A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington on Tuesday, April 12, 1960, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Balderston
Mr. Bopp
Mr. Bryan
Mr. Fulton
Mr. Leedy
Mr. Mills
Mr. Robertson
Mr. Shepardson
Mr. Szymczak
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Leach, Allen, Irons, and Mangels, Alternate Members of the Federal Open Market Committee

Messrs. Erickson, Johns, and Deming, Presidents of the Federal Reserve Banks of Boston, St. Louis, and Minneapolis, respectively

Mr. Young, Secretary
Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Brandt, Eastburn, Hostetler, Marget, Noyes, Roosa, and Tow, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Koch, Adviser, Division of Research and Statistics, Board of Governors
Mr. Keir, Chief, Government Finance Section, Division of Research and Statistics, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors

Messrs. Ellis, Storrs, Baughman, Jones, and Einzig, Vice Presidents of the Federal Reserve Banks of Boston, Richmond, Chicago, St. Louis, and San Francisco, respectively

Messrs. Parsons and Coldwell, Directors of Research of the Federal Reserve Banks of Minneapolis and Dallas, respectively
Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period March 22 through April 6, 1960, and a supplementary report covering the period April 7 through April 11, 1960. Copies of both reports have been placed in the files of the Committee.

With further regard to developments since the Committee meeting on March 22, 1960, Mr. Rouse made the following comments:

> Since the Committee last met, the Government securities market has lived through the Treasury's cash financing, prices and yields of Government securities have fluctuated widely, and this morning the market is preparing for the one-year bill auction at 1:30 p.m. today. As far as the Treasury cash financing of $2 billion 4 per cent notes maturing May 1962 and "up to" $1.5 billion 4-1/4 per cent bonds is concerned, I think it safe to say that we have not yet seen the end of the post-mortem on the bond issue. The artificiality of the long-term bond market--where prices have moved rapidly in either direction without any significant volume of trading--has been pointed up by the lack of public response, but I doubt that this will prove anything to the Treasury's Congressional critics. The claim that there would have been a far better response if more time had been allowed prospective subscribers has little merit. At the close last night, the new issues were selling in the when-issued market at discounts that exceeded the value of Tax and Loan accounts to commercial banks.
>
> I should like to make two comments on the sharp run-up in Treasury bill rates over the past few days that resulted in average rates of 3.622 per cent and 3.854 per cent in yesterday's auction of three- and six-month Treasury bills--about 7/8 point above the average rates a week earlier. First of all, the upward readjustment of rates to a point closer to the discount rate may provide some sort of an anchor for the short-term rate structure and make for a better auction of the one-year bills this afternoon. On the other hand, there does not

appear to be much interest in the April bills from banks, dealers, or corporations, and there is some concern in the market about adequate demand to cover the $2 billion offering at anything like a rate which, in relation to existing rates, could be regarded as reasonable. Secondly, the gyration that the short-term bill rate has been undergoing over the past few months is undoubtedly a reflection of the fact that the bill market has increasingly become a market where nonbank trading predominates. With banks relegated to the background, the market has lost something of its continuity, and rate movements have become increasingly independent of the bank reserve situation.

In today's auction the Account Management plans to tender to roll over its holdings of $122 million special Treasury bills maturing April 15. This action appears appropriate in the light of the prospective reserve situation and also to give the Treasury some help in what may be a difficult financing operation.

I should also like to call the Committee's attention to the fact that payment date for the new one-year bills falls on Friday, when both the Chicago and Philadelphia banks will be closed. The Treasury will consequently not receive payment for subscriptions allotted in those districts until the 18th, while it anticipates that the bulk of maturing bills will be presented for payment in New York or other districts open for business on the 15th. In addition, many of the New York Government securities dealers will not be open on the 15th, and this may create additional complications. It all adds up to the possibility of a difficult situation around the week end; there is a possibility that the Treasury balance may dip sharply, and even result in a need for the System to purchase special certificates to tide the Treasury over the week end. Our best estimate at the present time is that this will not be necessary, but I wanted to make the Committee aware of this possible development.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the open market transactions during the period March 22 through April 11, 1960, were approved, ratified, and confirmed.

Supplementing the staff memorandum distributed under date of April 8, 1960, Mr. Noyes made the following statement with regard to economic developments:

The uncertainty which has characterized the economic outlook for several months remains unchanged. There has been, however, considerable shifting among the components that make up the uncertain mixture. The weather has been good, and department store sales showed a spectacular increase. Automobile sales improved enough in the last ten days of March to bring about a seasonally adjusted increase for the month as a whole. The Consumer Finances Survey reported that consumers' buying plans were up and at high levels, by historical standards, confirming the relatively optimistic indications of the quarterly Census survey, mentioned at the last meeting. Boom or near boom conditions continue to develop in most industrialized countries overseas. Business loans at city banks expanded more than in any March except 1956. The money market firmed dramatically in the last few days, as has already been reported.

Set against these indications that we may have been experiencing no more than an exaggerated version of the late winter lull are a counter-seasonal rise in unemployment in March and an estimated decline in industrial production of another 1 per cent. Construction activity dropped back to about the November level, after three months of increase. The mortgage market eased noticeably last month, and five of the Home Loan Banks dropped their lending rates. Steel production, which had slipped to 92 per cent of capacity in March, was off further to a rate of 85 per cent last week, and is scheduled at 80 per cent this week.

The stock market, at levels well above the early March lows, showed little signs of decisive movement in either direction--and commodity prices, another composite indicator which might reflect some shift in the balance of underlying forces, were substantially unchanged. There was an upward creep in the consumer index, attributable largely to technical factors. Hence, we find again that the only really significant development, taking everything together, is that an uneasy and uncertain balance has been maintained another three weeks. Yesterday was almost a typical day--both equities and fixed-income securities dropped substantially in price, rather than following the orthodox pattern of crosswise movement. Two classic blue chip companies reported first quarter earnings--du Pont a drop, and IBM at an all-time high. Perhaps the only generalization that is justified is that, with the passage of time, the chances that the average for 1960 as a whole will be spectacular on either side are thereby reduced.

Mr. Thomas presented the following statement with respect to financial developments:

Since the last meeting of the Committee, "liquidation of the inflationary psychology", which the Chairman was quoted as mentioning, seems to have continued further, but developments in the money market and the stock market during the past week show evidences of a possible shift.

Interest rates declined further in the latter part of March and the early days of April. Yields on Government securities reached the lowest levels in about a year. Yields on corporate and State and local government issues, however, did not decline as much as those on United States Government securities. Last week, large tenders by dealers bid down rates on Treasury bills to new low levels for the year, leaving dealers with larger awards than they expected. During the past week, however, there has been an upturn in rates on United States Government securities almost as spectacular as the March decline. Treasury bill rates have risen sharply, and this week's auction averages are about 7/8 of a point above those of last week. In addition to the pressure of large positions held by dealers, bills acquired in Chicago for the April 1 tax date have come onto the market. Also, banks have been offering securities to cover reserve needs arising from subscriptions to the new Treasury issues for which payment is to be made this week.

On the basis of past experience, pressures on the money market and rising bill rates are not unusual for the first half of April. There are large cash needs for dividend and other payments, and the Treasury usually has a cash borrowing operation at this time. A special factor this year may be that the lower bill rates that have developed are not sufficiently attractive to many nonbank pruchasers to hold them in bills. With market rates as far below the discount rate as at present, pressures of this sort are likely to result in sharp fluctuations in Treasury bill rates. Whether the upturn in rates is due to these temporary influences or to more fundamental forces remains to be seen.

The upturn in prices of stocks that has occurred in the past three weeks may indicate a change in expectations. These increases in stock prices and in short-term interest rates have been accompanied by some decline in Treasury bond prices following the previous rise. Yields on corporate and municipal bonds, which did not decline as much in the first quarter as those in Treasury bonds, have not risen noticeably in the past week. But new issues of corporate securities offered last week at relatively low yields were not satisfactorily distributed.

Turning back to analysis of the puzzling declining interest rate trend in the first quarter of the year, one possible explanation is that credit demands in the aggregate

were not as large as they were during 1959. The Federal Government retired more debt than in the first quarter of any year since 1956. Corporate and State and local government borrowing in the long-term capital market has been substantially smaller than in other recent years. Loans on securities by banks and by brokers have shown a pronounced decline. Real estate loans at banks have increased only moderately and there are reports of an easing in the mortgage market generally, although it is questionable whether there has been a decrease in the total volume of mortgage loans made.

Short-term borrowing by business at banks has continued at a high level, and consumer credit has increased. The total volume of bank credit has continued to decline, as the increase in business and consumer loans at banks has been more than offset by the decline in other loans and by further reduction in bank holdings of securities.

The second major factor that has been suggested as a reason for declining interest rates is the large nonbank demand for Government securities. This may be divided into three elements: One is the shift in liquid asset holdings--particularly by corporations but also by others--from bank deposits to short-term Government securities, attracted by the interest return available. This shift is in effect the counterpart to the large volume of short-term securities that the Treasury had to issue last year and the high interest rates that had to be offered to float them. The public could have liquidity with interest without holding cash balances that give no return. This may be adequate to explain the decline in bank deposits. It raises a question as to the economic significence of such a decline which merely represents a shift in types of liquid assets held and not a decrease in liquidity.

The second element in the large nonbank demand for Government securities--and the consequent decline in interest rates--is the shift from equities to bonds. This is the main feature of the "liquidation of inflationary psychology." The turn of events in the past week or so raises a question as to whether this shift has been brought to an end by the very adjustments which it caused in the relative prices of stocks and bonds. Stocks have tended to be firmer while bond prices have been soft.

The third element that may be responsible for the nonbank demand for Government securities--and perhaps for the slackening of the increase in economic activity--is more conjectural. That is the possibility that the rate of saving has increased further and that spending for goods and services might have been curtailed. This may be another aspect of the liquidation of inflationary psychology.

It seems evident that business saving has tended to increase. Information is not yet available to show whether consumers are also saving more. It does appear, in any event, that they have been channelling more savings into holdings of Government securities. It is not unlikely that consumer practices as to spending and saving are being increasingly determined by their attitudes toward the price structure, rather than by the level of their incomes. In this type of situation, fiscal and monetary policies are less significant than are the pricing and selling practices of business. Nevertheless, if the economic situation should weaken for this reason, there is less reason for the maintenance of a restrictive credit policy.

The trend of the money supply in March is uncertain because of statistical complexities in adjusting for seasonal variations. Figures available for March 30, the last Wednesday in the month, seem to indicate a smaller than seasonal decline in the five weeks since February 24. The seasonal correction, however, is questionable because of the difficulty of allowing for shifts incident to the Cook County tax. The decline this year by March 30 seems to have been smaller than has occurred in most other previous years. There is some evidence that this is due to a change in technique of handling the Illinois tax situation rather than to a change in the trend of deposits.

