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, August 1, 1961, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman
Mr. Allen
Mr. Balderston
Mr. King
Mr. Mills
Mr. Shepardson
Mr. Swan
Mr. Wayne
Mr. Johns, Alternate for Mr. Irons
Mr. Treiber, Alternate for Mr. Hayes

Messrs. Ellis, Fulton, and Deming, Alternate Members of the Federal Open Market Committee

Messrs. Bopp, Bryan, and Clay, Presidents of the Federal Reserve Banks of Philadelphia, Atlanta, and Kansas City, respectively

Mr. Young, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Coldwell, Einzig, Garvy, Mitchell, and Noyes, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Mr. Holland, Adviser, Division of Research and Statistics, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board of Governors
Mr. Yager, Economist, Government Finance Section, Division of Research and Statistics, Board of Governors

Messrs. Hostetler, Jones, and Tow, Vice Presidents of the Federal Reserve Banks of Cleveland, St. Louis, and Kansas City, respectively

Mr. Eisenmenger, Acting Director of Research, Federal Reserve Bank of Boston
Messrs. Holmes and Stone, Managers, Securities Department, Federal Reserve Bank of New York
Mr. Anderson, Economic Adviser, Federal Reserve Bank of Philadelphia
Mr. Black, Assistant Vice President, Federal Reserve Bank of Richmond
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta
Mr. Hellweg, Economist, Federal Reserve Bank of Minneapolis

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on June 20, 1961, were approved.

In view of certain questions that had been raised following distribution of the preliminary draft, it was agreed, at the suggestion of Chairman Martin, to defer until the next meeting consideration of approval of the minutes for the Committee meeting on July 11, 1961, in order that these questions might be studied further.

Upon motion duly made and seconded, the action of the Federal Open Market Committee on July 18, 1961, in approving the recommendation of the Account Management that the Account exchange its entire holdings of 3-1/8 per cent certificates and 4 per cent notes due August 1, 1961, for $3,216,150,000 3-1/4 per cent notes maturing November 15, 1962, and $1,600 million 3-3/4 per cent notes maturing August 15, 1964; and that $13,800,000 2-3/4 per cent bonds due September 15, 1961, and $5 million 1-1/2 per cent notes due October 15, 1961, be exchanged for 3-1/4 per cent notes due November 15, 1962, was approved, ratified, and confirmed.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period July 11 through July 26, 1961, and a supplemental report covering the period July 27 through July 31, 1961. Copies of these reports have been placed in the files of the Open Market Committee.

Mr. Rouse stated that he had returned to the New York Bank only yesterday from a European trip, but that he and Mr. Marsh had prepared a short statement amplifying the aforementioned written reports on open market operations. Mr. Rouse then presented substantially the following statement:

> Since the last meeting of the Federal Open Market Committee, the money market has remained generally easy with Federal funds trading for the most part around 1 per cent. At the start of the period prospects were that reserves would have to be absorbed in the week ended July 19, in part to offset the usual monthly bulge in float. Projections for the rest of the period indicated that reserves would have to be supplied in size. Complicating considerations were the need for an even keel during the Treasury financing operations and the persistent downward pressures on Treasury bill rates that assumed increasing importance following the rise in the British discount rate.
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> In the first statement week, System holdings of Government securities were reduced through sales and redemptions of Treasury bills, not only to reduce the redundant bank reserves but also in an effort to head off a decline in Treasury bill rates. Although the 91-day bill rate dropped below 2.20 per cent, sales of bills were limited to avoid interference with the Treasury's financing operations and also because of the need for a large amount of additional reserves in the following statement week.
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> At the start of the second statement week, bill rates were again under downward pressure and it was evident that the injection of the large amount of needed reserves would have to be made to a considerable extent through issues other than bills--which would take several days to acquire. Accordingly, buying started on Thursday, July 20, and it

soon developed that the System was getting an assist from the large volume of swaps undertaken by banks against purchases of the new issues made available by the Treasury. The System was thus able to buy substantial amounts of shorter-intermediate securities before the week end of July 22-23. Market selling of intermediate issues was augmented after the week end when uncertainties over the international situation began to appear, culminating in the increase in the British bank rate on Tuesday and the President's speech on the Berlin situation that evening. As a result, banks again shifted their thinking toward shortening up their investment portfolios, in contrast to the willingness to extend maturities which was displayed in the Treasury's refunding. These events also focused greater attention on the relationship of our short-term rates to those in other countries. Against this background, the System continued to make purchases outside the short-term area. By Wednesday, July 26, it was evident that despite these purchases more funds would have to be provided to meet the reserve requirements arising from bank acquisitions of new tax anticipation bills. In order to acquire the volume of securities needed to provide the reserves, the scope of our purchases was broadened to include shorter securities, principally notes and certificates maturing within 15 months.

On Thursday and Friday, July 27 and 28, purchases were curtailed. The tone of the money market was easy and the provision of additional reserves at that time would have aggravated the downward pressures on short rates. On the other hand, projections indicated a need for supplying additional reserves after the week end. Thus the decision to curtail operations on Thursday and Friday was made with the expectation that substantial action would later have to be taken to supply reserves. As anticipated, the money market firmed yesterday, and the System responded by making repurchase agreements, at 2-1/2 per cent, and by resuming the purchase of securities on an outright basis (including the purchase of bills from foreign accounts).

It should be noted that the System purchases of issues beyond the short-term area have been to a large extent in two- and three-year maturities. Offerings of maturities beyond that range have not been large; in fact, offerings beyond ten years have been quite scarce. Since most of the purchases have been made in a falling market, the impact on the market has been moderate, and the market has been able to adjust readily to other influences.

It is evident that the very easy money conditions over the past several weeks have encouraged banks to buy Treasury bills, mostly short-term issues. However, the continued reserve ease, coupled with other investment factors, has extended the buying out to the 91-day area and has been an important factor in keeping downward pressure on the 91-day bill rate. The average rate for 91-day bills in the auction yesterday was 2.30 per cent. I believe the System could ease its problem with regard to short-term rates by allowing free reserves to work a little lower, and thus avoid the "sloppy" condition of this recent period.

The Treasury's recent financing operations have been eminently successful as commercial banks evidenced a willingness to extend their maturities to the three-year 3-3/4 per cent issue offered in the exchange. The attrition was moderate and the Treasury can look with satisfaction on the substantial amount of debt moved out to the three- and seven-year area. The auction of the $3.5 billion tax anticipation bills was equally satisfactory; the average rate in that auction was 2.49 per cent.

Finally, the favorable atmosphere created by the refunding has faded due to international developments and the prospect for greater Government spending and economic activity, which suggest higher interest rates. While the prospects for an advance refunding in the near future had been good, the Treasury must now adopt an attitude of "wait-and-see." Having cleared the decks for the next two months, it will undoubtedly still be on the alert for opportunities to move in that direction.

Mr. Rouse added the comment that in talks during his recent trip to Europe, mostly with central bankers but also with commercial bankers, he found a continuing and growing distrust about the ability of the United States to keep its financial house in order. Without much doubt, developments last week must have aggravated that feeling. In making this comment, he did not mean to imply that he had found evidence of distrust in terms of immediate pressures on the dollar, but there was a background of "wanting to be shown." Among those with whom he talked on this trip, and with whom he had also talked earlier in the year, he sensed that the feeling he had mentioned was growing, and this of course had a relationship to the short-term rate situation. Mr. Rouse noted, in this connection, that any outflow of funds from this country would be unfortunate.

Thereupon, upon motion duly made and seconded, the open market transactions during the period July 11 through July 31, 1961, were approved, ratified, and confirmed.

Mr. Noyes presented the following statement with regard to economic developments:

As background for a summary of the most recent economic developments, it may be useful to run through some of the revisions in the National Income and Product accounts released since the last meeting. The revision goes back to 1958, but as it is difficult to follow too many numbers presented orally, I shall limit these remarks to the most recent twelve-month period and the broad aggregates.

Economic activity, as measured by GNP, reached a cyclical high in the second quarter of 1960, estimated at the time to be $505 billion. It declined to an estimated $503.5 billion in the third quarter--held at that level in the fourth quarter, and then dropped again to the cyclical low of $499.8 billion in the first quarter of 1961. Activity increased sharply in the second quarter--and preliminary guesses as to the extent of improvement were revised upward as the quarter progressed. You will recall that at the last meeting we suggested a figure of $513 billion on the unrevised basis.

It now appears that the peak in the second quarter of 1960 was $506.4 billion, rather than $505. The decline in the third quarter was to $505.1--in the fourth to $504.5, and the first quarter low was $500.8 rather than $499.8. Thus we see that the decline in the third quarter of 1960 was less than originally reported, due in large part to the fact that personal consumption expenditures were better maintained and the cutback in inventory accumulation was less than originally estimated.

However, the over-all magnitude of the recession was about the same. Taking it from the second quarter high of \$506.4 to the first quarter low of \$500.8, the revised figures show a decline of \$5.6 billion, while the original decline from \$505 to \$499.8 amounted to \$5.2 billion--declines of 1.11 per cent and 1.03 per cent, respectively.

