BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

February 24, 1964.

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Sherman

SUBJECT: Proposed revisions in continuing authority directive for open market operations.

Attached are: (1) a memorandum from Mr. Stone in his capacity as Manager of the System Open Market Account recommending that the Committee increase the standing limitation on change in System holdings of Government securities between meetings of the Committee from $1 billion to $1.5 billion; (2) a memorandum from the Secretariat proposing certain clarifications in the language of the continuing authority directive for open market operations; and (3) a draft for Committee consideration of a revised version of the continuing authority directive, incorporating both the recommended change in the leeway and the proposed language clarifications.

These materials are being distributed in connection with the planned review at the March 3, 1964 meeting of the Committee of all of its continuing authorizations and directives.

Merritt Sherman, Assistant Secretary,
Federal Open Market Committee.

Attachments

February 24, 1964

CONFIDENTIAL (FR)

TO: The Federal Open Market Committee

FROM: The Secretariat

SUBJECT: Proposed clarifying revisions of continuing authority directive for open market operations.

The purpose of this memorandum, which has been prepared in consultation with the Committee's General Counsel, is to discuss certain problems with the language in the Committee's continuing authority directive under which System Open Market Account transactions are carried out implementing the current economic policy directive, and to propose clarifying revisions.

As a point of departure, it will be recalled that prior to December 19, 1961, transactions in the Account were governed by a single directive issued by the Committee at each meeting, embodying both (1) operating instructions of a generally continuing nature and (2) policy guidelines that were changed from time to time.

At its meeting in December 1961, the Committee adopted a revised procedure, under which operating instructions of a continuing nature were given in a continuing authority directive, and policy guidelines were provided at each meeting in a current economic policy directive.

The policy record entry for the December 1961 meeting contained the statement that "The language in the new continuing authority directive was rephrased from that of earlier instruments for the sake of greater clarity...." However, the new language poses certain problems that are discussed below.

1. The "leeway" proviso appended to paragraph 1 of the continuing authority directive states that-

> ". . . The aggregate amount of such /U.S. Government/ securities held in such Account. . .shall not be increased or decreased by more than $1 billion during any period between meetings of the Committee..."1/ /Emphasis added./

The phrase "during any period" is susceptible of at least three different interpretations:

(1) At no time in the interval between meetings shall holdings of Government securities differ from the holdings on the day of the previous meeting by more than $1 billion;

(2) Regardless of the magnitude of interim fluctuations, the net change in Government security holdings between one meeting and the next shall not exceed $1 billion; or

(3) Between no two points in time in the interval between meetings may the holdings of Government securities differ by more than $1 billion.

The Account Manager has interpreted the leeway provision in accordance with the first of these alternatives. This interpretation is consistent with the leeway provision in the single directive issued at meetings before December 19, 1961, which specified that-

> ". . . the aggregate amount of securities held in the System Account . . . at the close of this date . . . shall not be increased or decreased by more than $1 billion . . . ." /Emphasis added./

It is clear that the Committee did not intend to change its instructions on this matter in adopting the new directive, since the policy record entry for the December 19, 1961, meeting declared that the Committee had made, with one

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1/ On several recent occasions the $1 billion limit temporarily has been increased to $1.5 billion. For simplicity the figure of $1 billion is used in this memorandum.

exception not pertinent here, "no substantive changes in its authorizations and directions to the Account Manager". It would appeared sirable to make the Committee's intent explicit in the directive.

2. The phrase "between meetings of the Committee" could lead to uncertainty as to the exact timing of the period during which the leeway restriction applies. The Account Manager has proceeded on the premise that a leeway, once established, is in effect from the close of business on the day of a Committee meeting through the close of business n the day of the next meeting. While this undoubtedly is the Committee's intent, the phrase "between meetings of the Committee" might be taken to imply that the leeway restriction applies to the period from the end of one meeting to the beginning of the next meeting. Thus, one could argue that the Account Manager technically has authority to effect transactions without limitation as to dollar amount on the day of Committee meetings. It would appear desirable to remove this ambiguity.

