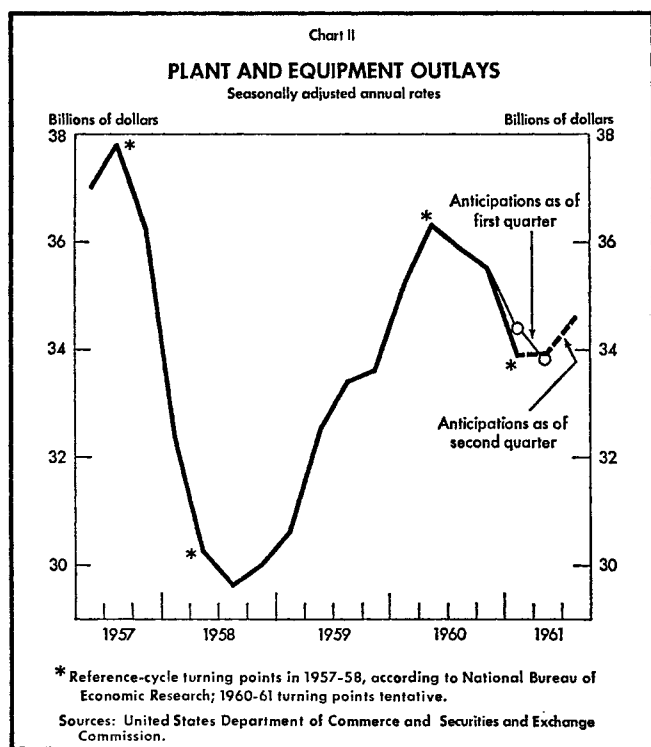
If the most recent plans are realized, the performance of the capital goods sector will compare very favorably with the experience in the 1957-58 recession and recovery. At that time, capital spending continued to fall for one

quarter following the trough in general business and the total decline was more than three times as large as in the recent recession. The expansion of outlays in the

three quarters following the 1958 trough was less than one fourth of the expansion anticipated in the corresponding period of this recovery.

Total new construction activity, which has been rising at a modest pace since February, increased by another 1½ per cent (seasonally adjusted) in June. Private residential building continued to spark the expansion in construction, but the behavior of several leading indicators, particularly housing starts, suggests that the rate of advance in this sector may prove to be somewhat slower in the months ahead. Private business construction outlays continued to move slightly downward, while public construction outlays rose in June for the second consecutive month.

Recent improvements in consumer spending have remained rather moderate despite a continuous expansion in personal income since February. Retail sales, which had dipped disappointingly in April, moved up in May by 1.2 per cent, seasonally adjusted, but were still slightly short of the March rate. Most of the increase was in sales of durable goods, particularly automobiles, which had accounted for most of the April decline. The daily average rate of deliveries of new cars in May spurted by much more than the usual seasonal rise. New car sales appear to have leveled off or even declined slightly in June, but some contraseasonal strengthening in department store sales may indicate expanded buying of other consumer goods.



The Money Market in June

The money market was easy over most of June. Although the effective rate on Federal funds generally ranged between 1½ and 2¾ per cent, some trading was occasionally reported at rates as low as ¼ per cent. Similarly, while rates on loans to Government securities dealers generally fluctuated between 1¾ and 3 per cent, they were at times posted as low as 1 per cent.

Prices in the market for Treasury notes and bonds declined rather sharply early in the month, in part reflecting market uncertainty regarding future rate movements. A depressing influence was also exerted by the upward adjustment of yields in the corporate and tax-exempt bond markets which resulted from a large volume of new corporate and municipal issues at a time when a considerable backlog of unsold bonds had accumulated in dealer inventories. As the month progressed, the market for intermediate- and long-term Government securities stabilized somewhat, although prices continued to drift irregu-

larly downward in very light trading. Treasury bill rates rose perceptibly early in the month, but subsequently declined and, except for a temporary dip in the latter part of the month, remained generally steady throughout the balance of the period.

MEMBER BANK RESERVES

Free reserves averaged \$517 million for the four state-ment weeks ended June 28, an increase over the \$453 million average for the five weeks in May. Average excess reserves rose to \$581 million from \$544 million, while average borrowings from the Federal Reserve Banks declined to \$64 million from \$91 million.