The official estimate, on the new basis, for the second quarter of 1960 is \$515 billion--well above the \$506.4 of a year ago. Some perspective on this rather striking improvement is added if we look at the figures in terms of per capita real income and product, as was suggested by Governor Mills at the Board meeting yesterday. In these terms the GNP is still a little below the 1960 peak, and disposable personal income was at exactly the same level in the second quarter of this year as it was a year ago.

Up to last week it was easy to summarize the situation as one of rapid, but apparently healthy recovery, especially as the stock market appeared to settle down after its spurt in the spring months. Commodity markets--and in fact wholesale prices generally--showed no evidence of inflationary conditions or expectations. Production was rising rapidly, but the most rapid advances were in industries that had been operating far below capacity, and there was no evidence that any important bottlenecks were developing.

Industrial production was back to 110 per cent of the 1957 level in June and a further advance of one or two points is indicated for July.

Department store sales appear to be recovering from the slight dip in June--attributed to the weather--and may be at near record levels for the month. Consumer credit probably increased moderately again, following several months of substantial decline.

Employment in both manufacturing and other nonagricultural lines improved very rapidly from April onward. For both categories together, almost one million workers, over and above the normal seasonal change, were added to payrolls in the three months ending in June. Despite this very rapid advance in employment, unemployment remained high, however, at a seasonally adjusted rate of 6.8 per cent in June, but it may be that the July figure, to be released shortly, will show some improvement.

Early reports suggest that about the expected improvement in corporate profits took place in the second quarter.

Financial markets were extraordinarily stable despite a very large volume of financing, both public and private. A week ago it was hard to escape the feeling that the situation was a little too good to be true--and it was.

On top of substantial increases in expenditures to finance space exploration and longer-run defense measures, and general acceptance of the fact that the recommended postal rate increase is not likely to be enacted, the President has found it necessary to recommend an increase of $3-1/2 billion in current defense expenditures, thus substantially increasing the prospective deficit for the current fiscal year, and reducing the possibility of a budget surplus in fiscal 1963.

It is too early to tell whether this will be the straw that will convert a rapid, but orderly, recovery into a boom which will threaten both internal stability and our still fragile balance-of-payments position. At least, it seems to have dispelled very rapidly the doubts that were growing in some quarters about the continuing strength of the recovery--doubts which may have incidentally served a very useful purpose in tempering some of the excessive speculative activity in security markets associated with the early stages of the recovery.

Fortunately, perhaps, no one has a clear idea as yet of just what the budget deficit for fiscal 1962 will be. More important, the President accompanied his recommendations with a very firm statement regarding his intentions with respect to the 1963 budget. These factors have certainly tended to minimize the immediate inflationary expectations and the urgency of the need for counter-measures.

As of this moment in time, actual developments do not seem to call for any change in monetary policy. It would be foolhardy, however, to ignore the fact that recent events, both in this country and overseas, have increased the chances that monetary policy may be required to play a less expansive role if we are to protect the integrity of the dollar.

Mr. Thomas presented the following statement with regard to credit developments:

Progression of economic recovery brought no striking credit developments in July prior to the President's statement. Subsequently evidences of a changed situation have appeared in money and securities markets, which are influenced by expectations in advance of actual events. Banks had adequate reserves for credit expansion throughout the month, and a sizable expansion ensued. Large increases occurred in bank holdings of Government securities and in loans on securities, reflecting active bank participation in Treasury financing operations during the month. Business loans, including those to finance companies, showed rather large declines, as is common in July. New capital issues continued in large volume, although below the high level of the second quarter.

Private demand deposits appear to have increased by close to the usual seasonal amount in July, while time deposits continued to show a large increase. U. S. Government deposits, which began the month at a high level, moved steadily down until July 26 and then increased sharply, showing little net change for the four weeks as a whole. It appears that the daily average money supply, seasonally adjusted, was about the same in July as the average that has prevailed since April.

Money markets remained generally easy during the month, and short-term money rates tended down, but did not fall below the lowest levels of the past year. Yields on medium- and long-term Government securities, which had risen fairly sharply in June, leveled off or declined slightly. Yields on State and local Government bonds also tended to decline, while those on high-grade corporate bonds rose at a slower pace than in May and June. In the past week, following the President's statement, interest rates have turned up moderately. Some of the increase in the last two business days reflects a tightening of bank reserve positions from the rather easy situation that has prevailed recently.

Free reserves of member banks were relatively large during most of July, averaging nearly $580 million. Required reserves declined slightly, reflecting a substantial decrease in the reserves needed to be held against U. S. deposits and a slightly more than seasonal increase in those against other deposits. Wide fluctuations in market factors affecting the supply of reserves were broadly counterbalanced by correspondingly wide changes in Federal Reserve holdings of securities. In the current week, reserve availability is being sharply reduced by a combination of market factors and by increased required reserves because of the additions to tax and loan accounts in connection with Treasury financing. Additional reserves are being supplied by heavy System purchases of securities, but free reserves are likely to decline to an average of less than $400 million, in the absence of further System purchases. Additional purchases will be needed to supply reserves next week. After that, except for rather wide temporary variations, partly related to Treasury accounts, no sustained increase in System holdings will be needed until November.

As for future System policies and operations, three broad sets of questions need to be considered: (1) What would be required for continued recovery at a reasonable pace? (2) What will be the effect of the stepped-up defense program? (3) What may be the effect of the new restraints adopted in the United Kingdom?

As to the first question, it appears that continued bank credit expansion at somewhat more than an average secular rate of growth will be appropriate until the economy is close to reasonably full utilization of resources. By one rather rough basis of comparison, bank credit expansion during the 1960 recession and early period of recovery compares favorably with that in 1958. Although credit expansion has not been as large in the first half of 1961 as in the first half of 1958, expansion began somewhat more promptly after the downturn in 1960 than it did in 1957. Taking 12-month periods from close to the peak of activity in 1960 (June) and in 1957 (July), total loans and investments of all commercial banks increased by $13 billion in the 12 months ending June 1961, compared with $12 billion in the 1957-58 period--a little over 7 per cent in each case. The increase in holdings of Government securities was a little less than $8 billion in each period.

Privately-owned demand deposits have increased more in the past year than in the 12 months ending July 1958--using semi-monthly daily averages, $2.5 billion against $1.5 billion. There has been no increase, however, in the last few months compared with a steady growth throughout 1958. Time deposits increased sharply in both periods, but more so in the past year--$11 billion against $8 billion in 1957-58. Thus in each case bank credit was abundantly available, and the funds thereby provided found their way into time deposits at banks to a larger extent than into demand deposits.

On the basis of a longer standard of comparison, it can be shown that expansion in the money supply has slackened in recent years to a pace that may be considered inadequate for a satisfactory rate of growth in the economy.* Since 1955, the computed annual rate of growth in the money supply has

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* This view and related developments are analyzed in a memorandum prepared in the Board's Research Division which has been distributed to the members of the Committee under date of July 31, 1961.

been only 1 per cent. When time deposits are added, the rate of growth has been larger, but not as great as some analysts consider appropriate. Consideration might also be given to changes in the public's holdings of liquid assets other than bank deposits, which have grown somewhat more rapidly than total bank deposits in the past decade and also increased sharply in 1959 and again in 1961. When these are added to deposits, the rate of growth in the total during the past year has corresponded closely to the average for the decade and to the 1958 increase. Since 1955 the increase in the aggregate of all these assets has been only slightly less than GNP in current dollars.

In the meantime, the turnover of demand deposits has increased, as the balances held in checking accounts are called upon to finance a more rapid rate of increase in transactions. This rate of turnover is now comparable to the level that prevailed in the 1920's. An important and strategic question is whether this ratio can be expected to rise further or whether it will be necessary in the future for holdings of cash balances to increase more nearly in pace with expansion in GNP. In recent years the rate of growth in GNP has been viewed as inadequate. Reasons for this retarded rate of growth are largely nonmonetary, but any accelerated increase in GNP would probably need to be accompanied by a greater increase in money than has occurred in recent years. This question must be taken into consideration in the determination of monetary policy.

In any event, it may be concluded that for the immediate future, continued credit expansion at approximately the pace of recent months would be appropriate in order to permit further economic recovery. An approximation of the amount of reserves that need to be made available to permit such expansion is indicated on the tables that have been presented to the Committee.

Turning to the possible effect of the projected expansion in the defense program upon credit and monetary needs, it should first be kept in mind that this program and any threat of inflation that it may entail do not call for a slowing down of credit expansion below the rate that would otherwise be needed. The amount of reserves to be supplied in future months should be fully as large as the totals projected in the tables presented, which indicate the probable needs for a normal recovery. This does not mean, of course, that free reserves should necessarily be kept at $550 million. If credit demands increase and expansion in credit and in required reserves exceeds the amounts projected, then banks should have to borrow to obtain the additional reserves, and free reserves should decline. But, if monetary expansion and required reserves fail to come up to the projected amounts, then free reserves should be maintained at $550 million or more. Whether more credit and monetary expansion than has been projected would be desirable may be a question for future consideration.