Averages of daily figures for weekly and semimonthly periods continued to show a greater than seasonal decline in demand deposits in the last half of March. The total money supply, seasonally adjusted, is about a billion dollars less than a year ago and nearly $2 billion below the peak of last summer. At member banks alone the decline in demand deposits has been larger. Turnover of demand deposits, however, has increased by more than 7 per cent in the past year. Time deposits at commercial banks and also at mutual savings banks increased more in March than in any month in over a year, showing an aggregate rise of about $1 billion, but for the first quarter as a whole the increase of less than half a billion dollars was smaller than usual.

Federal Reserve operations and policies have been relatively passive in recent weeks and might be said to have had no positive influence on the recent trend of interest rates. Open market operations--besides adjusting to rather wide temporary variations in reserve needs--have shown little net contribution. In effect reserves released by the more than seasonal decline in deposits have been used by banks to reduce indebtedness, and net borrowed reserves have declined accordingly. No positive stimulus in the way of additional reserves has been supplied by the System. It may be said that the market has eased itself and the System has permitted this ease to develop.

Maintenance of the discount rate and the repurchase rate at above market rates on Treasury bills, however, has exerted something of a restraining influence. In such a situation banks have an inducement to cover temporary reserve needs by selling bills rather than by borrowing, or to sell bills in order to reduce borrowing. One result of this type of relationship between discount rates and open market rates is to cause rather wide short-term fluctuations in market rates in response to variations in reserve needs. Such fluctuations are likely to have a greater restrictive influence than is intended in the current policy posture.

Greater than desired restraint can be avoided by one of three methods, each of which has advantages and disadvantages: (1) The discount and repurchase rates could be lowered. (2) The repurchase rate could be reduced, while keeping the discount rate unchanged. (3) The Account Management could actively purchase and sell bills on a day-to-day basis in an endeavor to cover temporary needs. A forth possibility, of course, is that market rates may eventually adjust upward to the level of the discount rate. To some extent this has been happening in the last few days. The level of rates achieved yesterday seems to be reasonably consistent with a discount rate of 4 per cent and net borrowed reserves of $300 million or less.

Whether this adjustment is more than a sharp temporary fluctuation remains to be seen. If credit demands should be vigorous, then rates are likely to stay at the current level or to rise further. They are not high relative to the latter part of 1959. If, however, credit demands should be slack, the upward adjustment may be short-lived. If rates decline again, then the question of appropriate discount and repurchase rates will need consideration.

Another--and more basic--decision facing this Committee is whether to take more positive action in an endeavor to check the net decline in bank credit and the money supply. Any such decision should be based upon a judgment as to the significance of the recent continued decline in bank deposits. Is it merely a shift in asset holdings with no significant change in liquidity or attitudes of the public? Or has there been a decrease in spending and an increase in saving relative to incomes? Events of the last few days might indicate that, whatever its cause, the decrease in the money supply may be ending. The situation needs careful watching.

On the basis of the customary seasonal pattern and the schedule of Treasury financing, and assuming the maintenance of net borrowed reserves at somewhat below $300 million, it

appears that no additional reserves may need to be supplied during April. The estimates for the next statement week, however, are uncertain, and operations may need to be based on the performance of the market.

Mr. Marget commented as follows regarding the balance of payments:

Since it was the massive gold outflow of 1958 that made this country aware that it, too, not only could have a balance-of-payments problem, but quite obviously did have one, I might begin by inviting the Committee's attention to what has been happening in the way of gold outflow more recently. For the year 1959, as you know, if we exclude the quite exceptional payment of $344 million in gold to the International Monetary Fund as part of a program to increase that institution's resources, the level of gold outflow from the United States, at around $650 million, was less than 30 per cent of the 1958 gold outflow of $2.3 billion. We now have the figure for foreign gold purchases for the first quarter of 1960: at $42 million, it is less than half the already relatively low figure for the first quarter of last year.

A decline of this order of magnitude in the level of gold outflow from the spectacularly high level of 1958 deserves, I think, itself to be called spectacular. Nothing anywhere near as spectacular, of course, can be found in the figures for the combined outflow of gold and dollars, which is what we take as the measure of the over-all deficit in our balance of payments. Nevertheless, while it would be quite wrong to characterize as "spectacular" the improvement that has taken place with respect to our balance of payments over the last nine months, it would not be wrong to characterize it--with all due caveats, of course--as impressive.

This is a conclusion, I grant, which one would not be likely to reach on the basis of some of the public discussion of our balance-of-payments position. We still find reference in that discussion, for example, to the balance-of-payments position of the United States as one which is still "deteriorating." There can, I think, be only one explanation of this kind of talk: and that is the habit--quite understandable otherwise, of course--of taking the calendar year as our unit for comparison. It is true that the over-all deficit in our balance of payments was larger for the calendar year 1959, at $3.7 billion, than it was for the calendar year 1958, at $3.4 billion. But this completely obscures what was happening during the calendar year 1959, as between the earlier and the later parts of the year, respectively.

What happened during the earlier part of 1959 was that our balance-of-payments position was continuing to "deteriorate." Indeed, if we are to appreciate the degree of improvement that we have been witnessing in our balance-of-payments position since the middle of 1959, it is important to understand that the degree of deterioration in the first part of last year was very much greater than is suggested by the figure of $3.7 billion for calendar 1959 as against the figure of $3.4 billion for calendar 1958. The blunt fact is that in the second quarter of 1959 the deficit in our over-all balance of payments reached an annual rate of around $5 billion. It is from this low point that we have to measure the degree of improvement in our balance of payments that has taken place since we first witnessed the turn; and, so measured, the degree of improvement can fairly be called impressive.

There were times, to be sure, within the last nine months, when one wondered whether the improvement that had seemed to be setting in around the middle of 1959 was likely to continue. For example, the effects first of the port strike in October and then of the steel strike made the changes appear rather irregular, and there were also a good many ups and downs from month to month in trade in particular commodity groups not obviously affected by the steel strike. But the export figures for last December, at an annual rate of something like $18 billion, as against a realized export level in 1958 of around $16 billion, gave reason to hope that the process of adjustment had been resumed. Then came January, with exports at an annual rate even slightly higher, at $18-1/2 billion. And now the February trade figures, adjusted for seasonal variation and the extra day for leap year, show a still higher annual rate, of around $19 billion.

During this whole period, moreover, imports have been averaging around the $15-1/2 billion level they showed during the second half of 1959. This means that our merchandise export surplus for the first quarter of 1960, assuming no great change in exports in March, may be at an annual rate of about $3 billion. This is just about double the $1-1/2 billion average that we showed during the second half of 1959; and, if we remember that at the low point, in the second quarter of 1959, our export surplus was virtually at zero, I think we must agree that "impressive" is not too strong a word to describe the improvement that has taken place in our trade position over the last nine months.

The improvement in the trade figures, I should like to add, is quite clearly reflected in our gold and dollar figures. As I have previously reported, the January gold and dollar figures were so favorable that none of us believed that they could

continue to improve at the same rate. They have not; but I must here report that when, at the last meeting of this Committee, I characterized the movements of gold and dollars for February and the first half of March as "anything but spectacularly favorable," I did less than justice to the degree of improvement which they in fact represented, because I did not have available, at that time, the figures for foreign holdings at the commercial banks. When those holdings are taken into account, it is not unreasonable to estimate the gold and dollar transfers in the first quarter of 1960 as between $350 and $450 million. This is to be compared with a level of around $700 million in the first quarter of 1959. The year is still young, and we still have a long way to go before our international accounts are balanced; but it can hardly be denied that the showing of the last nine months, as we now view it, looks not only impressive on its own account, but also particularly encouraging from the standpoint of those of us who want the balance in our international accounts to be brought about by methods of expansion, rather than contraction.

Mr. Treiber presented the following statement of his views on the business outlook and credit policy:

The first quarter of 1960 was marked by high but not spectacular business activity. The sideways movement in March followed a February in which some business indicators registered an improvement while others remained unchanged or declined slightly. Hesitations of this type are not, of course, at all unusual during the course of a sustained business expansion. But they always create uncertainty as to whether there has been a pause for breath which will be followed by renewed progress or whether, on the other hand, an advance warning of business recession has been posted.

The impact of this kind of uncertainty on the climate of opinion in the last few months had probably been unusually strong because the pace of economic activity has clearly fallen short of the exuberant expectations held by many observers at the start of the year. Sales and output have indeed lagged somewhat, but this may turn out to be largely the result of a relatively severe winter, culminating in the heavy snow storms in many parts of the country during March. To some extent also, these lags have probably been a transitional condition. The welcome diminution of inflationary psychology and the comparative respite in labor unrest have encouraged wholesome shifts in inventory and production policies involving a reduced pace from the initial poststrike speed.

As for the future, the recent survey by the University of Michigan of consumer intentions suggests that consumers' optimism is strong and that their buying plans are considerably larger than a year ago. In addition, plant and equipment expenditures rose substantially in the first quarter, and business plans indicate that outlays during the year may rise at a rate which, if realized, would push fixed-investment expenditures (in current dollars) above the previous record reached in 1957.

Increased consumer spending will be needed to offset the effects of a slower pace of inventory accumulation, to assure the optimistic background essential to the expansion of investment expenditures, and to expand production and employment.

Credit is more readily available for mortgages; and we may see a further expansion of mortgage credit stimulating construction. A recent Fortune survey shows that home builders are generally optimistic with respect to the outlook this year. Municipal construction is also likely to expand as municipalities become aware of the easier availability of long-term market financing.

The banks have been experiencing a strong demand for business loans. Bankers with whom we have discussed the matter are looking forward to a continuation of a strong loan demand. Short-term liquid asset ratios are at postwar lows at reporting banks both in New York and outside of New York. Loan-deposit ratios are at new highs.

Despite the fact that the money supply is now lower than it was a year ago, the first quarter of 1960 has seen increased credit availability and reduced interest rates. The reduced money supply has been accompanied, as one might expect, by increased velocity, and over the year there has been a decided increase in money substitutes held by business concerns and the public. In such circumstances, I am not yet disturbed about the present size of the money supply. Sufficient time has probably not yet elapsed for the System's relaxation of the pressure on net borrowed reserves to have an appreciable effect on the money supply. The present size of the money supply makes it possible for the System to create more bank reserves without feeling that we are encouraging an inflationary expansion of bank credit.

While Treasury tax collections in March have been below expectations, the Treasury believes that expenditures are also likely to be below earlier expectations. Thus the over-all Treasury picture for the fiscal year ending June 30, 1960, is about the same as it had been projected earlier this year.