Operating factors as a whole released \$223 million of reserves over the four weeks, as a larger-than-usual expansion in average float was well in excess of the net absorption of reserves through movements in other operating factors. The net gain from operating factors, however,

was more than offset by a \$267 million increase in average required reserves, stemming from the rise in bank credit associated in part with loan demands around the tax date and from the banking system's payment for the Treasury's \$1.8 billion "strip" issue on June 14.

System open market operations provided a small volume of reserves, on a daily average basis, over the statement period ended June 28. While System purchases were concentrated in the early part of the statement period, a relatively substantial volume of both short and longer term Government securities was acquired by the System in the last few days of June, after the close of the June 28 statement week. Average outright System holdings rose \$18 million, net, while average holdings under repurchase agreements were unchanged over the statement period.

THE GOVERNMENT SECURITIES MARKET

The market for United States Government securities over most of June was influenced by the interest rate implications of business recovery and developments in the markets for corporate and municipal bonds, on the one side, and by the ready availability of funds for short-term investment, on the other.

On June 2, the Treasury announced its intention to borrow at auction on June 8 a total of \$1.8 billion in new cash through a strip offering of \$100 million of each of the regular weekly Treasury bills maturing over the eighteen weeks from August 3 to November 30. Yields on outstanding bills advanced to higher levels following the announcement, as the market pondered the implications of the Treasury's use of an unfamiliar financing technique. Anticipation of market pressures usually associated with the approach of the mid-June tax and dividend date added impetus to the upward movement, and at the first weekly bill auction of the month, average issuing rates of discount were established at 2.516 and 2.727 per cent, respectively, for three- and six-month bills, up 8 and 13 basis points above the previous week. These rates were sufficiently attractive to stimulate a significant retail demand and, in the several days following the auction, rates adjusted downward toward levels prevailing when the month opened.

The strip of eighteen issues of bills, which could be paid for through credits in Tax and Loan Accounts, met strong demand from commercial banks. The average rate for the entire issue was 2.308 per cent, close to the lower end of the range expected by the market. The money market stringency which frequently occurs around quarterly tax dates did not appear, and in the very easy money market that developed around the middle of the month, rates on bills of short maturity continued their decline

in response to bank as well as nonbank demand. Average issuing rates on three- and six-month bills were established at 2.295 and 2.492 per cent, respectively, in the auction on June 12, or 22 and 24 basis points lower than in the previous week, and at 2.325 and 2.519 per cent, respectively, in the auction of June 19. Following two weeks of relative stability, rates moved lower in the particularly easy money market that developed later in the month, when funds tended to concentrate in the money market centers after the Treasury redeemed its tax anticipation bills maturing on June 22. At roughly the same time, there occurred the usual flow of funds to money market centers around member bank settlement dates. Subsequently, however, rates again moved up to about the levels that had prevailed over the midmonth period. Over the month as a whole, rates on the latest issues of three- and six-month bills had moved lower by 7 and 14 basis points, respectively.

In contrast to the short-term sector, the market for Treasury notes and bonds was generally heavy and prices moved lower over most of the month. Selling, however, was relatively light. Expectations that interest rates will rise as business activity recovers and that the monetary

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, June 1961
In millions of dollars; (+) denotes increase, (-) decrease in excess reserves