The second point to keep in mind regarding the enlarged defense program is that, taken by itself, the resulting increase in Government spending will not place any great burden on our economic resources. It is well within the capacity of the economy to provide and still allow for considerable increase in private consumption, as well as in investment needed for expanding resources. Any measures needed to restrict consumption or allocate resources will depend upon the response of the private economy. Evidence of that is still remote.

What is the possible magnitude of the impact on the economy? The indicated increase in defense expenditures of less than $3 billion in the next fiscal year is much less than the addition made in 1956-57 following the Suez crisis. When allowance is made, however, for the increase that has already occurred in defense spending this year, the comparison will be closer. At this time, moreover, there is more slack in the economy than there was in 1956.

Yet the prospective Federal budget deficit for this and other reasons is large and, along with recovery in the private economy, will probably be a stimulant to private spending. Altogether the pressure on resources may eventually become excessive. Published official estimates indicate that, after allowing for increased tax receipts expected from expanding incomes, the deficit in the administrative budget will be $5.3 billion in fiscal 1962--or about $6 billion if the proposed increase in postal rates is not adopted.

Analysis of the estimates of receipts underlying this figure indicates inadequate allowance for tax refunds and various miscellaneous receipts that could together amount to between $1 billion and $1.5 billion. These and other possible variations could easily produce an administrative budget deficit of $8 billion. Various items of expenditure outside the administrative budget could produce a cash budget deficit of close to $11 billion, which is a more accurate measure of borrowing needs.

These revised budget estimates probably will not significantly change the previous estimates of Treasury borrowing needs for the remainder of this calendar year, which will amount to over $7 billion, in addition to $4 billion already borrowed in July. The principal difference will be elimination of any debt retirement in the first six months of 1962. The net increase in the public debt in the entire fiscal year 1962 may be less than the cash deficit, because of the large Treasury cash balance at the beginning of the year, but nevertheless may be as much as $9 or $10 billion. This could have a materially stimulating effect on the economy.

Some reconsideration may be needed, moreover, of views as to private borrowing demands during the next few months. It had been believed that these would be moderate in view of prospects for corporate sources and uses of funds. The basic factors are not likely to be greatly changed, but if the new defense program should alter business views as to inventories and plant and equipment expenditures, credit demands could increase. This is a situation that will need careful watching and more information as to changes in business attitudes and plans. The trends of home buying and of expenditures for consumer durable goods and the credit involved, which had been thought to be factors that would moderate, rather than stimulate, economic expansion, may also accelerate their pace. Stock market speculation offers another potential element of instability, although the volume of credit involved is not likely to be substantial under existing margin requirements.

Until such pressures become evident, however, and actually affect credit demands, there seems to be no occasion for the adoption of measures of credit restraint. Some further expansion is still needed. Restrictive measures at an early stage could unduly inhibit essential financing of the Treasury and of private needs. If, subsequently, demands are sufficient to threaten credit expansion at a rate that would exert undue pressures on resources, then the restraint on expansion can be permitted to operate or be applied by limiting the availability of reserves.

I have not discussed the other new influence that has been brought into the situation during the past week in a dramatic manner, namely, the British measures of restraint. These will be discussed by Mr. Young. To the extent that they tend to cause a flow of funds abroad because of interest rate differentials, care may be needed to avoid keeping our rates too low. Increases in domestic credit demands accompanying recovery or induced by the new defense program may be sufficient to prevent this problem from arising.

Mr. Young presented the following statement on balance-of-payments and related developments, particularly in the light of meetings last week in Paris in which he participated:

Significant balance-of-payments changes for major countries from the first to the second quarter were:

(a) A moderate increase in the over-all U. S. deficit, excluding debt prepayments;

(b) A significant reduction in the basic deficit in Britain's external balance but a worsening of its global balance because of a large short-term capital outflow;

(c) A strengthening of the surplus in France's basic balance, supplemented by a sizable short-term capital inflow;

(d) A continuing large surplus in Germany's basic balance, moderated in recent weeks by liquidation of foreign holdings of German securities and otherwise offset in part by some short-term capital outflow;

(e) A further inflow of short-term money into the Swiss, Dutch and Italian money markets.

These balance-of-payments developments for key currencies were reviewed at length in a three-day international discussion in Paris last week--one day in the meeting of the OEEC Working Party 3 and two days in a meeting of the OEEC Economic Policy Committee.

The Working Party 3 meeting concentrated its attention on the German surplus particularly. Many deeply probing questions were directed to the German delegation concerning the adequacy of the program for dealing with and correcting Germany's surplus position. Main points of criticism related to:

(a) Whether Germany's internal correction in terms of rising wages, other costs and prices was proceeding fast enough?

(b) Whether Germany was not offsetting apparently liberal monetary policy by a too tight fiscal policy, with Federal Government and Laender Government fiscal surpluses piling up in idle Bundesbank balances?

(c) Whether Germany's monetary policy was <u>per se</u> sufficiently expansive?

(d) Whether Germany was exerting enough downward pressure on long-term interest rates and doing enough otherwise to encourage long-term capital exports? And

(e) Whether Germany was stepping up aggressively enough its participation in foreign aid and development?

The answers given were, of course, defensive:

(a) That Germany was in a boom, with three or four job openings for every worker seeking employment;
(b) That the boom had reached a slackening-off stage, and this would shortly become reflected in the current external balance;
(c) That wages, other costs and prices were rising, with the wage rise proceeding currently at a rate about three times that occurring in manhour productivity;
(d) That credit and capital demands were so strong it was difficult for monetary policy to press down further short- and long-term interest rates without giving up all control of bank credit expansion and the money market;
(e) That German business concerns were now shifting borrowing from foreign to domestic sources;
(f) That the Berlin crisis was now inducing liquidation of foreign holdings of German securities as well as affecting tourist trade adversely;
(g) That the fiscal surpluses of German governmental units were not too large and that in any case were needed to keep inflationary pressures within bounds;
(h) That Germany's revaluation required time to work out corrective effects;
(i) That Germany's efforts to expand foreign lending and foreign aid and development were proceeding as rapidly as practicable; and
(j) That Germany couldn't be asked by its trading partners to press inflation too fast and too far because of inflationary apprehensions of the German people and because of Germany's position as a buffer and as a stable free economy example as regards Russia.

These responses of the German delegation were not altogether persuasive to many Working Party participants and the Germans were asked to convey to their Government the anxiety of other delegations about the continuing large German surpluses on external account. Specifically, the hope was expressed that the German Government could take further steps, without undue inflationary impact, to reduce Germany's current external surpluses and even convert them for a time into deficits. Some further aggressive addition to monetary liquidity, the elimination of fiscal surpluses, and measures to increase foreign lending and to expand foreign aid were highlighted as desirable steps under the circumstances. The German delegation in its turn emphasized the responsibility falling on countries experiencing balance-of-payments deficits to intensify steps to correct their own deficit situations.

Other discussions of Working Party 3 related to recent balance-of-payments developments for the U. S. and France. These tended to be subordinated to a more general issue suggested first by the discussion of German developments, namely, the precise nature of the mechanism for correcting balance-of-payments disequilibria under modern conditions of currency convertibility internationally. Since this issue carried over into the following two-day discussion of the Economic Policy Committee, it merits special comment here.

The challenge facing the Economic Policy Committee, it was suggested, was to decide upon the "rules of the game" for modern-day convertibility and then to see that member countries adhered to the rules. The problem arose because, in the post-war world, there are new constraints on the policies that national governments can pursue. Full employment philosophy, widely accepted today, excludes acceptance of large and persistent deflation of demand. The strength of labor unions, furthermore, precludes any broad-scale reduction in wage levels. Then, too, the dangers of a wage-cost spiral make governments hesitant to foster wage increases in excess of productivity gains. Finally, governments have become committed to general price stability as essential for greatest efficiency in employing resources and for greatest equity in distributing income.

For convertibility to be maintained, it was argued, surplus countries must allow external surpluses to be registered in internal inflation, i.e., surplus countries must import inflation, while deficit countries must allow deficits to be reflected in deflationary tendencies, i.e., must import deflation. These developments need only be relative. But, because of rigidities that characterize modern economies, it is important to recognize explicitly the inevitabilities of the needed financial adjustment and to reenforce necessary corrective tendencies by deliberate policies. If relative adjustment is too slow and too inadequate, convertibility will break down. Correction of disequilibria, it was urged, needs to be accomplished in a reasonable time.

Various delegates took exception to this doctrine and pointed out that there was much that could be done by governments to correct balance-of-payments disequilibria without relative inflation or deflation. Much room exists, it was alleged, for governmental action to influence the composition of demand. Deficit countries could encourage export competitiveness, curb imports, and avoid capital outflow and surplus countries could discourage exports, encourage imports, and curb capital inflow. More study of these alternatives and ways to accomplish them on a temporary basis, it was held, was needed.