Today the Treasury is conducting an auction to sell $2 billion of special one-year Treasury bills to refund the $2 billion of one-year Treasury bills that mature April 15. Toward

the end of this month the Treasury will be announcing the terms of a new issue or issues, the proceeds of which will be used to retire the three Treasury issues totaling over $6 billion which mature May 15.

Within the last month or so we have seen volatile changes in short-term interest rates. The dominant influence of corporate investors in the Treasury bill market has undoubtedly accentuated the movement of bill rates. Rates can easily move downward or upward with a modest change in the relationship of the supply of credit and the demand for credit. Indeed, in recent days we have seen the rate pendulum move sharply upward. The upward movement is good in the light of the underlying situation; it also has the advantage of bringing present rates into better relationship with the discount rate.

It seems to us that the economy is basically strong and that the next move is more likely to be renewed expansion than stagnation or recession. Therefore, it would be unwise to signal doubts as to the strength of the economy by either reducing the discount rate at this time or making any substantial change in open market policy.

Therefore, we favor the continuation of about the present degree of restraint, with no change in the directive. To the extent that consideration is given to net borrowed reserves, a figure of plus or minus a quarter billion dollars would seem appropriate, recognizing that the actual figure might fluctuate a good deal either way, particularly on the side of lower net borrowed reserves.

Turning to another subject, Mr. Treiber went on to say:

Mr. Sherman has just informed the Reserve Banks of the success the Federal Reserve Bank of Philadelphia has had in obtaining daily information on deposits and related items from member banks. I am pleased to report that the New York Bank has arranged to collect daily reports from all member banks in the Second Federal Reserve District beginning in the latter part of May.

The techniques we are following are basically those developed by Philadelphia, with such modifications as seemed to suit our situation. After we have had sufficient experience to afford adequate analysis and to button up any loose ends, we will report to the Board and the other Reserve Banks on our program.

We are looking forward to using the earlier available information to improve our estimates and projections of member bank reserve balances for use in the planning of open market operations.

Mr. Erickson said that the elements of strength in the First District continued to outweigh the elements of weakness. In February, the New England index of industrial production was up one percentage point. In the March survey of New England purchasing agents, 37 per cent of the respondents looked forward to increased production activity, compared with 29 per cent in February, while the number of respondents looking for a downturn was only one per cent greater than in February. Compared with the same month a year ago, construction contracts in February were off 17 per cent, reflecting a substantial decrease in the nonresidential and utility company sectors. Residential construction appeared to be going counter to the national figures, registering an increase of 17 per cent in the past four months compared with the same four months a year ago. February was 23 per cent ahead of February 1959, which in turn was 87 per cent ahead of February 1958. Nonagricultural employment was down a fraction of one per cent, with employment in textiles, apparel, and leather off somewhat. Transportation equipment also was down becuase of a strike, now 12 weeks old, that closed the Bethelehem Steel shipyards. Retail trade was following the national pattern closely; the past four months were even with the same four months a year ago. For the week ended April 2, however, department store sales were up 21 per cent. Automobile registrations were better than they had been.

Mr. Erickson also said that during the past three weeks District reporting banks purchased more Federal funds than they sold. In the same period, member banks used the Reserve Bank discount window a little more

actively than in the previous three weeks. There were two or three days when borrowings were at the highest levels for a number of weeks.

Mr. Erickson then commented on the Regional Outlook Conference held during the past week, which was attended by economists from throughout New England. It was the consensus of the participants, he said, that there would be healthy growth in the economy for the rest of the year. The median of predictions for gross national product in the last quarter of 1960 was $514.5 billion, annual rate, and for the index of industrial production a figure of 113.5. A 5 per cent rate of unemployment was expected in December 1960, and the median of forecasts for the consumer price index in December was 126.5.

Mr. Erickson expressed agreement with the views stated by Mr. Treiber with regard to the outlook. He recommended no change in the discount rate or the policy directive at this time. As to open market operations for the next three weeks, he would leave it to the Manager of the Account to maintain the situation about as it had been, being sure there was no undue ease and no further tightness.

Mr. Irons said that Eleventh District conditions had been mixed, as was true nationally, but probably for somewhat different reasons. In general, District activity was on a high plateau, although some elements were up, some were holding about even, and some were down a little. Department store sales and retail trade in general were showing satisfactory improvement, while nonfarm employment increased contraseasonally in February and was expected to show a seasonal increase in March.

Unemployment was declining slightly. Farm activity had stepped up greatly as better weather conditions prevailed, and in general the agricultural outlook appeared favorable. The major area of slowing down of activity continued to be in the petroleum industry. The nine-day allowable basis remained in effect, and it appeared to be the present thinking of oil men that the industry must learn to live with nine- or ten-day allowables at least as far ahead as one could look this year. This decline in crude oil production, and in refining, had had some effect on the District's industrial production index, which dropped one point. Construction developments appeared to be about seasonal in the early part of the year, and there were indications that mortgage credit was now more available. On the whole, the situation in the District was strong, with the only real problem being in the petroleum industry.

Turning to the financial side of the picture, Mr. Irons said that loan demand was still strong, but not pressingly so. There continued to be some liquidation of Government securities by banks, deposits continued to decline, and the reserve positions of banks seemed to have shown some improvement, that is, some lessening of pressure. Borrowings from the Reserve Bank had dropped substantially. Whereas they were running earlier at from 10 to 15 per cent of the System total, recently they had dropped to the range from 5 to 10 per cent. In the past week or 10 days, large banks of the District had reduced their purchases of Federal funds to more or less nominal amounts. In substance, it appeared that District banks were getting their houses in better order than they were a few weeks ago.

Mr. Irons expressed agreement with the comments of Mr. Treiber regarding the national picture. In view of the Treasury situation, conditions in the Government securities market, the economic situation, and "straws in the wind" pointing to strength rather than weakness or deterioration, he would hold steady for the next three weeks and avoid any overt action. He would not favor a change in the discount rate, in the directive, or in open market policy or objectives. An overt action might be regarded as signalling doubts at a time when it was questionable whether any such signal would be justified. Accordingly, he would continue to move along as at present.

Mr. Mangels said that Twelfth District employment data for March were not yet available, but that an increase in unemployment insurance claims had been observed, no doubt reflecting reduced employment at aircraft plants. Because of the decision to discontinue the Bomarc missile program, Boeing planned to release some 2,500 or 3,000 workers, and plans for four Bomarc bases on the Pacific Coast had been cancelled in line with the decision. Steel production was down 10 per cent in March from February and was about 4 per cent below 1959. The three large mills were producing at a little less than 81 per cent of capacity, compared with 90 per cent in February. While lumber prices had been fairly steady during the past few weeks, the mills were revising their 1960 sales estimates downward and were becoming more cautious about building inventories. The total value of construction contracts in February was up 8 per cent from 1959, reflecting principally increases in public works and utilities. Nonresi-

dential construction was up 11 per cent, while residential construction showed an increase of 2 per cent. For the four weeks ended April 2, department store sales showed a slight decrease from 1959, but after making allowance for the difference in Easter dates, it was expected that they would compare favorably with last year. In the first three weeks of March, sales of new cars in California were up 12 per cent from February and up the same extent from a year ago.

Mr. Mangels said that loans of District banks increased moderately in the three weeks ended March 30, the increase being much smaller than in the corresponding period a year ago, and that reporting banks reduced their holdings of Government securities almost $100 million. Demand deposits were down somewhat and time deposits were down slightly, but savings deposits increased $7 million. While the increase in savings deposits was not large, it might indicate a reversal of the recent trend. One savings and loan association in southern California had now gone to a dividend rate of 4-3/4 per cent, and there was again considerable general discussion of the 3 per cent interest rate ceiling on savings deposits. Reporting banks were net sellers of Federal funds in the past week and expected to be net sellers in nominal amount this week. Borrowings from the Reserve Bank were quite nominal.

There appeared to be a moderate degree of strength in the general business and credit situation, Mr. Mangels said, with no particular indication that the economy was going to move up rather fast or, on the other hand, that it was going to go down fast. There was considerable

excess productive capacity, and there continued to be a larger amount of unemployment than would be desired. Bank loans had not increased excessively, and predictions for this year were in terms that, although there would be some further increase in loans, the amount of that increase would be substantially less than last year. At the same time, there had not been any downward modification of lending rates.

Under present conditions, Mr. Mangels felt that there should not be any change in the discount rate or the directive. As to operations of the System Open Market Account, he would favor going perhaps a little further in supplying reserves than Messrs. Treiber, Erickson, and Irons had indicated. He would have in mind somewhere around $100 million of net borrowed reserves as an indication of maintenance of restraint, but to a lesser degree than in the past.

Mr. Deming reported that automobile sales in the Twin Cities, as measured by registrations, were down in the first half of March but up in the second half of the month, and the favorable trend appeared to be continuing in April. Accordingly, dealers were now enthusiastic about prospects for the rest of the year. Department store men in the area also were satisfied, because sales thus far in April were higher and at satisfactory levels. The improvement extended not only to sales of apparel but also to sales of appliances and home furnishings. A recent survey by the Minnesota Home Builders Association indicated that inventories of unsold new houses, which were quite high earlier, had now been reduced to a rather low figure. It appeared that there would not be

too much in the way of speculative building during the coming year, and that building would be more on a contract basis. Although there was as yet no large movement, shipments of ore down the Great Lakes had gotten under way.

Mr. Deming went on to say that District banks, both city and country, showed sharp loan increases, sharp declines in security holdings, and contraseasonal deposit decreases. As measured against a year ago, loans were up 12 per cent, holdings of Government securities were down 12 per cent, holdings of other securities were down 9 per cent, and deposits were off 5 per cent. Thus, liquidity positions continued to worsen.

Mr. Deming then reported briefly on certain statistics that had been compiled on average bank reserves over a period of years. These figures showed that a decline from December to March was quite usual from year to year, but that the decrease was more marked, in terms of both percentages and dollars, from December 1959 to March 1960 than in any other comparable period since 1951.

Mr. Deming said he was somewhat concerned about the total reserve base and the money supply. As to the national picture in general, he felt that sentiment was running a little better than production and unemployment statistics would justify. He came out in his thinking to a position much like that expressed by Mr. Mengels. In his opinion, there should be no change in the discount rate or the directive, but the Committee should be moving toward a somewhat easier position through open market operations.

He did not have in mind easing too much and would not want to suggest any particular figures, but he felt it would be advisable to probe toward easier money market conditions through the open market device.

Mr. Allen said he expected reports for March, as they became available, to continue to include less favorable news, such as a drop in total industrial production and an increase in unemployment. However, the situation varied with areas and industries. Although in general it seemed to be the durable goods industries that were experiencing a sag in demand, Wisconsin, an important producer of durables, had the strongest employment situation of any State, based on the classification of major labor markets. In March, all four of the Wisconsin centers classified by the Department of Labor showed less than 3 per cent unemployment, and the two centers classified in Iowa were in the same group. The unemployment situation in Indiana and Illinois was better than for the nation, so only Michigan, among the Seventh District States, was worse off than the average, as it had been for several years.