Factor	Daily averages—week ended				Net changes
	June 7	June 14	June 21	June 28	
Operating transactions					
Treasury operations*	- 105	+ 12	- 1	- 136	- 230
Federal Reserve float	+ 45	+ 108	+ 438	- 177	+ 414
Currency in circulation	- 143	- 101	+ 52	+ 45	- 147
Gold and foreign account	+ 21	+ 34	+ 48	+ 18	+ 121
Other deposits, etc.	+ 38	+ 25	+ 31	- 28	+ 66
Total	- 145	+ 78	+ 567	- 277	+ 223
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 242	- 95	- 101	- 28	+ 18
Held under repurchase agreements	+ 17	- 20	+ 3	-	-
Loans, discounts, and advances:					
Member bank borrowings	- 30	+ 9	- 29	+ 39	- 11
Other	- 1	-	- 2	+ 1	- 2
Bankers' acceptances:					
Bought outright	- 3	+ 1	-	- 1	- 3
Under repurchase agreements	-	-	-	-	-
Total	+ 226	- 106	- 129	+ 10	+ 1
Member bank reserves					
With Federal Reserve Banks	+ 81	- 28	+ 438	- 267	+ 224
Cash allowed as reserves †	- 150	+ 68	+ 14	+ 72	+ 4
Total reserves †	- 69	+ 40	+ 452	- 195	+ 228
Effect of change in required reserves †	+ 24	+ 18	- 535	+ 226	- 267
Excess reserves †	- 45	+ 58	- 83	+ 31	- 39
Daily average level of member bank:					
Borrowings from Reserve Banks	62	71	42	81	64 ‡
Excess reserves †	571	629	546	577	581 ‡
Free reserves †	509	558	504	496	517 ‡

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for four weeks ended June 28.

authorities would not attempt to prevent such a rise seem to have been influencing factors during the first week of June when price declines ranged from $\frac{1}{2}$ to $1\frac{3}{4}$ points. In addition, uncertainty with regard to the forthcoming Treasury financing as well as the heavy volume of new offerings of corporate and tax-exempt securities exerted some upward pressure on long-term rates in these markets which, in turn, induced some switching out of Government bonds into higher yielding corporate securities. Although the market for Treasury notes and bonds tended to stabilize toward the middle of the month, as the congestion in corporate and municipal bond markets lessened somewhat, prices resumed their downward drift on news of a three-point rise in production, further reinforcing an optimistic business outlook. As the end of the month approached, the market was further depressed by reports that the Treasury was considering an intermediate-term offering in its next refunding operation. Over the month as a whole, prices of intermediate-term Treasury securities declined from $\frac{1}{32}$ to $\frac{3}{4}$ of a point, while longer term bonds fell from $\frac{3}{8}$ to more than 2 points.

OTHER SECURITIES MARKETS

The volume of publicly offered new corporate bonds, including refundings, amounted to approximately \$1 billion in June, the largest total for any month in recent years. Net of refundings, however, the volume declined in the

period to \$540 million from \$615 million in May; this compares with \$505 million in June 1960. In the early part of the month, the corporate bond market was dominated by the \$250 million refunding issue of the American Telephone and Telegraph Company. Priced to yield 4.68 per cent, somewhat less than the market expected, these debentures were not immediately distributed as investors were induced to buy higher yielding competitive issues. Demand later broadened and, in a firmer market, distribution was more successful at the original reoffering price. Yields on new corporate issues exhibited a persistent upward tendency over most of the month, under the influence of a large backlog of unsold bonds in dealer inventories and of signs of further improvement in business conditions. Seasoned corporate bond yields also moved higher in competitive adjustment to yields available on the large volume of new issues. The month-end average yield on Moody's Aaa-rated seasoned corporate bonds was 4.37, or 9 basis points above the end-of-May level.

The volume of new tax-exempt flotations rose sharply to \$980 million in June, the highest monthly total in recent years, compared with \$550 million in May and \$876 million reached in June 1960. Most issues were accorded fair receptions, as investor demand was selective. Yields on seasoned Aaa-rated tax-exempt bonds, as measured by Moody's, rose to 3.37 over the month under the same influences as prevailed in the corporate market; this was 9 basis points above the level prevailing at the end of May.

International Financial Problems and Policies*

STATEMENT by ALFRED HAYES
President, Federal Reserve Bank of New York

In creating the Subcommittee on International Exchange and Payments, the Joint Economic Committee has recognized the need for periodic review of United States international financial policy and, more generally, of the performance of the international financial system. Certainly the experience of the last few years has impressed upon all of us the necessity of continuing intensive study of the very complex problems we face in this area.

* Statement filed with the Subcommittee on International Exchange and Payments of the Joint Economic Committee of the Congress of the United States (Reuss Subcommittee), June 20, 1961.