3. On rare occasions the Committee may hold a meeting in the course of which no action is taken with respect to a policy directive. One such occasion was the telephone conference meeting held on June 21, 1962, which was concerned exclusively with the Canadian problem.

The preamble to the present authority directive authorizes and directs the Account Manager to conduct specified operations-

> "to the extent necessary to carry out the current economic policy directive adopted at the most recent meeting of the Committee." [Emphasis added]

Because the Manager's authority is now limited to carrying out the policy directive adopted at the most recent meeting, it is at least arguable that there is nothing for him to implement if no policy directive is adopted at a meeting, and his authority to effect any Account transactions thereafter may be subject to question. The directive can be amended to avoid this problem.

Recommendation

The following revisions of language in the authority directive would appear to resolve the problems discussed in this memorandum.

"1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the MOST RECENT current economic policy directive adopted at ~~the most recent~~ A meeting of the Committee:

> "(a)...; provided that the aggregate amount of such securities held in such Account ... AT THE CLOSE OF BUSINESS ON THE DAY OF A MEETING OF THE COMMITTEE AT WHICH ACTION IS TAKEN WITH RESPECT TO A CURRENT ECONOMIC POLICY DIRECTIVE shall not be increased or decreased by more than $1 billion during ~~any~~ THE period ~~between meetings of the Committee~~ COMMENCING WITH THE OPENING OF BUSINESS ON THE DAY FOLLOWING SUCH MEETING AND ENDING WITH THE CLOSE OF BUSINESS ON THE DAY OF THE NEXT SUCH MEETING."

CONFIDENTIAL (FR)

February 14, 1964.

TO: Federal Open Market Committee

FROM: Robert W. Stone

SUBJECT: Limit~~ation on the change~~ in System holdings of Government securities between meetings of the Federal Open Market Committee.

Experience with the practical administration of the System Open Market Account in 1963 suggests the desirability of increasing from $1 billion to $1.5 billion the standing limitation placed by the Federal Open Market Committee on changes in System Account holdings of United States Government securities between meetings of the Committee.

At present it is the Committee's practice to limit the change in Account holdings of Government securities between meetings to $1 billion, with this amount being revised upward by the Committee when it appears likely that greater leeway will be required. The $1 billion limitation was adopted at the meeting of the Committee on June 22, 1955, at which time the executive committee of the Federal Open Market Committee, to which the full Committee formerly issued its directives, was abolished.

Since 1955 the amplitude of reserve fluctuations with which the Account Management must deal has increased significantly, leading to greater swings in System holdings. Thus, in 1963, the average Wednesday-to-Wednesday change in System holdings of Government securities--both outright and under repurchase agreements--was $288 million compared with $108 million in 1955. (Weekly changes in <u>total</u> holdings reflect the size of the task of open market operations, although outright transactions subject to the limitation need not be as large if repurchase agreements can be used.) It is apparent that the accumulation of such weekly changes in holdings over a three week period was much more likely to breach the $1 billion limit in 1963 than in 1955.

As a consequence, the Manager found it necessary for 4 of 18 periods in 1963 to ask that the leeway be $1.5 billion; and it was at that level for the two periods ending January 28 and February 11, 1964. Ordinarily, the reserve estimates were sufficiently accurate to enable the Manager to anticipate the need for additional leeway, but on one occasion--the three weeks ended December 3--System holdings rose to within $8 million of the $1 billion limit on the day of the Committee's meeting.

In view of the increased amplitude of fluctuations in System holdings since 1955, I recommend that the Committee increase the standing limitation from $1 billion to $1.5 billion.

February 24, 1964.

Proposed Revised Continuing Authority Directive
for Open Market Operations

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent current economic policy directive adopted at a meeting of the Committee:

(a) To buy or sell United States Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing United States Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $1.5 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting.

(b) To buy or sell prime bankers' acceptances of the kinds designated in the Regulation of the Federal Open Market Committee in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed $75 million or 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York.

(c) To buy United States Government securities with maturities of 24 months or less at the time of purchase, and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, from nonbank dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or acceptances in 15 calendar days or less, at rates not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower; provided that in the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to purchase directly from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the rate charged on such certificates shall be a rate 1/4 of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed $500 million.