Mr. Allen went on to say that the expected seasonal increase in auto sales, stimulated by incentive sales contests, may have materialized. The daily sales rate for the last ten days of March was 26,023 cars, higher than any similar period since 1955, and first-quarter sales totaled 1,515,000 units, 14 per cent higher than last year. In the first quarter, 2,000,000 cars were produced, and estimates for the next three quarters were 1,700,000, 1,000,000, and 1,700,000, making 6,400,000 for the year. New car inventories were 1,020,000 on March 31. Therefore, if production

followed the estimates, and if inventories were reduced by September 30 to the desired target of 500,000, sales in the second and third quarters must exceed those of last year by 12 per cent. Right now the feeling in Detroit was again one of optimism.

Mr. Allen commented that capital expenditures had been estimated as substantially higher this year than last, and that spot checks with a number of business firms had not revealed cancellation or postponement of plans. All firms contacted appeared to be going ahead as planned. In fact, there seemed to be no feeling that recent less favorable business reports marked the beginning of a recession; rather, it was felt that favorable elements in the picture would soon be more evident and that the total demand for goods and services was much more likely to rise than to contract.

Mr. Allen reported that during the past three weeks the mortgage market had eased in the Chicago area. Two of the largest savings and loan associations had reduced their "prime" mortgage interest rates from 6-1/4 to 6 per cent. This was undoubtedly a reflection of a low demand for loans in the first quarter, but it was understood there had been a pickup in the past two weeks. There seemed little point in mentioning banking statistics because the Chicago banks, which bulk large in Seventh District figures, were not yet past their April 1 dislocation. However, in the first quarter of this year earning assets of District banks declined less than a year ago, while for the nation the decline this year had been much larger than last year. Moreover, loans at Seventh District banks were

up slightly from the year end, although all reporting banks in the country showed a net decrease in excess of $1 billion.

On the basis of the information at his disposal, Mr. Allen said that, as at the March 22 meeting, he would prefer to await the results of the Easter season before changing the direction of monetary policy or the degree of restraint. He would leave the directive and the discount rate as they were.

Mr. Leedy commented that there had been no significant developments in the Tenth District in the past three weeks. Business loan figures were in line with the national figures; that category of loans continued to increase, but liquidation of Government securities by the banks had more than offset the increase.

Mr. Leedy said he shared the concern that had been expressed about the money supply. In view of the uncertainties existing at the present time, whatever the causes might be, the downward trend of money supply, and the high loan-deposit ratios of the banks, it seemed to him that the System should use every opportunity that might be presented to it to make some additions to the money supply. He would not want to do anything drastic or create an impression that the System was fearful regarding the economic future. However, the nature of open market developments since the Committee decided to move toward lower levels of net borrowed reserves indicated to him that there was an area within which the System could inject some additional reserves and at the same time not create an impression of the kind to which he had referred. It was his feeling,

therefore, although perhaps not quite to the same extent as Mr. Mangels, that the Committee should use whatever opportunities might arise to make some injections of reserves. Beyond that, and particularly with respect to the discount rate, he would make no change.

Mr. Leach said that scattered but definite signs of a spring sales pickup constituted the only recent change that had been noted in the high level of Fifth District business activity. Weather was apparently the only factor that had exerted any significant downward pressure, and such evidence as was available pointed to continuing high levels of personal income and potential pruchasing power in the District. Textile mills had recently granted wage increases averaging about 5 per cent, and it was expected that these increases will be absorbed by the manufacturers. This highly competitive industry had increased wages 39 per cent sincethe 1947-49 base period, while prices received for its products decreased 9 per cent.

The slightly easier position of District member banks at the time of the March 22 Committee meeting seemed to have been temporary, Mr. Leach said. Loan demand during the past three weeks had been greater than seasonal, investments had been liquidated at a faster rate than customary, borrowing at the discount window had been fairly heavy, and District banks had been net purchasers of Federal funds.

With respect to policy, Mr. Leach suggested that the principal question was whether to continue as at present or become a little easier. At a time when available economic data provided inadequate guidance for

policy decisions, it seemed to him desirable to pay particular attention to credit developments. For the past six weeks, Mr. Leach noted, clause (b) of the directive had provided for "fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion." As stated in the staff report distributed prior to this meeting, total credit at city banks declinedmoderately over the five weeks ending March 30 in contrast to substantial increases in comparable periods of most other recent years. Moreover, new offerings of corporate and municipal securities continued to be light. Under these circumstances, it seemed to him appropriate to increase reserve availability somewhat and to eliminate from the directive the reference to special concern over excessive credit expansion. In this connection, he did not favor an approach that sought to determine whether the Committee could do what it wanted to do under an existing directive. Instead, he favored flexibility in directives as well as in policy.

Under the policy he had in mind for the next three weeks, Mr. Leach said, net borrowed reserves might be in the neighborhood of $150 million. He would not change the discount rate at the moment, for reasons already expressed by others. He would not want to lead others to think that the System was more gloomy than it actually was. However, the elimination of the final part of clause (b) of the directive would not be an overt action, and in his opinion it would make the record look better.

Mr. Mills said he was one of those who believed that the money supply, as conventionally defined, was the pressing tactical problem to which policy should continue to be addressed. In his opinion, the fact that the money supply had continued to shrink should give pause for thought and was reason for concern. In this connection, an interesting problem had developed that deserved analysis, namely, that over the past three weeks the money markets had been relatively tight in the face of a lower level of negative free reserves. According to past thinking, the lower level of negative free reserves presumably afforded a basis on which credit would have expanded and the decline in the money supply would have been at least arrested. However, such had not been the case. A possible reason could be found in the staff memorandum on the outlook for member bank reserve positions, distributed to the Committee under date of April 8, which showed that in January through March 1959, when the System was commencing policywise to accelerate pressure on the expansion of bank credit, member bank required reserves declined to the extent of $656 million. In the same period of 1960, there had been a decline in member bank required reserves of $998 million. It would be possible to interpret the greater decline this year as being attributable to the accelerated pressure that System policy had exerted over a period of many months. This pressure continued into the first quarter of the current year, a period of the year when there is customarily a decline in commercial bank deposits.

It does not come into the practical reasoning of the management of a member bank, Mr. Mills said, that because the bank's required reserves are declining and the bank is in a sense thereby reaching an easier reserve position, it is in a better position to expand its loans and investments. Instead, the banker fashions his thinking on the movement of his deposits. Looking at developments in that light, one could likewise make the interpretation that a level of $250 million of negative free reserves, more or less, over the past several weeks had in fact represented much greater pressure on the reserve positions of the banks than the actual figures would indicate. This would be for the reason previously mentioned, namely, that a major element that had brought down the level of negative free reserves was the decline in required reserves. This was not a comforting factor to the banks or the kind of development that would stimulate banks to act in such a way as to check the contraction of the money supply.

Mr. Mills said that what he was saying went back to what he understood to be Mr. Bryan's thesis. The System had neglected and ignored the movement of total reserves and the downward movement in total reserves, if not arrested, would in due course lead to serious financial and economic consequences. In further explanation of his reasoning, Mr. Mills read the following statement:

> There are recurrent occasions in the economic history of the United States when financial factors reach a position of dominating significance. The piling up of cash balances and huge holdings of short-term U. S. Government securities in the hands of large corporations may signify such an occasion by

way of denoting a malfunctioning between debtor and creditor relationships. Idle cash balances and inert investments in U. S. Government securities in creditor hands represent resources which, as they fail to circulate back through the economy, do not lodge in debtor hands where they can be availed of for constructive purposes that assist in the service of outstanding debts. When at the same time monetary policy has limited the availability of credit and has contracted the money supply, the economy may be left in a position where the gap between idle money resources and the availability of credit reaches proportions that tend to induce economic stagnation. If this kind of situation should be left unattended, a period of over-saving and underspending could put in an appearance.

In the belief that while capital formation is a process of saving it must nevertheless be lubricated by an appropriate flow of newly created bank credit, it follows that the stimulus of new credit is now needed to prime the economy's powers of consumption in ways that will better activate corporation functioning and release impounded money reserves to fruitful uses. If that objective can be reached, an improved relationship between consumption and production, and between debtors and creditors, will have been realized. In closing the gap between consumer-debtors and producer-creditors it can be hoped that an enlivened economy, besides giving a material assist to debt service, will also provide the means for reducing its burden through a return flow of repayments on outstanding obligations.

Mr. Mills then said that the immediate implementation of a policy based on the reasoning he had outlined would be to bring the level of negative free reserves down to a lower level, with a maximum of $200 million as a ceiling that ought to be avoided and a lower level sought. If the Government securities market should be as disturbed and unsettled today as it was yesterday, a favorable opportunity would be at hand for injecting additional reserves. This would serve the purpose of giving some confidence to the market at the same time that the economic objective was being accomplished.

Mr. Robertson said that as he looked to the future he had no feeling of gloom whatsoever. It seemed to him the chances were strong that the country was on the verge of a definite upswing of economic activity, accompanied by a surge of inflationary psychology and by inflation itself. In his opinion, therefore, this would be exactly the wrong time to reduce the weights that were on the pendulum. Instead, the wise course would be to hold steady, with no reduction whatever in the degree of restraint that had been provided. If anything, he would be inclined to move on the other side, and it was his guess that in another three weeks the Committee would be moving in that direction. He would not change the directive or the discount rate, nor, as he had indicated, would he change the degree of ease or of tightness (whichever one might call it) that the Account had been striving for in the past three weeks.

Mr. Shepardson said he saw no reason to review in detail the various trends in the economy. Suffice it to say that some of them were up and some were down. However, the reports on some of the most recent shifts were indicative of an upswing with the advent of spring weather, which was belatedly beginning to make itself manifest. Since there were still some uncertainties, it seemed to him that it would not be advisable to make any move in the direction of greater restraint until the conditions that he had mentioned actually manifested themselves. At the same time, there was sufficient promise of them that it would be unwise to make any move in the way of a lessening of restraint.

Mr. Shepardson said he would go along closely with the views expressed by Mr. Treiber. He would favor holding about the degree of restraint that had prevailed in recent weeks, and he would not favor any easing. (Subsequently, as recorded later in the minutes, Mr. Shepardson indicated that he saw no objection to permitting such ease as might develop in the market through the operation of natural forces to remain in the market.)

Mr. Fulton commented that in general Fourth District activity could be characterized as an operation of relative dullness at a high level. Steel production was going down rather precipitantly. One mill which was producing at over 100 per cent of capacity a short time ago was now in the 70's and admitted that cancellations were greater than new orders coming in. Other mills reported a good demand for galvanized sheet and tin plate, but pipe of all sizes was a drug on the market. Sales departments of the mills indicated that customers were buying hand to mouth and apparently had larger inventories at the end of the strike than many admitted at the time.