For many years after World War II the United States economy was alone equipped to supply the goods and services so urgently required by a war-devastated world, and the resultant dollar shortage forced many foreign governments to impose severe controls over trade and capital transactions with this country. Today, the economies of Europe and Japan—assisted by generous United States aid—have not only fully recovered but have moved on into a new phase of dynamic expansion. Their resurgent economic strength has permitted the restoration of currency convertibility and the dismantling of most discriminatory

exchange controls against the dollar. They have made major progress, as we have so often urged, toward a closer relationship of their commodity and financial markets with our own. But our very success in thus stimulating the recovery of Europe and Japan, and the liberalization of trade and payments among the nations of the Free World, has brought in its train a whole series of new problems.

From the experience of the past year, it has become abundantly clear that national economic and financial policies can no longer be based solely upon domestic considerations; they must also take into account potential repercussions in the exchange markets and the balance of payments. As the major foreign currencies have regained their strength and prestige, and facilities for capital transfers have become more readily available, we have now to face the problem of dealing with large-scale, and potentially disruptive, flows of short-term funds and other payments from one financial center to another. Further, the United States and, more recently, other developed countries, have undertaken to support massive programs of economic development in those vast areas of the world where an intolerably low standard of living still prevails. But unless the financial burden of this development effort is equitably shared among all countries capable of supplying capital and other assistance, the dollar, and indeed the entire international financial structure, could be subjected to excessive strain.

We thus face a wide range of new and perplexing problems to which there are no easy answers. The defense of the dollar is a job for all of us, since it depends basically on the maintenance of a sound and growing American economy. In the area of monetary policy, the Federal Reserve System must continue to seek to promote maximum sustainable economic growth. For the period immediately ahead, the System must continue to encourage the forces of recovery while at the same time guarding against the re-emergence of inflationary forces as the recovery progresses. Proper fiscal and debt management policies are highly important; there is a danger that too great a burden will again be placed on monetary policy if budget deficits that were appropriate during a period of recession are allowed to persist during a phase of the business cycle in which such deficits would be inappropriate. Defense of the dollar equally requires the most serious efforts by both labor and management, and a growing awareness by the public generally that the American economy is not isolated from the rest of the world. The sellers' market of the early postwar period has become a part of history, and the vigorous competition of today serves as an additional warning that costs must be kept down and productivity increased if the United States is to retain its role as a leading exporter

in world markets. These competitive forces have not been without a healthy influence on our domestic price structure, and there is hope—provided we keep our own house in order—that a period of sustained growth with reasonable price stability lies ahead for us and for the other leading countries of the world.

To some students of international finance the challenge appears so formidable as to require sweeping reforms in the international financial system itself. I do not agree. In my view, there is no reason to fear this new era of international competition and currency convertibility, nor to shrink from the challenge posed by the development needs of Latin America, Africa, and Asia. For me, the key to all these problems lies primarily in the formulation of appropriate policies and in their co-ordination through international consultations, rather than by radically transforming existing institutional arrangements. This is hardly intended to suggest that the present international financial system does not suffer from certain weaknesses, and I shall mention later some modifications which I think are needed.

The present international financial system is, of course, the result of gradual evolution over many years. The cornerstone of the whole structure is the link between gold and the United States dollar, with the dollar firmly anchored by its interconvertibility with gold at a fixed price of \$35 per fine ounce. Most other governments in the Western World have established with the International Monetary Fund par values for their currencies in terms of either gold or the dollar, and monetary authorities generally are committed to maintaining these par values by buying or selling dollars in their exchange markets to maintain the rates for their currencies within a relatively narrow range. This network of fixed exchange rates has greatly facilitated the growth of international trade and capital movements, and has thereby contributed to the increasingly close integration of world trade and payments.

In this international system the United States plays the dual role of the most powerful trading nation and the foremost banker for the rest of the world.

The role of the United States as the world's leading trader is based upon many factors—the massive raw material requirements of our factories, the high consumption demands of our people, the competitive strength of many export industries, an abundant flow of private savings into investment abroad, and sizable governmental programs of foreign economic aid. The growth of our foreign trade has been further strongly stimulated by United States Government policy which has consistently sought to minimize artificial barriers to trade and payments between our domestic market and the rest of the world. Last year our total payments and receipts came to some \$57 billion,

with receipts falling short of the payments by \$3.8 billion or, roughly, 13 per cent.