A summary report about such a discussion is necessarily inadequate, but it suffices to indicate that a basic problem exists, to which solution must be found if recurrent exchange rate adjustment and realignment is to be avoided. Naturally, this particular discussion was inconclusive. But it did open up the subject and there were various expressions favorable to further and more intensive attention to it at subsequent meetings. It remains to be seen how far exploration of the "rules of the game" for modern-day convertibility can be carried and developed into operational form through international discussions of governmental officials.

In the end, there were some delegates who contended that governments must retain their ability to alter their exchange values as an alternative to other courses of action. Other delegates, however, argued that, with industrial countries so much richer and liquid funds so much more ample and more mobile, the entire international system had become ultrasensitive and responsive to exchange rate changes. Hence, recurrent exchange rate alteration was no longer a tolerable alternative to a system of fixed exchange rates with relative inflation and deflation the central reliance for international adjustment.

Discussion of this problem in the Economic Policy Committee preceded discussion of the British program to correct its cumulative external disequilibrium. This latter discussion had to await the Chancellor's announcement of its contents on Tuesday afternoon. The first order of business at Wednesday's meeting, therefore, was a detailed review and defense of the British program by the British delegation. Since the substance of the program is now well known, it is enough here to comment on points especially stressed by the British.

The program comprises six main restraints:

(1) Restraint on income-generated demand through higher taxes that bear most heavily on consumption, plus restraint on demand financed through bank and insurance company loans through higher interest rates and reduced availability of credit;

(2) Restraint on wage increases in both the public and private sectors. In the private sector, such restraint is at first to be voluntary and cooperative, but as soon as practicable, it will be reenforced by more formal governmental steps;
(3) Restraint on public expenditures overseas and on private foreign investment;
(4) Restraint on internal public expenditures and increased reliance by nationalized industries on internal financing of investment expansion;
(5) Restraint on dividend increases by business corporations at governmental request; and
(6) Restraint, so far as possible, on restrictive and monopolistic trade practices.

The program, while focused on the short term, has longer-term aspects, especially as to public expenditures, wage policy, and taxation of capital gains. Regarding public expenditures, the British intend that they shall become a declining proportion of GNP, thus in effect renouncing a role for government expenditures in promoting economic growth. Some continuing mechanism of public policy to keep wage increases in line with productivity gains is to be sought. Taxation of capital gains, to be introduced with the next Budget, will be a permanent step; its objective in part is to placate the trade unions and encourage their cooperation in a governmental wage policy.

The bank rate increase, it was explained, was a necessary shock effect action, intended to put an abrupt curb on speculative tendencies in equity and real property markets, to discourage additional inventory build-up, to restrain further consumer instalment buying by supplementing restrictive credit terms with higher finance charges, and to bring to a halt the outflow to foreign markets of short-term funds. It was categorically stated that, when evidence has accumulated that the higher bank rate has done its work, it will be reduced. The British emphasized that they sought to avoid reliance on an inflow of "hot money" to help solve their balance-of-payments problem, even temporarily.

It was to be expected, the British explained, that the gilt-edge market would react further to the bank rate change. The market, however, was in a strong technical position. It would soon benefit from the restraints on bank advances resulting from the increase in the Special Deposits percentage and the directive to the banks and insurance companies to limit loans to productive uses domestically and for export and especially to avoid advances to finance equity and property speculation. In addition, the instalment credit effects of the action to limit credit availability, together with suspension of the subsidy to home purchase finance and the restraints on stock market and property speculation, will tend to divert the flow of personal savings to fixed income securities. Finally, it was emphasized that the program is geared to produce an increase in the volume of personal and corporate savings, and that the gilt-edge market would benefit directly and indirectly from this too. One gathered the impression from this overly-complete diagnosis of prospects for the gilt-edge market that some foreign buying in the gilt-edge sector, if it were not too short-term-gain motivated and hot, would be entirely welcome.

British comment on their IMF drawing and its role was appropriately brief. It was indicated by the discussion that some part of a drawing would go to repay central bank credits originating in the so-called Basle agreements, but that at least the Swiss credits would be extended for the time being.

Many questions were asked of the British by other delegations, reflecting to be sure some degree of skepticism as to the adequacy of the program, as to the hazards that were being run through its monetary policy features, and as to the political capability of the British Government to carry it through. These questions were all well handled by the British delegation, but whether all skepticism was dissolved remains a question. Incidentally, a confidential report just received from Frankfurt suggests that skepticism as to the potential effectiveness of the British program pervades the first reaction of informed German business and banking circles.

The balance of the Economic Policy Committee's discussion consisted of various individual country reports. Of these, only two merit special comment.

The head of the Swiss delegation (the Swiss Minister of Finance) restated that the Swiss Government was not giving consideration to a revaluation of the Swiss franc and did not think that the Swiss national interest could be served in any way whatsoever by revaluation. The head of the Canadian delegation, after an extended review of recent Canadian exchange rate action, intimated that the Canadians might be willing to consider moving from a floating to a fixed rate, once an acceptable exchange rate had been established by market forces.

Other discussion of the Economic Policy Committee related to the future of the two extant Working Parties. The life of

Working Party 2 on differential rates of economic growth and on forces making for such differentials was extended to June 1962; that of Working Party 3 on monetary and fiscal policies as they impinge on balance-of-payments equilibria was extended to the end of this year. These formal extensions of life were accompanied by some general discussion of the further usefulness of the two working parties, especially as groups to study and foster appropriate governmental policies, and it was the consensus that the whole matter of continuation of activity be reviewed again at the fall meeting of the Committee. In summarizing the report he would make to the OEEC Council, the Chairman of the Economic Policy Committee stated he would suggest that the two working parties be regarded as continuing adjuncts to the Economic Policy Committee's organizational arrangements.

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

Since the last meeting of the Committee there have been three developments of special significance for monetary policy:

First: The progress of the economic recovery has been confirmed by numerous economic indicators.

Second: The President of the United States has requested substantial additional expenditures for defense, with a resulting increase in the prospective Federal Government deficit.

Third: Recent U. S. balance-of-payments developments have been disappointing and the British have taken action which may stimulate short-term capital outflows from this country.

On the whole, the economy seems to be rising at about the same rate as it did following other recent recessions. As expected, the rate of expansion in June and July was not as great as in the preceding months. Employment, income, sales, industrial production, and construction all continue to move up. At the same time, prices continue to be stable and there is a good deal of unused resources, both men and capital. The high level of unemployment continues to be a knotty problem.

Total bank credit has increased substantially as the banks have acquired large amounts of Treasury securities as a result of the Treasury's recent financing program. Business loans and other bank loans strengthened somewhat in July following a relatively weak showing in June. There were heavy repayments of loans to sales finance companies in June, a typical pattern for early recovery. In addition, probably some of the proceeds of the large amount of capital issues floated in the second quarter were used to reduce bank loans. As the Treasury expands its borrowing in the coming months and spends the money, a rise in the money supply and a rise in bank reserves may be expected. The general liquidity position of the economy is good.

The money market has been quite easy. During the period just ended, free reserves have averaged about $560 million, compared with an average of about $525 million in the preceding period. Other money market indices have reflected greater ease. Federal funds have been freely available, with the rate in the 1 to 1-1/2 per cent range during most of the period, dropping below 1 per cent on several occasions.

The impact of a sizable Federal budget deficit, including the additional defense expenditures now proposed, could be pronounced by the end of the year. The military program taken by itself, however, is not likely to put a serious strain on the economy's resources. The chief effect will be to call manpower into uniform and to increase the output of conventional weapons that can be produced without much expansion in present plant capacity.

The inflationary impact lies more in a possible change in business and consumer outlook regarding potential shortages and future prices. The administrative deficit for the fiscal year ended June 30, 1962, has been estimated by the Administration to be about $5 billion. The cash deficit could be about $10 billion. Concern is being expressed at home and abroad as to the magnitude of the prospective deficit. The proposed increased Federal deficit constitutes a potential danger to the stability of the economy and confidence in the dollar. As yet, however, the extent of the danger cannot be adequately evaluated. As the Federal Government adds the stimulus of greater deficit spending to the domestic economy, there is less need for a policy of monetary ease and low short-term interest rates that might adversely affect our international financial relations. As of today, however, the recent budgetary developments call for increased alertness rather than an actual change in monetary policy.

The United States continues to have a stubborn balance-of-payments problem and our international financial situation is quite sensitive. The over-all U. S. balance of payments in the second quarter will apparently show a surplus of $700 million at a seasonally adjusted annual rate. Leaving out the German debt prepayment, however, there was a deficit of $1.6 billion at an annual rate. This is a $400 million increase from the first quarter deficit rate despite the decline in short-term capital outflows from $2.0 billion to virtually zero. The loss seems to be explained by a sharp increase in outflows of medium- and long-term capital. Exports declined in the second quarter and the outlook for the next few months is no brighter. The austerity program in Britain can be expected to cut into our exports, and shipments to Canada may be adversely affected by recent Canadian measures. Imports remain a question but with recovery at home they may tend to move up. The emergence of a sizable deficit in the United States budget may be interpreted abroad as a weakening of sound fiscal policy and thus ultimately lead to more gold losses.