In further comments on the steel situation, Mr. Fulton noted that if present rates of production continued, total production of about 120 million tons for the year would be indicated. Turning to the foundries, he said there were reports of widespread cutbacks; while those in the industry felt that the year as a whole would be a good one, March, April, and May typically are months of high production. Inventories of consumer durable goods were reported to be particularly high. On the other hand,

one company reported a marked pickup in orders in March, with the export situation strong, particularly to Latin American countries. Another report, from a large maker of heavy machinery, was to the effect that it had been working full time to get out drawings and proposals for manufacturers that had not yet been put in the form of orders. It was still generally expected that a good deal of money would be spent for machinery and modernization of equipment throughout the current year.

Mr. Fulton also made reference to a recent meeting of Fourth District business economists, at which projections for the fourth quarter of the year were quite good. The economists foresaw some slackening in the second quarter and felt that the third quarter would be marked by the usual summer doldrums, but they expected a pickup in the fourth quarter and felt that as a whole this would be a good year.

Mr. Fulton went on to say that department store sales and automobile sales were following the trend already reported, department store sales being 2 per cent above last year and automobile sales 8 per cent higher. Construction activity, which had been in the doldrums until recently, now seemed to be picking up, while unemployment insurance claims declined substantially in the past week. Bank loans were 8 per cent above last year, demand deposits had gone down, and time deposits were up. Borrowings from the Reserve Bank had been quite modest, averaging around 2 or 3 per cent of the System total.

Mr. Fulton expressed the view that the current dullness was the result of a number of factors, including expectations that were too high,

weather conditions, and the existence of larger inventories than had previously been admitted. He would not be averse to a slight easing of the net borrowed reserve position, and he suggested $200 million, give or take. He would not change the discount rate or the directive at the present time.

Mr. Bopp said that employment, a factor always of concern in the Third District, was 4 per cent higher in February than in February 1959. Both new and continued unemployment insurance claims also were below 1959. The Johnstown, Pennsylvania, area had been reclassified upward by the Department of Labor, but only from F to E, and four of the 13 major labor areas in the District were classified E (unemployment from 9 to 11.9 per cent). The employment situation in the District, Mr. Bopp said, was one reason he had frequently been on the pessimistic side, although he was not pessimistic today.

One area of difference between the District and the nation was in the banking picture, Mr. Bopp said. There had been some expansion of loans which was not equalled by reduction of investments. A decline in deposits, which had persisted over the years and was larger this year, created a problem for District banks in adjusting their reserve positions. Until the past two or three days the banks had been making their adjustments primarily through purchases of Federal funds, but recently they had been borrowing more heavily from the Federal Reserve Bank.

Mr. Bopp said that he would recommend that there be no change in the directive or the discount rate at this time. Neither would he

recommend any change in the degree of restraint or in the tone of the money market. In the latter respect, he referred, of course, to the general tone that had prevailed in the market rather than the erratic movements of the past few days. (Subsequently, as recorded later in the minutes, Mr. Bopp said that in the light of the discussion at this meeting he would favor some easing of the reserve positions of banks.)

Mr. Bryan said that most recent Sixth District statistics showed only small changes, which were essentially similar to those reported nationally. As he saw the national situation, there was at the moment little basis for predicting a marked upsurge in the economy, and certainly not a downturn. For that reason, he was in agreement with those who had expressed the opinion that it would be a mistake to embark on any massive or overt easing operation through the use of any of the instruments of Federal Reserve policy. At the same time, he felt that none of the economic and financial criteria seemed to justify a policy of restraint. As he listened to the discussion this morning, it occurred to him that one of the crucial points involved was a determination of what System policy actually had been, either overtly or through inadvertence. Such a determination seemed to him extraordinarily important because until the Committee came to a conclusion as to what its policy had been, it was not in a position to modify policy in either direction. In his opinion, Committee policy, _de facto_, had been one of restraint. The actual level of total reserves had been following a downward trend, even allowing for no growth at all, and the total was lower than a year ago. Required

reserves continued to fall, banks continued to liquidate investments, and the banking system was being kept in debt to the Federal Reserve System. Average net borrowed reserves had fallen, but to him that was deceptive because ultimately that decline had come about simply because of a reduction in required reserves. System policy had permitted the total of Federal Reserve credit to move downward, so that member banks had actually received no easing of their positions from that source. How the Committee could have expected the money supply to do anything other than it actually had done, he did not know.

Mr. Bryan repeated that he considered the level of net borrowed reserves especially deceptive as a guide to policy in a period when required reserves were falling sharply, so sharply in fact that the estimates were frequently overrun by the facts. There was enough historical experience, he said, to indicate that if the System kept the reserve supplies of the banking system either declining or completely stable, this would sooner or later exert a deflationary pressure on the economy. He shared the views of Mr. Mills regarding the position of the banking system, which he felt was highly illiquid and potentially dangerous.

The problem, as Mr. Bryan saw it, was to take no massive action in either direction, but to use available opportunities to put some additional reserves into the banking system. He did not think that anything disastrous had happened so far, but if System policy continued _de facto_ as it had been, he saw trouble ahead that would be hard to explain. If the net borrowed reserve concept was to be used, he felt that during the

next couple of months it would be advisable to move toward a zero figure.

Mr. Johns said he continued to associate himself, as he had three weeks ago, with the view that the continued decline in total reserves and the money supply ought to be at least arrested or, better yet, reversed. He then presented substantially the following statement:

> There has been for some time a conjuncture of forces operating to bring about a continuing reduction of total member bank reserves and contraction of the money supply. Parenthetically these resulting phenomena--contraction of total reserves and the money supply--have at times been obscured by other developments heralded in various quarters as indicators of lessening monetary restraint, namely, a sharp decline in interest rates (until recently) and a decrease in that widely accepted barometer of monetary policy, net borrowed reserves.
>
> On March 1, 1960, the Committee took note, among other things, of a February decline in the seasonally adjusted money supply to a level as much as $300 million below a year earlier and concluded, to quote the draft of policy record entry for that meeting, that "it would be appropriate to supply reserves to the banking system somewhat more readily." "Accordingly," the draft says, "the consensus favored, for the immediate future, a policy of moderately less restraint." Notwithstanding this, total reserves and the money supply have continued to decline, and the responsibility for this state of affairs is, I think, substantially the Committee's own. I want to say why I think so, although I have spoken along these lines before.
>
> Insofar as the Management of the System Account receives from the Committee a guide to open market operations, it is in terms of a net borrowed reserve target or range, subject, expressly or tacitly, to latitude or leeway according to the way things develop and to the "feel of the market." In the immediate past I would judge that the range of net borrowed reserves has been about $200 to $300 million. This means that member bank indebtedness to the Federal Reserve Banks has averaged between, say, $600 and $800 million.
>
> However, with Treasury bills yielding 3 per cent or below (as they were until last Friday), and with the discount rate at 4 per cent, profit-minded bankers may generally be counted

on to prefer liquidating bills for purposes of adjusting to reserve drains, rather than borrowing from their Reserve Banks. Even if the recent increase in bill rates should prove to be permanent, it is not at all certain that member banks will not continue to desire to reduce their indebtedness to the Reserve Banks.

The Committee's staff has been pointing out for some time that bank liquidation of short-term Government securities has been occurring at a rapid rate. Nevertheless, in order to induce borrowings at such levels as would bring about net borrowed reserves within the target range, the Management of the System Account has had to sell bills. Thus, a mechanism has been adopted by the Committee which, under the conditions existing, virtually assured a continuing contraction of total reserves, commercial bank credit, and the money supply. These results may reasonably be calculated to persist until one, or more, of the following events occurs: (1) the disparity between market interest rates and the discount rate is redressed; or (2) the Committee, having made clear its intent with respect to total reserves and the money supply, adopts a guide or guides to open market operations which will not result in defeating the Committee's intentions, at least, as to the direction of movement which should occur in the supply of reserves and, over time, in the quantity of money.

In attributing the liquidation of Government securities by banks to the combination of a penalty discount rate and a policy of keeping banks indebted to the System, I may have oversimplified. Some have seemed to think that the banking community has been reflecting a change in the expectations of the business community. If so, this could be considered ominous. But whether that is so or not, it appears to me that steps should be taken to reverse the decline in total reserves with a view to reversing also the decline in the money supply, if for no other reason than because the Committee made a decision at the March 1 meeting to supply reserves more readily and at the March 22 meeting did not, as I recall it, indicate that it wanted reserves again and further reduced. Unless the policy adopted March 1 and 22 is to be reversed, I see no way to defend continued contraction of the supply of total reserves and money.

If the Committee does not want to continue reducing total reserves and the money supply, what means can it employ? The way I prefer is to direct the Desk to increase total reserves, seasonally adjusted, at a designated annual rate, say about 2 per cent. However, if it is desired, at least for the time being, that net borrowed reserves be used as an operating

guide to open market operations, I suggest that the Desk be authorized to cause or permit the level of net borrowed reserves to fluctuate more flexibly with a view to bringing about the Committee's desired results as to total reserves and the money supply, rather than treating net borrowed reserves as if they were the proximate objective of policy. In such case the level of net borrowed reserves in the near-term future may need to be substantially reduced, maybe as low as $100 million or even free reserves. If net borrowed reserves are thus used as a means to an observable end, it would make sense to give the Management of the Account considerable latitude as to the level of net borrowed reserves which from time to time will be deemed appropriate in order to induce the effect upon reserves and the money supply which the Committee desires. This, I think, would preserve a meaningful distinction between the Committee's policy responsibility and the Desk's operating function.

The present discount rate, in its effect upon bank reserves and money supply, has been substantially more restrictive in the period since about February than it was in the previous six months when the discount rate was below the bill rate. Unless we think that the recent rise in short-term rates will persist, a logical technical case can be made, I think, for reducing the discount rate to a closer relationship with market rates. I agree, however, that it would be better to wait and see what the recent movement in market rates amounts to, and whether it will persist.

Mr. Szymczak commented that the views presented by Messrs. Mills, Bryan, and Johns merited study. At the present time, he felt that the economy, over-all, was strong. There were, however, uncertainties in the Government securities market and in his opinion, therefore, this would be a good time to provide some reserves through open market operations. When it came to the volume of reserves that might be supplied, he would leave the decision to the judgment of the Manager of the Account, but he would allow the level of net borrowed reserves to go down.