I am sure that many competent witnesses have already provided you with an exhaustive analysis of our balance-of-payments experience during recent years, and I shall try to highlight only a few points which, to me, seem particularly important.

As you know, the deficit position of 1960 was not something new. Indeed, such deficits have been a characteristic feature, except in 1957, of our balance of payments for more than a decade. Prior to 1958, however, these deficits generally ran in the magnitude of \$1.0 to \$2.0 billion and served the highly useful purpose of reconstituting foreign dollar balances and securing a more appropriate distribution of gold stocks. Such deficits, in fact, were instrumental in helping to bring about the rapid expansion of international trade and investment, the dismantling of discriminatory controls abroad, and the restoration of currency convertibility by the leading Western European countries at the end of 1958. While some might be tempted to criticize what seemed a delayed awakening by the United States to its growing balance-of-payments problem, full recognition must be given to the changing nature of the problem during these transitional years.

By late 1959 it was reasonably clear that convertibility was a solid success and that most of the leading trading nations had so reconstituted their international reserves that they had little need to build them up further. Moreover, there had been a very sizable increase in the dollar working balances in the hands of private foreign interests, and, with the restoration of confidence in European currencies, there was an increasing tendency for funds to flow to foreign financial centers where interest rates were most attractive. In this new context, and particularly with declining interest rates in the United States in 1960, the continuing balance-of-payments deficits of the United States took on a more ominous aspect. The storm signals had been raised.

I do not believe it is necessary to review with this group in any detail the various measures that were undertaken to defend the dollar. While I would reject the tying of United States foreign aid to the American market as a basic long-run principle of our aid program, I believe that the moves which have been taken in that direction since late 1959 are entirely appropriate under the circumstances. Subsequent measures and proposals designed to secure a more equitable sharing with our allies of economic and defense aid outlays, to stimulate exports, to economize on military expenditures abroad, to prohibit private United States ownership of gold abroad, and to reduce the duty-free allowances for returning tourists were all highly de-

sirable. In addition, various official statements, especially President Kennedy's Message on Balance of Payments and Gold to the Congress in February of this year, had a highly beneficial effect, providing impressive reassurance to the world of our determination to defend the dollar. I have been particularly gratified that recourse to restrictive trade and other controls has had no part to play in this program. Continued efforts are still necessary to eliminate restrictions against United States exports and to encourage a number of countries to make their capital markets more freely accessible to foreign borrowers. We would only hurt ourselves by turning our backs on the principles of liberal trade and unrestricted international payments for which we have stood. Much still needs to be done to create a sufficient awareness of the need to expand our exports. It is encouraging, however, that there are indications of a more vigorous pursuit of foreign markets. I have full confidence in the ability of American labor and management to rise to the challenge, with benefits to all concerned.

I should now like to turn to the role of the United States as banker for the rest of the Free World. As a central banker, I am of course particularly concerned with this banking function of the United States and with the role of the dollar as an international reserve currency. The Federal Reserve Bank of New York now maintains accounts for 97 central banks and monetary authorities throughout the world, and this brings us into close day-by-day contact with the many complex problems facing the dollar as a reserve currency.

As of the end of 1948, foreign official holdings of gold and dollar reserves amounted to \$8.8 billion and \$2.8 billion, respectively. Since then, there has been an impressive rise in both types of reserve assets, with foreign official holdings of gold amounting as of the end of March 1961 to nearly \$21 billion, while official dollar reserves had risen to somewhat more than \$11 billion as of the same date. We hold earmarked in our vaults in New York \$9.5 billion, or nearly one half, of total foreign official gold holdings, and also hold for foreign official account roughly \$6.5 billion of dollar balances and other liquid dollar assets. In addition to these official dollar holdings, foreign private and international holdings now amount to about \$12 billion.

It is important to note that the \$11 billion in official short-term balances is convertible into gold on demand. Balances held by foreign private interests, as well as those of domestic holders, acquire the convertibility privilege if they are shifted into foreign official accounts. Since the United States stands ready to convert, at a fixed price, foreign official dollar balances into gold on demand, these

dollar balances are regarded by foreign countries as equivalent to gold itself and hence have been included in their official reserves. By thus serving as the banker for such a "gold exchange" or "dollar exchange" system, as it is sometimes called, the United States has made possible a massive reinforcement of international liquidity upon which the free flow of world trade so heavily depends.