The higher interest rates now in effect in Great Britain will be an added inducement for funds to leave this country. With a 7 per cent Bank rate in England and a British Treasury bill rate between 6 and 7 per cent, American investors in British Treasury bills with full foreign exchange protection can obtain a higher yield (now about 1/4 per cent better) than that on a comparable investment in U. S. Treasury bills. If the British program is successful and confidence in sterling is restored--and we hope it will be--the forward discount on sterling will probably decline, and there will be an incentive to move funds abroad without exchange cover. More immediately, the higher interest rate on sterling loans in London may cause corporations with international operations to shift their borrowing to the United States and to use the borrowed dollars in their international operations. We may expect an increasingly strong outward pull on short-term funds from this country to Europe unless our own short-term rates move up considerably in the interim. The pull will be not only from Britain but even more importantly from the Continent. If business here recovers vigorously, of course, our rates will probably rise. There is no guarantee, however, that the level of U. S. rates required to check the export of capital will coincide with the level considered appropriate from a domestic viewpoint.

The domestic business and credit situation still calls for a policy of monetary ease. On the horizon, however, are factors that bear careful watching. If enlarged defense expenditures and related private spending result in an upsurge of activity with inflationary aspects, we may have to modify our policy of basic monetary ease sooner than we would otherwise have done.

In the coming period undue ease should be avoided. The level of free reserves is important but it is only one of several factors to be considered. We think that the so-called "feel" of the market is especially important. Too low money market rates, such as the Federal funds rate and rates on dealer loans, should be avoided.

For almost a year the rate on three-month Treasury bills has been within the range of 2-1/8 to 2-5/8 per cent. During most of the time the effective range has been 2-1/4 to 2-1/2 per cent. We think that the rate should continue within this range, but that in the light of both domestic and international developments it is highly desirable that the rate be in the upper rather than in the lower part of the range. This seems desirable even if at the expense of a somewhat lower level of free reserves.

Observers abroad are watching us closely. They are likely to interpret excessive ease here, particularly as symbolized by a low Treasury bill rate, as indicative of an unwillingness or inability on the part of the United States to take the steps necessary to assure the soundness of the dollar.

We believe that the discount rate should not be changed, that there is no need to change the directive, and that the authority to engage in transactions in longer-term securities should be continued.

Mr. Ellis reported that in New England business activity was continuing its recovery. Recovery rather than expansion was still the predominant tone, although the stage of the cycle had been reached where some new records were being posted. For example, manufacturing output seemed about ready to overtake year-ago levels. It should be noted, of course, that the mere reaching of year-ago levels was somewhat less than fully satisfactory. The regional shoe industry, which accounts for one-third of national output, had been affected adversely by the early date of Easter. The industry experienced a greater than seasonal drop in April. Activity continued below year-ago levels in May, but in late May retail sales began to improve and this stimulated some pick-up in orders from the factories. Construction was being stimulated by activity in the residential category in recent months, with the result that the cumulative contract total for the first half of the year was up 2 per cent, equal to the national rate. On the other hand, nonresidential construction was running 7 per cent behind year-ago levels. Unemployment was down slightly in June. Incomplete data for the District indicated that although employment had increased for four successive months, the total remained about .6 per cent below last year's levels. At no time during this cyclical decline did total employment fall as much as one per cent behind year-ago levels, so not much recovery was necessary to surpass those levels. New claims for unemployment compensation were now down to normal seasonal levels.

Retail trade statistics suggested that New England consumers were buying department store products somewhat more aggresively than consumers in the nation at large. Registrations at private summer camps were running one per cent behind year-ago levels, while agency camps (those supported by public funds) showed gains in July and August enrollments. With better weather, tourist trade had improved recently.

Some resort area banks credited the delayed tourist season with delaying the normal June-July gain in deposits. Whatever the causes, however, demand deposits were weak, with July totals down from the June average and below seasonal expectations. Loan demand also had weakened, with business loans in July below a year ago for the first time this year in the District. Nevertheless, loan-deposit ratios of weekly reporting banks averaged 65.2 per cent, this figure being identical with a year ago and some 5 percentage points above the average ratio for the United States. The banks had built up secondary reserves, and borrowing from the Federal Reserve Bank had virtually dried up.

Turning to policy considerations on a national basis, Mr. Ellis commented that the most significant change in the economic outlook had been the rapid emergence of the stepped-up defense preparedness program, with its ramifications in terms of consumer expectations, public psychology, and business reactions as well as its direct impact in terms of the placing of orders and subsequent increase in expenditures. He agreed with those who felt that the most likely prospect was for a rapid and vigorous surge in business activity during the forthcoming fall and winter. However, in view of the present underutilization of resources, it would appear that an expansion of activity could carry a considerable distance and for a considerable period of time without severe inflationary impact. If this was correct, it would appear that the proper course of policy for the present would be to continue to encourage bank credit expansion in support of greater economic activity.

Mr. Ellis expressed the view that the present directive was probably still acceptable, but that the Committee would soon have to recognize that the economy was passing through a period when the forces of recovery were developing into forces of expansion. Therefore, a suitable change in the directive at some forthcoming meeting would seem appropriate. Also in the light of recent developments in the United Kingdom, which might stimulate some outward flow of capital from this country, it was necessary again to consider the appropriateness of avoiding downward pressure on short-term rates. This suggested the desirability of continuing the present practice of operating in all maturities in supplying reserves.

For the next three weeks, Mr. Ellis said, he would make no change in the directive, he would supply reserves liberally to encourage credit expansion, he would recommend no change in the discount rate, and he would continue the special authorization covering operations in longer-term securities, along with the present pattern of operations under that authorization.

Mr. Swan reported that employment in the Pacific Coast States reached a record high in June and that the rate of unemployment fell.

On a seasonally adjusted basis, however, unemployment was somewhat over 7 per cent. Although the Twelfth District did not suffer as severely as the nation in 1960 and early 1961, as was also true in the previous postwar recessions, it had lagged behind the nation in recovery, in terms of employment at least, for the first time in any postwar recovery. This lag in a sense was not general. Rather, it seemed to arise primarily out of special circumstances, including the continuing decline in aircraft employment and the slow recovery in residential construction, which had a particular impact in the District in view of the importance of that area of activity in the past. However, there were now definite indications of improvement in the prospects for home building in the District and the outlook for heavy engineering construction, in terms of several major projects, was quite favorable. Department store sales in June rose considerably beyond both May 1961 and June 1960, and the gains continued into July.

District banks were still in a relatively easy position, and there was only nominal borrowing from the Federal Reserve Bank. While the demand for bank loans continued to be quite weak, some of the large banks had indicated that they were anticipating a strong demand within the next month or so. To the extent possible, they were arranging their investment portfolios so as to be able to accommodate the anticipated demand.

Turning to policy, Mr. Swan commented that the available statistics did not yet reflect the impact of recent international developments and the announced plans for increased defense spending on business and consumer expectations. The outlook was for a combination of Treasury needs for funds which might be intensified in the months ahead and a possible increase in private demands for credit over and above those that might have been expected from the normal process of recovery. This raised the prospect of some considerable tightening of credit markets in the not too distant future. In view of the uncertainties in the international picture, and also the availability of excess manpower and plant capacity, he would certainly not advocate significantly less ease for the next three weeks. It did seem to him, however, that the Committee should be considering carefully the possibility of a definitely less easy situation developing in the months ahead. For the period immediately ahead, he would only go as far as to suggest that it would be desirable if the bill rate did not go below 2-1/4 per cent and instead remained in the 2-1/4--2-1/2 per cent range. Also, he would suggest a free reserve target from $550 million down to $500 million, rather than $550 million up to $600 million. These were hardly significant changes; possibly he was only saying in effect that the Account Management should not resolve doubts on the side of ease to quite the same extent as in recent weeks. In supplying reserves, he felt it would be quite desirable to purchase securities in the intermediate area, so far as possible, rather than bills. Therefore, he would favor continuing the special authorization covering operations in longer-term securities. Although he would not suggest a change in the discount rate or the directive at this time, he felt, like Mr. Ellis, that the Committee might want to consider a change in the directive before too long. Also, if the recent reaction in the stock market should continue, with a further increase in the flow of credit into that area, it seemed to him that at some point the Board of Governors might want to give consideration to a possible increase in margin requirements.

Mr. Deming commented that the most significant Ninth District economic development this summer had been the persistence of drouth over much of the area. The dry weather had been centered in the spring wheat producing areas of the western part of the Dakotas and eastern Montana, but the drouth extended into adjacent grazing areas and also into northern Minnesota. As of mid-July, only southeastern South Dakota and the southern third of Minnesota were free from drouth damage to crops. Since mid-July, fairly widespread showers had occurred over the District, which had given temporary relief, but they came too late for the small grain crops. North Dakota had been hardest hit by the dry weather, with less than 50 per cent of last year's production of small grains expected. In Montana, a 25 per cent reduction in all wheat was indicated on July 1. All things considered, cash income from District crops in 1961 might be reduced by one-fourth to one-third from last year. Total cash income from farm marketings during the first half of the year appeared likely to have exceeded the same period a year ago, but cash income might fall behind during the second half, perhaps by as much as 15 to 25 per cent. Farm income, he noted, comprises about 12 per cent of total District income.