Mr. Balderston said the situation at the moment seemed to be one that might be described as "rolling prosperity." Whether it was rolling

uphill, on the level, or downhill, he did not know, and he suspected that his own uncertainty with regard to the future was shared by many businessmen and by those in the financial markets. On the one hand, there were evidences of strength, such as an 8 per cent increase over a year ago in long-distance telephone toll calls. Also, he had gotten a report from a chemical company that despite unsatisfactory sales in January and February, both of which had fallen behind the budget, sales in the last two weeks of March were surprisingly good. A report from an electrical company indicated that while export business was off, sales of components to a large number of customers, large and small, had been very strong, leading the company to suppose that its users of components were doing well and that the export business would be better. On the other hand, there was ahead Treasury financing that ought not fail, and there was the continued decline in the money supply that had already been discussed this morning. Then, too, the period of business expansion was already two years old and, if past cyclical movements were to repeat themselves, there would be happenings under the surface that it would be difficult to observe until too late. He hoped the System would act sooner rather than later to counter any weaknesses that might be coming into the economy that would cause the rolling prosperity to roll downhill.

Mr. Balderston said he had been somewhat disturbed in the past three weeks by the apparent failure to let the economy have and hold such ease as had developed. While he could not be sure of this, he had the uneasy feeling as the weeks passed that such ease as developed was

again being mopped up by the System. The net borrowed reserve level that had emerged in the past three weeks was higher than he would have liked, and thus far the System apparently had failed to cause the money supply to increase. He hoped that corrective action might be taken in the next three weeks, but that it could be taken unobtrusively. If the net borrowed reserve figure should drop to around $200 million or less--a development he would like to see--that would be noted, of course, and publicized. However, he thought it necessary to move in that direction because the System may have overstayed restraint in the fashion explained by Messrs. Mills and Bryan. At the same time, since businessmen themselves seemed to be groping to discover what the future might hold, he hoped that overt action by the System might be avoided.

Chairman Martin commented that Mr. Thomas had quoted him correctly as saying that the inflationary psychology had somewhat diminished. That did not necessarily mean, of course, that inflationary psychology would not reassert itself. He was inclined to think that System policy, generally speaking, had been quite correct. It could perhaps have been modified in a number of respects, and without criticizing the Desk it was his impression that there may have been too much reliance on net borrowed reserve figures over the past few weeks. Too much attention may have been given to them by the Desk. This was just an observation of the kind it is easy to make when not operating the Desk, but it was one that he thought was rather obvious.

Chairman Martin said he thought a fairly good case could be made that the general economic picture required that some attention be paid to making additions to the money supply. How such additions might be brought about, he did not know, but the reason he considered it important was that monetary policy and debt management policy had now come together for the first time in a long period. Also, even with the prospect that Government spending for welfare programs might be in the headlines in the course of the next few weeks, it looked as though there would be a small budget surplus for this fiscal year and a substantial budget surplus in the next fiscal year. Thus, the Treasury would be paying down debt for the first time in a long period. Furthermore, although only about $370 million had gone into the new long-term Treasury bond, that was a deflationary step. The Treasury had indicated, and the market expected, that the Treasury would lengthen the debt whenever it had an opportunity. Thus, monetary policy was being supplemented actively by debt management policy, and this was something to bear in mind.

Turning to the discussion at this meeting, the Chairman noted that there had been practically no sentiment in favor of an increase in restraint. With regard to the question of what Committee policy had been, he suggested that this fell somewhat into the area of semantics. The Committee could never quite know whether its intentions were carried out or to what extent the situation developed on its own accord.

Continuing, the Chairman said it should be recognized that the Treasury was now in the market for some time. The Committee had generally

followed a policy of even keel at such times. By and large, however, and without any overt action, he felt that a trend toward lower net borrowed reserves would be the part of wisdom and would be what the economy required. As to the broad economic picture, he did not want to repeat what he had said on previous occasions. However, the farm situation still concerned him, for he saw gradual pressures in that area that were likely to multiply. In his opinion, the banks had made themselves illiquid; one of the things now in the picture was that many of the easy credit plans the banks were espousing so actively several months ago were now a source of some worry to the banks. Taking all these things together, it seemed to him that when debt management policy and monetary policy came together as at present, and when there were uncertainties in the economy, the System certainly ought not absorb any more of the reserves being created by the action of the economy itself than it was necessary to absorb. Looking at the matter as an outsider and not in any way as a critic, it seemed to him that during the past week or so the Desk had been keeping up a target that got into the area of more restraint rather than less. That again touched upon the cumulative effect of policy over a period of time.

Chairman Martin expressed the view that any overt action on the part of the System in either direction would be unfortunate at this time. However, he felt that the Account Management might look toward a lower level of net borrowed reserves when that level was coming about from natural sources and could be avoided only by sales from the System Account

portfolio. That, he suggested, would be in accord with both the spirit and purpose of System policy. As he had said on other occasions, he thought there was a tendency to take what monetary policy can do too seriously. He did not think $100 million of reserves one way or the other was going to make or break the economy. However, with the management of the debt and open market policy now complementing each other, ordinary prudence would make the System lean in the direction of supplying more reserves than there had been in the banking system until it could be seen clearly where the economy was going. At that point, the System might want to take overt action. It was possible, of course, that there might be another bonfire of inflationary psychology; that was the essential problem in the balance of payments. The System ought to take overt action if something like that should occur, but he considered it unlikely, and in his judgment it would be the last bonfire of this particular cycle if it did occur.

Chairman Martin commented that there had been only one suggestion for a change in the directive during today's discussion. When it came to the level of net borrowed reserves, a tally just handed to him by the Secretary indicated that a large majority of those who had spoken appeared to favor moving downward.

In this connection, Mr. Bopp said he had found the discussion subsequent to his previous comments convincing, and that he would favor some slight easing.

Chairman Martin then said that the consensus favored no change in the directive. It was also the consensus that the Committee should move in the direction of slightly easing the picture as far as reserves were concerned, but with great care on the part of the Desk not to do this in an overt way.

Mr. Rouse, who had left the room somewhat earlier to confer with the Desk by telephone, commented at this point on developments in the Government securities market. The essence of his report was that the bill market, which closed more or less at bottom yesterday, had been deteriorating rather steadily this morning. It was now the view of the market that the auction of one-year bills this afternoon would result in an average rate higher than 4-1/2 per cent, with outside bidding likely to be weak and dealers reportedly reluctant to underwrite the issue. Mr. Rouse said that the Treasury expected to enter tenders for about $100 million of the one-year bills, and that if prices for the issue turned out to be spread over too wide a range, the Treasury might award less than the amount of the offering. In further comments, he said that the new three-month bills auctioned yesterday were now being quoted at 3.70-3.65 and the new 182-day bills at 4.00-3.96. The long-term market also had been affected.

Mr. Rouse said he had authorized the Desk to buy from $75 to $100 million of the bills auctioned yesterday for Thursday delivery, and to make repurchase agreements in about the same amount to mature on Thursday. He hoped that that would bring some degree of stability to the market, and he felt it was about all that could be done today. In view of the fact that

yesterday's net borrowed reserve figure was lower than estimated, he had thought there would be some payoffs of repurchase agreements. However, dealers evidently had not been able to make sales from their portfolios and there were no payoffs. He repeated that he thought the actions he outlined were about all that the Desk could do as far as today was concerned.

With respect to policy for the next three weeks, as indicated by Chairman Martin's statement of the concensus, Mr. Rouse said he thought the Desk could handle the situation on that basis. He hoped it would be possible to avoid any second-guessing about targets in terms of net borrowed reserves. There was always the problem of minds being fixed on some particular target.

Mr. Mills referred to the situation in the Government securities market, as described by Mr. Rouse, and inquired whether it would be profitable to have discussion as to whether this was a disorderly market that deserved aggressive action on the part of the Desk in the bill area. One possibility would be to let the market know that the System was interposing its buying power up to some certain amount of bills which would be acquired from the market following the auction. What amount would give assurance to the market, he did not know. If the figure was too low it would mean nothing; if too high it might look out of line with good common sense.

Mr. Rouse then said that in addition to what was already being done, the only other thing that in his opinion would make a contribution

would be to give assurance to the dealers of repurchase agreements being available on Friday, the payment date for the new one-year bills. In addition to the fact that Good Friday is a legal holiday in some States, it is a day when the Government securities market is normally closed, and many of the dealers' financing sources also would be closed. Therefore, the situation was an unusual one that might create additional complications. Accordingly, Mr. Rouse said, he would like to be able to advise the dealers that the Desk would be favorably disposed to assisting the dealers on Friday by making repurchase agreements available on a liberal basis.

Mr. Mills said that presumably this should be generous help, and the repurchase agreements should cover a period sufficient to allow the dealers bidding in the auction to work off their purchases.

Chairman Martin said he saw no objection, in the light of the holiday, to giving such an indication. He felt it would be unfortunate to intervene in the market in any other way than the manner in which the situation was being handled, because such intervention would produce more adverse comment and uncertainty than any good that might come out of it.

Mr. Rouse then said that if agreeable to the Committee he would like to be excused, because time was of importance, in order to authorize the Desk to advise the dealers that repurchase agreements would be available on Friday on a liberal basis in order to help them with any financing problems they might encounter.

The Chairman asked whether there were any further comments, and no dissenting views were stated. Accordingly, Mr. Rouse withdrew from the meeting to get in touch with the Desk.

Chairman Martin recalled that he had previously stated the consensus as to open market policy in the ensuing period. He went on to say that anyone who would like to be recorded as voting against the policy indicated by the consensus was free to express himself at this time.

Mr. Robertson said that he would vote in the negative except for the fact that this was not a large problem. As he understood the summary of the meeting, the consensus favored slight easing. Therefore, the problem was not a large one, and he would not want to make an issue of it, although in his own judgment it would be wiser to take the other course.

Chairman Martin said that he had used the word "overt" because he thought that was the real key to the problem. He would not want overt easing; he would not want to do anything that might be construed as overt.

Mr. Shepardson commented that the Chairman had referred earlier to not absorbing such ease as the market itself developed. He would not disagree with that, Mr. Shepardson said. It had been his thought that the Committee should not take positive action on its own to produce an easing, but it seemed appropriate to allow such ease as developed in the market to remain there.

Chairman Martin replied that a very thin line was involved, following which Mr. Shepardson said he did not wish to dissent from the policy indicated by the consensus.

Chairman Martin then said that, although this represented second-guessing, if one were talking of the color, tone, and feel of the market, along with the level of net borrowed reserves, he felt that the Desk had kept net borrowed reserves somewhat higher than he would have kept them himself during the past period. In saying this, he realized that it is easy to sit at a distance from the market and second-guess the targets, and he did not think for a moment that $100 million of reserves one way or the other was going to make or break the economy.

With reference to Mr. Shepardson's comments, Mr. Szymczak observed that situations might arise in the market where the policy indicated by the consensus would not only allow natural forces to operate but would add a little to the situation.

Mr. Shepardson agreed. He added that in his comments he had reverted to a phrase the Chairman used earlier.