There are many reasons why the dollar has acquired this status as a reserve or "key" currency and, of these, I would mention particularly its stability, its interconvertibility with gold, its widespread use in financing world trade, and the availability in New York of financial markets of unparalleled size and efficiency which permit dollar holdings to be readily put to work. These factors were instrumental in establishing the dollar equally with gold as the reference point for setting par values for other currencies with the International Monetary Fund. The emergence of the dollar as a "key" currency has been mainly a postwar phenomenon, although it had its beginnings in the prewar period when there was a massive inflow of capital from abroad in search of a safe haven.

It may be noted that the conditions which have made the dollar a reserve currency were not fostered solely, or even largely, for that purpose. Rather they are an integral part of our market economy and the result of our efforts to achieve much broader goals. The reserve currency status of the dollar thus ultimately flows from and depends upon the pre-eminent role of the United States in international trade and finance, a role which can be fulfilled only by continuing adherence to sound economic and financial policy. Any undermining of confidence in our ability to keep our financial house in order—any slackening of resolve in the pursuit of monetary stability or any weakening of fiscal responsibility—could result in a severe blow to the dollar as a reserve currency and, in fact, to the entire international financial system. This would be a development that would prejudice our economic well-being in the broadest sense by undermining the base on which so large a share of world trade and payments now depends. We, therefore, have a responsibility—and one not without advantages—which we have met, and should continue to meet, with a resolution equally as firm as that required for leadership in the security and economic progress of the Free World.

Since 1959 the United States has faced a new problem of insuring, in an increasingly competitive world market, a sufficient volume of exports and other earnings abroad to finance our import requirements, our military expenditures abroad, our foreign aid programs, and our foreign investment activities. Simultaneously, we have had to guard against the very real risk that the volume of our

short-term dollar liabilities, in our role of banker for the rest of the world, might grow so rapidly in relation to our gold stock as to create doubts as to our ability or willingness to pay out gold on demand. This dual problem, which has involved striking an appropriate balance in our economic and financial policy decisions between domestic and international considerations, has been a matter of concern to the Federal Reserve System for some time past. As the United States economy moved into recession in 1960, the problem of reconciling the domestic and international objectives of monetary policy became a very real and immediate issue. While domestic business conditions clearly required an easy money policy, the ever-present threat of sizable outflows of funds to foreign financial centers made it essential that short-term interest rates should not be permitted to decline to the low levels that had prevailed during comparable phases of the business cycle in 1958 and 1954. Here was a clear-cut example of the possibility of conflict in policy objectives that can emerge in the competitive and convertible world of the 1960's.

The domestic situation called for supplying the commercial banks of the country with additional reserves not only to meet their seasonal needs customarily arising in the second half of the year but also to improve their liquidity and encourage them to make more loans. Vast purchases of United States Treasury bills by the System would have unduly raised the price and depressed the yield of such securities and, thereby, would undoubtedly have stimulated a further outflow of funds from the United States. Accordingly, the Federal Reserve furnished the banks with a large amount of reserves in other ways than by Federal Reserve purchases of short-term Government securities. In several steps timed to meet seasonal needs, the commercial banks were authorized to count currency and coin held by them as part of their reserves, and the reserve requirements for banks in central reserve cities were reduced to make them the same as the requirements for banks in reserve cities, thus bringing about in 1960 a uniformity required by law not later than in 1962. In addition, beginning in October, open market operations were undertaken in short-term Government securities other than bills. Then, in February of this year, the System broadened the maturity range of its operations to include purchases of intermediate and longer term securities. Such securities were purchased by the System to supply reserves on balance as well as to offset the loss of reserves that otherwise would have resulted from the sale of short-term Government securities designed to counteract downward pressures on short-term rates. Of course they were intended also to facilitate the flow of longer term

funds into productive investments.