Some communities in the hardest hit drouth areas were already noting or anticipating the economic effects of smaller crop marketings. Farm machinery sales, as well as retail sales, were reported slow, and the processing and handling of the smaller crop would reduce employment and activity to a greater extent in the period ahead.

However, in spite of the reduced crop production prospects and a lack of vigorous activity in the iron ore mining areas, the over-all District economy as of midyear was in reasonably good shape. Nonagricultural employment increased 1.3 per cent from May to June in Minnesota, and unemployment declined from 6.6 per cent to 5.8 per cent of the labor force. However, in two major nonagricultural activities--mining and railroading--employment in 1961 was running about 33 per cent below five years ago, meaning a reduction of 35 to

40 thousand jobs. Also, although personal income in the District was up from a year ago by almost precisely the same percentage as nationally, there had been no gain since the beginning of the year, actually some little decline, while nationally there had been a rise in the past six months.

On the financial side, both deposits and loans at District member banks at midyear exceeded year-earlier figures, with substantial gains in time deposits. Loan totals, however, had shown little change for the past seven months.

Turning to policy, Mr. Deming said he could do no better than borrow the thought expressed by Mr. Treiber: that it would be well to operate with increased alertness over the forthcoming period, and perhaps the next two or three succeeding periods. He saw no reason to change the discount rate at this time. As to the directive, in the light of recent developments in Europe he would suggest the possibility of inserting the word "increased" before "consideration" in the phrase of clause (b) now reading: "while giving consideration to international factors." However, he did not regard this possible change as important. He would be inclined to aim at keeping free reserves about where they had been, he would favor renewing the special authorization covering operations in longer-term securities, and he would suggest operating substantially in the longer-term area to avoid pressure on the bill rate.

Mr. Allen reported that Seventh District businessmen and economists remained optimistic about the continuance of the economic uptrend into 1962. The nature of additional defense spending, in particular concentration on conventional arms, strengthened that optimism, for it meant that District participation in the defense program would again increase after a long decline which began in 1953.

Retail sales were edging upward, in the Seventh District as in the nation, but the record was spotty. In the four weeks ended July 23, for instance, department store sales in Chicago increased 4 per cent over a year ago, whereas Detroit showed no change and Milwaukee, Indianapolis, and Grand Rapids experienced declines.

In Detroit, Mr. Allen said, automotive management now seemed less optimistic about concluding negotiations without a strike, whereas he had reported a few weeks ago that they felt that a strike might well be avoided. Based on his experience in the area, he would say that the change in mood was characteristic of this stage in an important negotiation. Automobile sales spurted in mid-July, as reported in the staff review. All major manufacturers would be down completely by tomorrow for model changeover, and not more than 150,000 1962 models were expected to be built in August. That would be barely enough to supply dealer showrooms, which was regarded as a matter of union leverage in the negotiations.

The employment situation in the District continued to improve. In July new claims for unemployment compensation were slightly below the year-ago level, continuing a trend underway since the start of the year. It was becoming obvious that, according to precedent, the Seventh District had benefited more from the recovery than the rest of the nation, just as it declined more in the recession.

As to agriculture, cash receipts from farm marketings in Seventh District States in the first half of the year were 6 per cent higher than last year, compared with a 3 per cent increase for the entire country. Crop conditions were good over the entire District, and grain yields promised to be at a record level. The high yields reflected not only good weather but also retirement of the poorest land in the 1961 feed grain program.

With the conclusion of the sessions of the State legislatures, it was apparent that spending by State governments would rise substantially in the year ahead. Approved budgets indicated increases in outlays which varied from a high of 26 per cent in Illinois to a low of 8 per cent in Iowa.

District weekly reporting banks showed a further decline in loans during July, with a reduction of about $100 million in commercial-industrial, finance company, and consumer loans for the three weeks ended July 19, partially offset by a rise in loans on securities.

Substantial additions to Government security portfolios had been mainly in the under-one-year category, with the bill inventories of reporting banks in Chicago now $700 million, far above bill holdings at any time in recent years.

In the area of monetary policy, Mr. Allen said he found himself favoring, with a degree of apprehension in the light of the greatly improved state of business and the forthcoming impetus of increased governmental expenditures, continuance for the next three weeks of that degree of ease which the Committee had fostered for many months now. He was agreeable also to continuing the directive without change, although the word "recovery" in clause (1) (b) no longer seemed appropriate. On the other hand, the reference in the directive was to "the forces of recovery," and he would not urge a change at this meeting, although he could easily be persuaded otherwise. He felt that the special authorization should be withdrawn, for reasons he had heretofore stated.

Mr. Clay commented that System operations in securities other than short-term issues since February 20, 1961, had given rise to the question of criteria by which transactions in longer-maturity issues should be guided. The question had been brought into current focus by the July 7 memorandum of the Federal Reserve Bank of New York, in which it was suggested that a third criterion be added to the two then being employed by the Desk. The suggestion offered in the New

York memorandum was "that operations outside the short-term area should be undertaken on those occasions when congestion appears to be developing in the capital markets or when market expectations as to the future course of rates seem to be having clearly exaggerated effects." This proposal was formulated in the light of conditions now confronting the Open Market Committee. However, it seemed well to examine its implications under more general conditions.

There were times when it might be desirable to reduce long-term rates of interest and thus stimulate spending even though congestion was no problem in the capital markets. There were other times when a limited degree of congestion in the capital markets was desired in the interest of restricting investment spending and should not be offset by policy actions. Similarly, expectations of market participants as to the future course of rates might result in desirable as well as undesirable effects on the cost and availability of credit, and only in the latter case would corrective action be called for.

It would appear to him, then, that the criterion for System operations in intermediate and longer-term issues should be stated in terms broader than those suggested in the New York memorandum. In stating the various criteria by which open market operations were to be conducted, the Committee should give consideration to whether existing long-term rates were appropriate for attaining the Committee's economic objectives. The Account Manager should then be given as one of his instructions that of making purchases or sales of securities looking toward the desired impact on longer-term rates.

Manifestly, no one had a magic formula for determining the level of long-term rates that would be appropriate at any given time. The necessity of making this judgment was not avoided, however, by selecting a variable such as free reserves by which to guide open market operations. This variable has no direct relation to the expenditure decisions of the public nor is it a reliable guide to the availability of credit to private borrowers. To be given meaningful interpretation as a measure of monetary restraint or stimulus, it must first be translated into terms that measure or reflect its implications for the cost and availability of credit, including the level of long-term interest rates.

Turning to the posture of monetary policy for the period immediately ahead, Mr. Clay noted that the business news of recent weeks contained encouraging signs that recovery in economic activity had been more rapid than one might earlier have anticipated. Though a considerable volume of unused labor and capital resources remained to be productively employed, progress in opening up employment opportunities had been made since the first quarter, and this development should continue in the months ahead. The probable increase in defense expenditures occasioned by recent international developments would make an added contribution to this end, particularly since the character of the proposed outlays was likely to benefit durable goods industries in which ample resources were available for increasing real output.

Mr. Clay suggested that monetary policy for the immediate future should be directed toward maintaining the present degree of ease in the money and capital markets until the response of the private sector to the expected increase in Federal expenditures could be appraised. Such a course of action implied continuing transactions in longer-term securities geared to the objective of maintaining present levels of long-term rates. It also meant such additional transactions in short-term securities as might be necessary to continued expansion of bank credit and bank deposits at a seasonally adjusted rate comparable to that prevailing during the first half of this year. If the injection of reserves necessary to meet this latter condition could not be accomplished by purchase of Treasury bills without reducing the bill rate below recent levels, purchases of intermediate or longer-term issues should be undertaken for this purpose also.

In conclusion, Mr. Clay expressed the view that the authorization covering operations in longer-term securities should be renewed, and that no change appeared to be called for either in the Committee's directive or in the discount rate.

Mr. Wayne said that Fifth District business activity appeared to have continued the improvement that occurred in the second quarter. Like the New England area, however, the District was certainly in a period of recovery rather than expansion. By mid-June seasonally adjusted nonagricultural employment had risen 1.5 per cent from the recession low, slightly less than the rise of 1.7 per cent for the United States as a whole. Manufacturing manhours had risen 6.8 per cent compared with a gain of 6 per cent nationally. Total manufacturing manhours had regained 71 per cent of their recession decline, but some fairly important industries, including metals, furniture, lumber, and food processing, had recovered less than 45 per cent of their losses by mid-June.

A cross-section of industrial leaders contacted in a survey last week reported further increases in new orders, backlogs, shipments, employment, and average workweek. Business loans, however, were weaker than usual at this time of year, and the banks were in an easy position. Such borrowing as there was at the Reserve Bank seemed of a purely routine seasonal nature. Farm cash receipts for the first five months of the year were above last year. In general, it might be said that grass-roots contacts indicated moderately optimistic views. As to textiles, leaders in the industry felt that the agreement reached at the Geneva International Textile Conference in July would result in some restriction of imports in the months ahead.