The Chairman then stated that he would put the question, that he did not want to urge anyone to record a negative vote, and that a very modest thing was involved.

Mr. Robertson said that he did not want to record a negative vote, particularly in the light of the market situation which might call for putting reserves into the market, thereby automatically dropping the level of net borrowed reserves.

The Chairman then inquired of Mr. Treiber whether he saw any reason for a change in the directive, and Mr. Treiber responded in the negative.

Accordingly, upon motion duly made and seconded, the Committee voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the Committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to fostering sustainable growth in economic activity and employment while guarding against excessive credit expansion, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the Account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

(2) To purchase direct 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 total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million.

Chairman Martin referred to the discussion at the Committee meeting on March 22, 1960, relative to a memorandum from Messrs. Rouse, Thomas, and Young, dated March 18, 1960, with respect to ways in which the System Open Market Account might function so as to help minimize refinancing difficulties of the Treasury when such transactions do not interfere with Federal Reserve credit and monetary policy objectives. He indicated that the matter had been placed on the agenda for this

meeting to permit anyone who so desired to discuss it further at this time and that it would be the intention to bring up the subject periodically for consideration.

Mr. Treiber then made the following statement:

It is fortunate for the Federal Reserve System that the U. S. Treasury is subject to the discipline of the market in selling its securities and does not have a pipeline to the central bank. In order to assure the continuation of this fortunate situation the System must recognize an obligation to assist the Treasury wherever it can without jeopardizing System responsibilities.

The Federal Reserve is concerned with promoting maximum sustainable economic growth with reasonable price stability. Monetary policy can contribute to the attainment of this goal; so can debt management. The System has a duty to do the maximum within its power to promote the ultimate goal. To the extent the System can assist debt management in promoting that goal without adversely affecting monetary policy it has a duty to do so.

I think the System could offer assistance to the Treasury that would still be consistent with monetary policy and with general market conditions and that would not distort yield or price patterns. This would involve no specific commitment on the part of the System to undertake operations in prescribed amounts in either the one-year Treasury bills that mature quarterly or the 2-1/2 per cent bonds of 1961.

The Manager now has authority, I believe, to buy various issues of Treasury bills, including the special one-year bills which mature July 15 and quarterly thereafter. The Committee might indicate that it would look with favor upon the gradual acquisition of the July 15 and other quarterly bills in regular open market operations. In addition, the Committee might instruct the Manager to acquire July 15 bills in response to dealers' offers and concurrently to sell other securities provided the purchase and sale do not create distortions in the market prices of the securities involved. The Manager would proceed modestly under such instructions with the understanding that he would be expected not to acquire more than, say, $150 million of the July 15 Treasury bills between now and the next meeting of the Committee.

The System should also seek, I think, to increase its holdings of 2-1/2 per cent Treasury bonds of 1961. I would expect that the amount of such bonds so acquired would be modest and that they would be acquired in the same way as just outlined with respect to the one-year Treasury bills.

> Therefore, I suggest that we make a start on the acquisition of these issues, recognizing that the amount acquired between now and the next meeting may be small--or, indeed, that none at all may be acquired.
>
> Such acquisitions would also help to increase the flexibility and usability of the System's short-term portfolio--a goal that should be pursued in any event as an aid to the effectiveness of the management of the Account. It seems little short of remarkable that the Account has done so well in meeting the wide swings of reserve needs and reserve pressures with average holdings of less than $2 billion of Treasury bills, which have, for practicable purposes, been our only stock in trade. For the scale of present markets and reserves, I should think that the Account ought to contain at least twice that amount of bills or other short-term securities available for active trading.
>
> The question today is merely one of modest transactions in the special one-year Treasury bills maturing quarterly and in the 2-1/2 per cent Treasury bonds of 1961. It seems to me that such transactions should be undertaken.

In response to an inquiry by Chairman Martin, Mr. Treiber stated that, with respect to the one-year bills maturing July 15, 1960, he would have in mind an instruction to the Manager of the Account in terms of acquiring up to $150 million of such bills between now and the next meeting of the Committee, either through swaps or outright purchases. This, he pointed out, would represent a modest approach.

Mr. Allen noted that there were already $13.4 million of those bills in the Account portfolio.

Mr. Szymczak said that he agreed with this part of Mr. Treiber's proposal, but that he was not sure about the part of the proposal involving the acquisition of 2-1/2 per cent Treasury bonds of 1961. He suggested that the two parts of the proposal be discussed separately.

Accordingly, Chairman Martin stated that the part of the proposal relating to the one-year bills would be discussed first.

Mr. Erickson said that he would favor starting on a program of acquiring one-year bills. If it developed that such a program was helpful, he would extend it to comprehend the acquisition of other issues of one-year bills in addition to those maturing July 15. He raised the question whether it was advisable to fix any particular amount of such bills to be acquired between meetings of the Open Market Committee, and suggested that the instruction might be in terms of giving the Account Manager permission to acquire a modest amount of the bills as they appeared in the market.

Mr. Irons likewise expressed agreement with Mr. Treiber's suggestion for buying one-year bills. Upon inquiry by the Chairman as to whether his thought would be to review the matter at the next meeting of the Committee, Mr. Irons responded affirmatively. He indicated, however, that he would prefer not to specify acquisition of any particular amount of the bills in the period between meetings.

Messrs. Mangels, Deming, and Allen indicated that they would have no objection to this part of Mr. Treiber's proposal.

Mr. Leedy said that he would favor the proposal, if it was in terms of purchases of one-year bills maturing in July. However, if it contemplated swapping longer maturities to acquire the bills, he would have reservations. As he understood it, this would be involved.

Mr. Treiber commented that the ability of the Account to acquire any substantial amount of the bills would be reduced if the Account were not authorized to make offsetting sales, following which Mr. Leedy noted that according to current reserve projections, purchases of securities to the extent of as much as $150 million might be needed between now and the next meeting of the Committee to effectuate the objectives of open market policy. If the one-year bills could be acquired on that basis, he would have no objection. However, he would like to have the benefit of more discussion before taking a definite position on the question of swapping longer maturities into one-year bills.

Mr. Treiber commented that his suggestion did not mean necessarily that longer maturities would have to be sold. It might be possible to swap other bills in the Account portfolio for the one-year bills.

Mr. Leedy said that in view of the swings that had been occurring in the market he would be fearful of the interpretation that might be placed on transactions reflecting a decision to use longer maturities for the purpose of swap transactions. As he had understood it, Mr. Treiber's suggestion contemplated that in acquiring one-year bills maturing July 15, the Account would dispose of holdings other than bills through swap transactions.

Mr. Treiber then indicated that as far as this particular part of his proposal was concerned, he would think in terms of swapping holdings

in the System Account portfolio, to which Mr. Treiber replied in terms that his suggestions had been divided into two parts. One part had to do with the possible acquisition of quantities of the 2-1/2 per cent bonds of 1961 by purchasing them when they were available and selling something else, but he did not understand that this part of the proposal was presently under discussion. Neither did he understand that the question of future policy in building up the proportion of bill holdings, to which he had also referred in his statement, was comprehended by the suggestion presently being considered.

Mr. Leedy then said that he would not be averse to the type of operation in July 15 bills that had been outlined. However, a proposal that the Account sell securities other than bills in the market in the period immediately ahead would cause him to have some concern.

Chairman Martin stated that this was a good point, and Mr. Szymczak commented that if the Account were to buy July 15 bills at a time when it did not want to put additional reserves into the market, the Account would have to sell something else. However, in the period immediately ahead, it might not be necessary to sell other securities.

Mr. Leach said that he would agree with the program suggested by Mr. Treiber as it related to one-year bills. As he understood it, Mr. Treiber also had suggested the desirability of increasing the proportion of bills held in the Account portfolio but that was something for discussion in the future.

Mr. Leach went on to say that he would be in favor of experimenting with swaps in the short-term maturity area, which he would define as extending to securities, other than bills, with maturities as long as perhaps 1-1/2 years.

Mr. Mills said that he shared some of Mr. Leedy's reservations. While he believed that the Committee should experiment and get its feet wet, he would do it very gingerly. He doubted very much whether the Account should go immediately into a program such as had been suggested, that is, before the market situation had been clarified and steadiness in the market had developed.

Chairman Martin commented that he felt the Committee could rely on the Manager of the Account to understand that the Committee was talking about what it would be permissible for him to do when in his judgment it would be appropriate.

Mr. Robertson commented that this was the same kind of proposal that came before the Committee in 1956, at which time the Committee voted against it. He said that he had prepared a memorandum regarding "swaps" that he would like to read to the Committee. He wished to preface his reading of the memorandum by saying that as long as the program was confined to the area of bills it was of far less significance than if it were extended to other securities. On the other hand, he felt that this would be a step in the wrong direction, without any solid profits to be achieved. He was thoroughly in accord with buying,

in the ordinary course of operations, any particular maturities that would enable the Committee to assist the Treasury. However, his views on swap transactions were as stated in the following memorandum, which he then read:

Section "c" of the continuing operating policies of the Federal Open Market Committee, originally adopted in 1953 and reaffirmed at the March 22, 1960 meeting of the Open Market Committee, specified that: "Transactions for the System Account in the open market shall be entered into solely for the purpose of providing or absorbing reserves . . . and shall not include offsetting purchases and sales of securities . . . ." This obviously precludes "swaps". Just as obviously, this policy can be changed by the Committee. The question is whether it should be.

At the time this policy was under consideration I pointed out to the Committee that there may be circumstances in which our intervention elsewhere than in the shortest-term sector of the market might have beneficial effects from the point of view of debt management, without having any material relation to monetary and credit policy. I still hold to that view, but also I have been convinced by the intervening history that the possible advantages of participating in all sectors of the Government securities market, with a variety of objectives, are generally outweighed by the benefits of a strictly limited participation.

Our job, as the central bank of the United States, is to supply reserves and withdraw reserves in order to contribute to the maintenance of an economy that is both stable and highly productive. In ordinary circumstances, the way to accomplish this efficiently, without weakening the fiber of the Government securities market and without tinkering with problems of debt management that are primarily the responsibility of the Treasury, is to confine our open market operations to selling securities in the shortest-term sector when we believe reserves should be absorbed and buying such securities when we believe additional reserves should be supplied. This will enable us not only to pursue single-mindedly our most vital duty of keeping reserves as close as possible to the optimum level, but at the same time to contribute to the strength of the market by enabling dealers and investors to make decisions and take positions with a minimum of worry about a potentially massive but largely imponderable "X" factor--i.e., the effect of transactions on behalf of the mammoth portfolio of the Federal Reserve System.