While many other factors were also involved, I feel certain that these System actions were important in preventing further declines in the rate on the key three-month Treasury bill. Over the last nine months the three-month Treasury bill rate has been within a range of $2\frac{1}{8}$ - $2\frac{5}{8}$ per cent; during most of the time the range was $2\frac{1}{4}$ - $2\frac{1}{2}$ per cent. This compares with the $\frac{5}{8}$ per cent rate reached in both 1954 and 1958. The mere fact that it was widely recognized, both at home and abroad, that the Federal Reserve was actively concerned with the problem of relative interest rates was a reassuring factor in the exchange and money markets. To sum up Federal Reserve experience, I feel that in 1960-61 we were able to reconcile the apparently conflicting demands of the domestic and international situations through a flexible adaptation of our existing techniques. Future conflicts may prove more intractable, however, and we must be ever alert in the search for policies and techniques that will best serve the nation's over-all interests.

The letter inviting me to appear before this Committee raised a question as to the significance of the international currency movements of the past year as the result of speculation and of differences in money rates. I believe I have already indicated that the role of the dollar as a reserve currency means that the United States must constantly face the possibility of pressures arising from short-term capital movements and other abrupt changes in the flow of payments, and of resulting demands on our gold stock. It was such movements of funds, superimposed upon basic balance-of-payments deficits, that created serious problems in the fall of 1960 for the United States and, more recently, for certain European countries. In a reverse sense, such flows have caused difficulties for recipient nations, including particularly Switzerland and Germany. International capital flows will continue to take place as part and parcel of the Free World economy we have been striving so hard to build; the price of eliminating them would be to slide back into pervasive and rigid controls. Over the years I feel sure that the United States will have to face not only problems arising from undesirably large outflows of short-term capital but also those arising from massive inflows.

In my view, there are two major problems associated with short-term capital movements. The first problem involves the possibility that such movements will feed upon themselves and encourage speculative forces which could imperil a currency and, by causing disorderly exchange markets, disrupt trade and other financial transactions. The second is the possibility that such movements might threaten a reduction in the liquidity required by a par-

ticular country to sustain other trade and financial transactions. I believe there are means available to meet successfully these twin threats to currency stability and liquidity—and within the framework of the present international financial structure.

The importance of confidence in the underlying soundness of international currency relationships cannot be stressed too often. We must make sure that the rest of the world can have no doubt about the soundness of the dollar. If there is any basis for suspicion that we have relaxed our guard, techniques designed to insure international currency stability and liquidity can give only temporary relief. Techniques alone cannot solve problems for us, although proper techniques are essential for such solutions.

The first line of attack, therefore, involves clear and frank recognition on the part of all countries of the importance of international factors in the shaping of domestic monetary and fiscal policies. As mentioned earlier, for the United States this is a relatively new consideration, but it has been a real fact of life to most countries for many years. Over the past few months, to cite a limited period, foreign monetary authorities have taken a number of important measures with international considerations in mind. I would note, for example, that since last fall the Bank of England has twice reduced the bank rate, while the Deutsche Bundesbank has made three such reductions, together with substantial releases of additional reserves to the German banking system. This relaxation of credit restraint in the United Kingdom and Germany, while the United States Treasury bill rate has held firm around the $2\frac{1}{4}$ per cent level, has resulted in a significant narrowing of international interest rate differentials.

In all probability, however, co-ordination of national monetary policies cannot in many instances prevent interest rate spreads from reaching a magnitude sufficient to induce short-term capital flows from one financial center to another. Furthermore, we face the ever-present possibility of speculative pressures arising not only from fact but also from mere rumor, which can readily induce massive shifts of "hot money" in search of a safer haven. During recent months we have gained a great deal of useful and encouraging experience in the potential effectiveness of central bank cooperation to cushion and reverse such speculative capital movements.

During the early months of this year there was a further growth of speculation in the exchange markets on the possibility of revaluation of one or more European currencies. As a result, funds initially attracted to certain European markets by considerations of higher interest earnings or capital appreciation were strongly aug-

mented by a wave of speculative transfers across the exchanges. These speculative anticipations were partially confirmed by the revaluations of the German mark and the Dutch guilder on March 6 and March 7, respectively. Far from inducing profit-taking and a return flow of such speculative funds, however, the short-run effect of the revaluations was to excite still further speculative anticipations of further readjustments in European currency parities. To meet this threat to orderly and stable exchange markets, a group of central bankers at their monthly meeting in Basle, Switzerland, issued on March 12 a declaration of mutual support and cooperation. Such cooperative action has involved not only financial support to the currencies under attack but also a variety of coordinated operations on the foreign exchanges. Recently, as you know, the United States has undertaken certain exchange operations, notably in the forward market for German marks. These operations appear to have served a most useful purpose in sustaining stable and orderly exchange markets.