Mr. Wayne said that he could see no justification for any change in System policy in the next three weeks. The economic upswing was apparently continuing at about the same rate as in previous recovery periods, but unemployment was still high, plant capacity was still not fully utilized, and most prices were either stable or drifting downward. As others had pointed out, however, there were two significant uncertainties in the picture. The first was the impact of proposed defense spending, not only directly but on expectations. Second, there were the recent foreign developments, particularly in the United Kingdom. The stage might be set for an outflow of capital, and a British drawing on the International Monetary Fund might trigger such a movement. Nevertheless, until the effects of the factors he had mentioned could be better gauged, he felt that maintenance of the present degree of ease was the most appropriate posture for monetary policy.

After stating that he would not recommend a change in the directive at this time, Mr. Wayne said he had been a little concerned at recent Committee meetings regarding the emphasis placed from time to time on the failure of the money supply, as narrowly defined, to grow. In his view, the Committee should concentrate on changes in total liquidity rather than the money supply. It appeared to him that total liquidity had increased fast enough in recent months to foster adequate recovery despite the smallness of the rise in the money supply. If more demand deposits were needed, time deposits could have been converted. Therefore, he would not favor additional ease to encourage an increase in the money supply. Instead, he would favor a range of free reserves from $550 million down to $500 million, with particular emphasis on the international situation and on the bill rate at this time.

Mr. Mills commented that there could, of course, be different reactions to the remarks that had been made at this meeting up to this point. Hiw own interpretation was that there seemed to be a groping to find a monetary and credit policy that would continue to encourage bank credit expansion, while at the same time skirting the danger of generating subsequent inflationary pressures. He feared it amounted to wishful thinking to believe that a policy of that sort could be realized. Instead, it should be acknowledged that monetary and credit policy must anticipate events, in order to avoid having to take over-corrective actions later. For the purpose of outlining a policy that he felt would be proper at this particular juncture, Mr. Mills then read the following statement:

> Whether Federal Reserve System monetary and credit policy should aim at forcing an expansion in bank credit in order to stimulate growth in the money supply or whether policy sights should be guided by movements in the short-term interest rate structure are in effect the issues that are open for debate at today's meeting of the Federal Open Market Committee. In the light of neartime experience, it has been demonstrated clearly that in the

absence of an aggressive demand for commercial bank credit, the possibility of promoting an increase in the money supply from that source is limited and, consequently, judicious financing of the Treasury's deficit through the commercial banking system continues to be the most eligible medium for promoting the expansion of bank credit, with an assist from monetary and credit policy. Several occasions have already exhibited the support to commercial bank credit expansion that resides in the financing of new issues of U. S. Treasury securities with the commercial banks. At longer range, the problem presumably will prove to be how to decelerate Federal deficit financing through the commercial banking system in the prospect of a rising demand for private credit as economic activity increases in both its private and public sectors--all to the end that troublesome inflationary pressures will not take root.

Under the circumstances recited, it is clear that any concern about the need of pumping up the money supply can be set aside by the System Open Market Committee and its attention turned to developing a monetary and credit policy geared to movements in the short-term rate of interest. Examination of the levels of free reserves pertaining over many weeks past, with their correlation to the auction rates on new 90-day issues of U. S. Treasury bills, suggests that whereas a high level of free reserves undoubtedly exerts some expanding influence on bank credit, a relatively low level of free reserves does not force the interest yield on 90-day Treasury bills unduly upward. Such being the case and considering the status of international short-term interest rates, it appears desirable to bring down the level of free reserves from the high points which they have recently reached and so as to exert a reasonable but not excessive upward pressure on the short-term interest rate structure. Actions taken to that end should be productive of an interest rate structure consistent with current and prospective national and international economic developments, at the same time that measures taken to force-feed the money supply, with the attendant danger of setting the stage for a future inflation, will have been avoided. As far as the money supply is concerned, judicious Treasury deficit financing through the commercial banking system will remain as the obvious vehicle for promoting such further increase in the money supply as is demanded by rising economic activity.

A Federal Reserve System monetary and credit policy conforming to the reasoning outlined recommends bringing down

> the level of free reserves below current highs by gradual disengagement from the System Open Market Account's portfolio of longer-term U. S. Government securities, which holdings have recently been augmented substantially. It is recommended that the special authorization for operations outside of the Treasury bill sector should be renewed, but on the above basis of a reduction in the holdings of such securities.

Mr. Shepardson said it seemed to him that all of the economic reports indicated a continuing expansion of activity, slower in some areas, possibly, than in some others, but generally an upward trend. In the circumstances, the recently announced defense program and the change in the international situation gave real pause from the standpoint of considering just where things were going to go. He agreed with those who had indicated that the Committee should perhaps not be overly concerned about the lack of expansion of the money supply, narrowly defined. Since there appeared to be a continuing growth in total liquidity, which the forces of the Government spending program seemed likely to enhance, he questioned whether it was necessary to wait and see what was going to happen. It was known definitely that there was going to be a prompt expansion in military supplies and military manpower, and this would have both a real and a psychological effect.

A review of the reserve projections, Mr. Shepardson noted, would indicate that to maintain the prevailing level of free reserves it would be necessary to supply reserves shortly in considerable quantity, followed by reverse action. This was an appropriate occasion, he felt, not to try to supply all of the indicated reserves, but rather to let the level of free reserves fall to within the $500-$550 million range. In his opinion, in fact, free reserves had been at a higher level than necessary or desirable for the past three weeks. Accordingly, he concurred in the view that free reserves might be allowed to trend downward somewhat, although without going so far as to constitute a restraining action. A failure to meet the full indicated need for reserves in the period immediately ahead would also ease the problem with respect to short-term rates, and he felt the Committee should be concerned about such rates. To the extent that it was possible, consistent with the objectives he had mentioned, to reduce System activity in longer-term securities, that would in his opinion be desirable. He did not feel that the Committee should disengage completely from such operations, but he did feel that the Committee should take advantage of opportunities to reduce its activities in the longer-term area. He would not favor changing the directive or the discount rate at this time.

Mr. King said he would hope that the Desk might lean in the direction of supplying reserves through the purchase of bills, even though some drop in the bill rate might occur. Even though mindful of the international considerations that had been discussed, he saw no need for deliberate action designed to push the bill rate higher. He agreed with the idea of accepting a lower free reserve level, in the next week or so at least. Therefore, he would not make purchases in the longer-term area simply in order to provide free reserves in the vicinity of $500-$600 million. Even if free reserves were in the neighborhood of $400-$450 million, he would prefer to refrain from operations in the longer-term area to any great extent over the next three weeks. He would not suggest any change in the discount rate or the directive at this time.

Mr. Fulton said that Fourth District economic recovery, after coming along quite strongly through the month of June, had slowed down in July, reflecting among other things a number of seasonal factors such as holidays, vacations, and auto changeovers. Reports from the metalworking industries indicated that it was difficult to project the course of activity for the rest of the year. However, expectations were generally for a good fourth quarter, with activity going into next year at an accelerated rate. Certain products of the foundries were being taken well, but the railroads were not buying and the auto manufacturers had not been placing orders in quantity. Steel manufacturers reported that their orders were lower in July than in June, that deliveries scheduled for August were lower than for July, and that the automotive people just were not ordering. However, the hope was for a good fourth quarter and for going on into 1962 at an increased rate. There seemed to be no significant inventory accumulation on the part of any of the users of either basic materials or finished steel. In the staff review distributed prior to this meeting, it was indicated that there had been a considerable turnaround in inventory accumulation. However, those with whom he talked maintained that their customers just did not seem to be accumulating inventory beyond working levels for their own operations. The profit squeeze was a real problem in the steel industry, as in some other industries, and until business got considerably better the mills were not going to get into any reasonably profitable operation.

Department store sales had improved somewhat, although on a year-to-date basis they were 2 per cent below last year. While the volume of construction was quite good, the situation was spotty throughout the District. A large part of the volume was accounted for by Government money, Federal, State, or municipal.

Loans at District banks fell during July, with the only substantial demand coming from those preferring to take term loans rather than to go to the capital markets. These included smaller companies that probably would not have ready access to the capital markets.

As to policy, Mr. Fulton said that he would not recommend a change in the discount rate and that the directive seemed reasonably satisfactory for the immediate future. Although he would renew the special authorization covering operations in longer-term securities, he would align himself with those who had expressed the hope that activity in longer-term issues might be minimized. It occurred to him that the System might be getting into a rather difficult position by virtue of trying to maintain a level of rates in the bill market which in turn encouraged banks to buy bills. It seemed almost self-defeating to sell bills and purchase longer-term securities if the banks then acquired the bills because the rate was attractive, for the yield thereby was again depressed. He had a feeling that a lesser volume of free reserves might assist in maintaining the bill rate, and relieve the System of what it felt to be its duty to maintain the short-term rate structure. Therefore, he would feel that $500 million of free reserves should probably be the maximum. To put it another way, an easier position than one reflected by a maximum of $500 million of free reserves should not be encouraged.