Although, as stated, I am not opposed to a deviation from our existing policy in order to experiment for the purpose of testing the validity of the policy, there should be a purpose in mind which is sufficiently meritorious to warrant the action. I do not believe the stated purpose of this proposed experimental authorization to engage in "swaps"--i.e., to aid the Treasury in its debt management operations--will provide benefits sufficient to offset the potential detriments of such action.

In engaging in "swap" transactions, our efforts to acquire a particular issue would necessarily affect the structure of market prices, in some degree, for they would diminish the supply, of the issue purchased, available to investors and increase the availability of whatever issues were swapped therefor. The more aggressively we engaged in such transactions, the greater would be the effect on the market prices of the issues involved. At the same time the profits of the few dealers who handled the transactions would be enhanced--dealers who are sufficiently sophisticated to "outswap" the System. It is questionable whether this could be justified on the basis of potential benefits to the Treasury in its debt management operations.

In connection with the $11 billion issue of 2-1/2 per cent bonds of November 1961, some have suggested that it would be necessary to acquire between $2 and $3 billion of the issue in order to provide any substantial help to the Treasury in its refinancing. The effects of "swap" transactions of this size are readily apparent. To engage in such transactions in a lesser volume would be to inject into the Government securities market the upsetting factor of uncertainty as to the proposed use of our large portfolio with relatively slight benefits to the Treasury.

It might be argued--and has been--that the purpose of the "swap" transactions would not be exclusively for the purpose of aiding the Treasury, but rather would also help to perfect the maturity schedule of our own portfolio. The need for this now is not apparent. At the present time we have in our portfolio short-term securities of approximately $1,300 million. It appears to me that during the balance of this year at least we will be adding to the reserve supply rather than absorbing reserves, and therefore we will be acquiring an even larger portfolio of short-term securities. But even assuming that we did need to alter the maturity schedule of our portfolio, would it not be better to do so in transactions tailored for our needs by the Treasury--even though this might involve a special deal with the Treasury, a deal which would not be offered to other

investors? Or in the alternative, would it not be better to amend our policies so that the Account Management could in its normal operations, at times when market conditions were propitious, sell short certificates in lieu of bills, and then when purchases had to be made, make them in bills so as to build up the bill portfolio?

In my judgment, an authorization from the Committee to the Manager of the Account to engage in "swap" transactions on an experimental basis for the stated purpose of aiding the Treasury in its debt management functions would not be justified by the possible benefits to be derived therefrom by the Treasury. Such an arrangement would inject an additional element of uncertainty into the Government securities market, which might well have the effect of providing a disincentive for dealers to take positions in issues in which the System might be likely to buy or sell for purposes other than providing or absorbing reserves. In addition, it would appear to be a first step toward more general interference with forces in all areas of the Government securities market and might lead ultimately to relatively frequent operations for purposes other than providing or absorbing reserves; at the least it would lead to a fear thereof--which in itself would be disruptive to a freely-functioning market.

In short, it is my belief that, with institutional relationships like those prevailing within the System and between the System and the Treasury, it is very desirable to keep the lines of precedent as clear and clean as possible and to avoid muddying them by moves that might subsequently be used as levers for compromising basic monetary policy objectives--especially when the potential benefits of such moves appear to be so limited.

Mr. Shepardson indicated that he would favor the proposal of Mr. Treiber relating to the one-year bills, and Messrs. Fulton and Bopp also indicated that they would favor it, although Mr. Fulton added that he hoped the number and volume of swap transactions could be held to small proportions.

Mr. Bryan stated that he would have no objection, on the basis of precedent or otherwise, to the purchase from time to time of such amounts of one-year bills as seemed justifiable. Even in that, however, the Committee should note that it was establishing a precedent for it had

customarily confined open market operations to short-term securities, usually three-month bills. This had been for a number of reasons, among which was the theory that the three-month bill is an instrument that always goes through cash. The auction is always covered. Now it was proposed to go into one-year bills for precisely the opposite reason; namely, that the Treasury might be embarrassed. Nevertheless, the one-year bill is a short-term security, and he agreed with the proposal.

On other aspects of the matter, Mr. Bryan commented, he had a great deal of sympathy with what Mr. Robertson had said. He was afraid that if the Committee began tinkering with the 2-1/2 per cent bonds of 1961 it could do the Treasury an injustice. By a little tinkering, the Committee could create a situation in which public interest as to the rollover would practically disappear.

Mr. Johns said he would be willing to experiment, along the lines suggested by Mr. Treiber, with some acquisition of the July 15 bills, for example, even including some swaps in the short-term area. However, there had been one aspect of the discussion at the March 22 Committee meeting that was not clear to him. As he understood the comments made at that meeting by Mr. Larkin, who attended in place of Mr. Rouse, it was contemplated that a dealer with whom a transaction was being conducted would be advised that it was a swap transaction in order to avoid confusion with transactions intended to supply reserves.

There followed discussion of this point during which Mr. Roosa offered an explanation of what he understood Mr. Larkin had had in mind. In substance, Mr. Larkin's point was that if the Desk were to seek to effect a swap, it would of course wish to obtain the best price and it would as a general rule ask dealers for quotations on both sides of the transaction. Hence dealers would ordinarily know that a swap was involved and would not be confused or misled by the transactions.

Messrs. Szymczak and Balderston then stated that they would be favorable to the proposal outlined by Mr. Treiber insofar as it related to one-year bills.

Chairman Martin said that he would favor going ahead with the bills on an experimental basis, but that he would not go further and hoped there would be a minimum of swaps. He just did not like the technique of swaps, and nothing that had come up had persuaded him that it was a good technique for the Account to use. He might be wrong, and a little experimentation probably was a good thing. However, he certainly would be hesitant about going into the 2-1/2 per cent bonds of 1961, at the present time or in the near future.

Mr. Leedy commented that the explanation of swapping technique presented by Mr. Roosa had differed somewhat from his understanding of the procedure indicated by Mr. Larkin at the March 22 meeting. This clarification was helpful to him, for he felt that it would be a far

better technique to indicate generally that a swap was involved than to attempt to confine a whole swap transaction to any one dealer.

Mr. Rouse, who had returned to the meeting during the foregoing discussion, commented that the volume of business through the Desk, including open market transactions, foreign account transactions, and Treasury account business, is so large and continuous that the Desk has a good knowledge of its markets. Accordingly, if a dealer were to propose a swap transaction, the Desk would generally be in a position to effect the swap or to execute one side of the transaction with such dealer and the other side with another dealer, without further checking of prices. However, there would be times when the Desk would need to check further to ascertain whether a proposal was in line with the market.

Chairman Martin then suggested that the Committee act on the basis that had been outlined; namely, to authorize the Management of the Account to acquire up to $150 million of the one-year bills maturing July 15, 1960, between now and the next Committee meeting, either through swaps or outright purchases, with the understanding that the matter would be called up again for review at the next meeting of the Committee.

Mr. Robertson stated that he would vote against proceeding on that basis, for the reasons indicated in the memorandum that he had read pertaining to swap transactions.

No other member of the Committee indicated that he would be opposed to proceeding on the basis that had been suggested.

Chairman Martin then referred to the letter that had been addressed to him by a group of Senators under date of March 12, 1960, which contained suggestions for change in some of the Federal Reserve operating procedures, and to the draft of proposed reply that had been distributed to the Reserve Bank Presidents under date of April 8, 1960. He inquired whether any of the members of the Committee or other Presidents had comments on the draft of reply.

Mr. Leedy referred to that portion of the draft reply relating to the prevention of undue speculation in Government securities, particularly the part having to do with the possible issuance of a supervisory instruction to Federal bank examiners in terms that prudent and sound bank lending practice calls for appropriate margins in the case of all loans to nondealer borrowers against Government securities as collateral. Mr. Leedy pointed out that the Federal Reserve Banks loan at par on United States Government securities tendered as collateral for advances to member banks and that all of the Federal bank supervisory agencies permit banks under their supervision to carry Government securities at par regardless of market value. In these circumstances, he questioned whether the approach cited in the portion of the draft reply to which he had referred would be consistent with these practices and would be effective.

There followed some discussion of this point, during which Chairman Martin said that the possible approach to which Mr. Leedy referred had been discussed at length by the Board and the other Federal bank supervisory agencies. It was understood that one of the supervisors (the Comptroller

of the Currency) intended to go ahead with such an instruction to examiners regardless of what the other agencies did.

Mr. Young pointed out that the suggestion was not new, having been one of those advanced in the course of last year's Treasury-Federal Reserve study of the Government securities market.

Chairman Martin then commented that the points brought out by Mr. Leedy were worthy of consideration.

Mr. Treiber suggested that the group of Senators appeared to be urging massive purchases of longer-term Government securities by the Federal Reserve and that pertinent portions of the draft reply might be reviewed in that light.

There followed comments on whether massive purchases of longer-term securities appeared to be envisaged by the Senators, from which it seemed that there might be doubt as to what scale of open market operations in securities other than bills the group of Senators may have had in mind. In response to a question by the Chairman, Mr. Treiber said he had no specific language to suggest for the proposed letter in relation to the point he had mentioned, and the Chairman indicated that the point would be borne in mind.

Mr. Mills commented that the proposed reply represented a compromise of many views and, therefore, no one person might be completely satisfied with the reply in the light of his own thinking, following which Mr. Deming indicated that he had a suggestion of an editorial nature that he would pass along to the Board's staff for consideration.

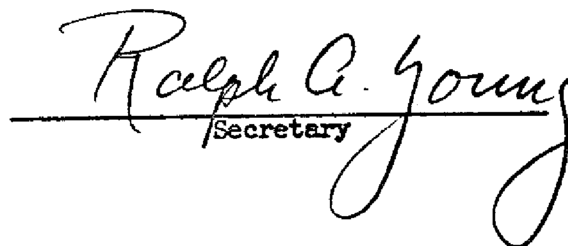
It was agreed that the next meeting of the Federal Open Market Committee would be held on Wednesday, May 4, 1960, at 10:00 a.m.

> Secretary's Note: In the light of subsequent developments, the members of the Committee and the other Presidents were polled by telegram and it was decided to hold the next meeting on Tuesday, May 3.

Chairman Martin stated, as a matter of information, that representatives of the Federal Reserve System, including a certain number of Reserve Bank Chairmen and Reserve Bank Presidents, might be called upon to appear at hearings before a Subcommittee of the House Banking and Currency Committee in connection with one of several bills introduced by Congressman Patman, probably H.R. 2790, which would call for a change in the number of members of the Board of Governors, abolishment of the Federal Open Market Committee, and transfer of the Committee's functions to the Board. No date had yet been announced, he said, but it did not appear that any such hearings would commence until after Easter.

> Secretary's Note: It was learned subsequently that hearings probably would be held instead on H.R. 8516, also introduced by Congressman Patman, which would provide for retirement of the stock of the Federal Reserve Banks and purportedly would make any insured bank eligible for System membership.

The meeting then adjourned.



Secretary