This cooperation has helped not only to temper speculation but has also provided a means of promptly reinforcing international liquidity in the required amounts. It would be my hope that close study of this heartening experience will suggest additional important steps which could be taken to broaden and regularize a system of inter-central bank cooperation. The United States will need to cooperate in the exploration of such steps and to consider the extent to which its participation in them would be required to assure their success.

It would be a mistake, however, to think of any system of central bank cooperation in the form of reciprocal credits as a substitute for the credit facilities now available from the International Monetary Fund. Inter-central bank credits are essentially of a short-term nature and the reversal of certain types of speculative capital flows may well require a somewhat longer period of time and possibly greater resources. In such circumstances, I would hope that access to the medium-term credit facilities of the International Monetary Fund would not be impeded by possible inadequacy of Fund supplies of certain currencies or by an unduly narrow interpretation of the eligible uses of the Fund's credit facilities.

In this connection, I have been encouraged by the consideration that is now being given to certain reinforcements of the Fund's resources and to a clarification of uncertainties as to the availability of Fund resources for meeting reserve drains generated by short-term capital movements. On the matter of expanding the Fund's re-

sources, various proposals have been made. In my mind, the most promising approach is that recently suggested by Mr. Per Jacobsson, the Managing Director of the International Monetary Fund, for the establishment of a system of dependable but limited stand-by credits to the Fund by the major industrialized countries likely to be subject to major flows of capital among their financial markets.

In conclusion, I should like to venture some comments on the question of the longer term problem of insuring an adequate growth of international liquidity over the years. It is sometimes contended that, if we succeed, as we must, in restoring balance-of-payments equilibrium, our very success will operate to the disadvantage of the rest of the world by limiting the amount of liquidity that will be added to the international financial system. I question seriously any such conclusion. Certainly there is at present a fully ample stock of world liquidity in the form of gold and foreign exchange balances and other forms of credit. While the rate of new gold production over the years may slip somewhat behind the growth of world trade, there is no particular reason to assume that world liquidity needs will rise automatically and proportionately with trade and investment. Just as we have developed within our economy increasingly efficient uses of money and credit, so also similar possibilities are available internationally through cooperative arrangements which will not impair the individual responsibilities of each country. Moreover, while the United States must keep its balance of payments under firm control, this does not preclude moderate flows of dollars abroad when such movements would serve a constructive purpose. Furthermore, to the extent that the United States may find it desirable to accumulate foreign exchange balances, new sources of liquidity would be opened up. In this connection, it is important to recognize that liquidity should not be defined narrowly with reference solely to existing stocks of gold and foreign exchange but should also be taken to include private and governmental credits, the inter-central bank credit facilities I have discussed, and the resources of the Monetary Fund.

If, therefore, domestic policies are appropriate and fashioned with due regard to international realities, and if means to deal with short-term capital flows are available and adequate, there is no reason, in my judgment, why the international financial system cannot work satisfactorily for at least the foreseeable future. I would thus conclude that there is no present need for far-reaching reforms which would basically alter the present financial structure, practices, and institutions of the world.

Implementation of the Policies of the Federal Open Market Committee*

STATEMENT by ROBERT G. ROUSE
*Vice President, Federal Reserve Bank of New York
and Manager, System Open Market Account*

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 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 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

* Statement before the Joint Economic Committee of the Congress of the United States (Patman Committee), June 1, 1961.

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.

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 nation-wide 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 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.

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 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 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.

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.

The Recording and Publicizing of Decisions Concerning Open Market Policy*

STATEMENT by ALFRED HAYES
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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 United States 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.

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

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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, 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 re-assessment 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 securities prices and yields. If somewhat later the System found it 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.