Mr. Bopp said that business continued to improve in the Third District, but at a more sluggish rate than in the nation generally. This was evident whether one looked at the business or the financial statistics. It was noted that for the past seven weeks there had been no further expansion of time deposits.

As to policy, Mr. Bopp said that he would favor continuing about the same degree of ease that had been maintained. He would not favor a change in the discount rate or in the directive at this time, and he would renew the special authorization covering operations in longer-term securities. The expanded defense program might mean that the Committee would have to take another look at the situation, but this did not apply to the next three weeks.

Mr. Bryan said that he had come to this meeting as devoid of convictions, possibly, as at any time he could recall. If one were to look at the present economic situation and the extent of recovery purely upon the basis of the figures that had been presented, an excellent case could be made for continuing present System policy more or less indefinitely. However, when one had to take into account the prospect of an increased Federal deficit, the repercussions of that deficit in the private sector of the economy, and the international situation, he became quite uncertain as to the proper posture of System policy. Mr. Bryan commented that he was sympathetic with those who had suggested the need for alertness to avoid getting again into an inflationary situation, and that he had sympathy with the remarks of Mr. Mills.

There were a couple of questions, Mr. Bryan said, that troubled him considerably. First, much emphasis seemed to have been placed upon the management of monetary policy in relation to balance-of-payments difficulties. In this connection, he wished to revert to a point that he had made before, namely, that those difficulties were not created by monetary policy and instead derived from other elements of national policy. While monetary policy might make some contribution to remedying those difficulties, he felt the System should not cherish the illusion that any major contribution to their solution by means of monetary policy was possible. Also, he was troubled by the feeling that because of the British situation the System must take what might be called a manipulative approach to short-term rates. The British were undertaking what was largely a classical adjustment to their problem. To the extent that the System took a manipulative approach to short-term rates, it was saying to the British in effect that the System wished to make no contribution to the amelioration of their situation. He had considerable doubt whether that would be a wise or morally correct posture.

Mr. Bryan concluded by saying that if he had to suggest a target for free reserves at the present time, he would suggest tending in a downward direction to something like $500 million, rather than the $575 million average of the past four weeks or the $600 million average of the past three weeks.

Mr. Johns reported that business activity in the Eighth District had been showing improvement, as it had elsewhere. As in the nation, more strength had been shown in the District in the output of durable goods than in the output of nondurables. Coal production had increased moderately in recent weeks, but crude oil production had risen only slightly. Major cities in the District had experienced a decline in the percentage of the labor force unemployed during May and June, in contrast to the constant rate of unemployment in the nation as a whole, and the situation improved further in early July according to indications from available weekly data and from outlook reports. Construction activity was improving somewhat more rapidly in the District than nationally.

Financial developments had been quite similar to those in the rest of the nation. Total loans and investments had grown, and loan demand was somewhat stronger than over the nation as a whole. The growth of deposits had been primarily in the time category, and borrowing from the Reserve Bank had been nominal.

On the whole, agricultural developments were satisfactory. Soy bean prospects were quite good; the expected production coupled with higher support prices pointed to increased returns. As usual, there were mixed reports concerning the cotton crop. Acreage was up in all the major producing areas except southeastern Missouri, but it was possible to get almost any kind of report about the condition of the crop. There was general agreement that the crop was a little late, but on the whole the major producers seemed to hold fairly optimistic views. Yield prospects for feed grains were generally good, but acreage was down substantially. Tobacco producers reported the outlook to be quite promising, with production estimates up about 8 per cent. In general, it was expected that cash farm income in the District might be up significantly from last year, although farmers were quick to warn that the crops were not yet harvested and that optimistic reports involved assumptions of good weather and other favorable conditions.

As to policy, Mr. Johns said he was inclined to align himself quite closely with the views of Mr. Ellis. With reference to the staff memorandum of July 28 on member bank reserves, he found it gratifying to observe that the increase in reserves held against deposits other than U. S. Government deposits increased in the four weeks ended July 26 rather closely in conformity with the pattern projected in the July 7 staff memorandum. In the projections shown in column three of table 3 of the current memorandum, there was built in a weekly increment for expansion of demand deposits adjusted and time deposits at an annual rate of about 5 per cent. Although he had suggested three weeks ago some additional increment, he would be disposed at this time to accept the $15 million weekly increment. This meant that he believed there should continue to be modest increases in total member bank reserves. He saw no need to change the discount rate or the directive at this time.

Mr. Balderston said that he would not recommend changing the directive until it was clear from the index of industrial production and other indices that the economy had moved onto higher ground. He would favor extending the special authorization covering operations in longer-term securities. As to policy for the next three weeks, he wished to associate himself closely with the views expressed by Mr. Johns. He would prefer to speak in terms of total reserves rather than free reserves, since the time might come this fall when member banks would return to the Reserve Bank discount windows and increase their borrowings. Until and unless defense and other Government spending created speculative exuberance, it was his view that the Open Market Committee should be guided by the staff projections of total reserves. This figure, which was about $19.4 billion for the week ended August 23, incorporated an allowance for growth at an annual rate of about 5 per cent in privately held demand and time deposits. The projections, he noted, had been followed almost precisely since February. As shown by Mr. Eckert's memorandum on the money supply and its close relatives that had been distributed prior to this meeting, the money supply plus time deposits of commercial banks had been expanding at an annual rate of close to 6.5 per cent since December and 5 per cent since February. Although the lack of growth in the active money supply was of concern to him, the money supply would undoubtedly respond in time if the Committee adhered to the target of total reserves set forth in the staff projections. When borrowers desired more bank credit, the banks would increase their discounting. Thus, free reserves would be reduced automatically if the Committee continued to adhere to the total reserve projections.

Chairman Martin commented that all things considered it seemed to him the economy was in a surprisingly healthy condition.

He was impressed today by the appearance that the Committee's thinking on policy was probably gradually turning. He thought Mr. Mills' use of the word "groping" was appropriate, because that is really the way policy is developed within the System. In his view, real progress was being made at the present time.

The Chairman then said that Secretary of the Treasury Dillon had asked him if he would make the observation to the Committee that the Secretary hoped the Federal Reserve would not be too gloomy about the budget. The Chairman felt that this statement, and the fact that the Secretary had authorized his making it, had some significance. It should be taken into consideration by the Committee that the Secretary was concerned about the budgetary problem, and likewise the President. There had been many gloomy estimates, and talk of a deficit of $8 to $10 billion, but the Secretary seemed to feel there was a good chance that the deficit could be held closer to the $5 billion area. This was a hopeful factor, and one that the Committee ought to have in mind.

Chairman Martin emphasized at this point that in a turning or transition period it was necessary to be particularly careful that System actions did not encourage unnecessary comment and speculation about what might be going to happen. This was of course a difficult thing to avoid. The System had been through this a number of times in the past decade, and almost every time there had been slips. In the circumstances, he did wish to bring out that it was necessary to try to guard against such slips to the fullest extent possible.

Chairman Martin said he happened to feel personally that at this juncture it would be better to resolve doubts on the side of tightness, whether speaking in terms of free reserves or total reserves, but without any significant change in policy being evidenced by the level of either free reserves or total reserves. This was about as close a concept as could be developed, he realized, but it would then be possible to see what unfolded.

Chairman Martin also expressed the view that there was an inclination to place too much emphasis on the money supply problem. Without question, he thought, sufficient money was around at the present time, and the money supply figures would be galvanized almost overnight when a real demand for money occurred. He did not mean to suggest that the System should be niggardly in supplying reserves, but he did mean that the System ought to be putting itself in the best possible position.

It was obvious from the go-around today, the Chairman continued, that there was no inclination to change the discount rate and no general desire to change the directive. There had been some discussion of the special authorization covering operations in longer-term securities, but it appeared that with one exception the members of the Committee did not desire to withdraw the special authorization.

The Chairman went on to say in the latter connection that he was glad the Account Management had acted as it did over the past three-week period. The Management had used its judgment and had made substantial purchases beyond the one-year area. He felt that it was desirable to get some experience and to obtain all the information possible about what was involved in this experience before arriving at any definitive conclusions. Today, however, he would certainly side with those who felt that the System should reduce its activity in the longer-term area to the extent that that could be done. On the other hand, he would like to leave discretion with the Account Management.

Chairman Martin suggested that it would be advisable to try to find out where the proceeds of some of the System purchases went; to try to analyze the market and find that out. He had talked with a number of people who said they knew positively that certain securities were sold to the Account and the proceeds immediately invested in bills. The special operations would not seem to accomplish much good if that was true. Therefore, he felt that in evaluating the special operations the Committee should try to get as much information as possible about the securities that were acquired and what was being done with the proceeds of those purchases. While this was a difficult question, it was something of real importance in any longer-range evaluation.

Continuing, the Chairman expressed the view that it would be inadvisable at the present time to place any limitations on the Management of the Account. In his opinion the Management had done well with a difficult problem, and it ought to be free to operate to the best of its ability, in terms of policy, in all maturities. Of course, the Desk should not go overboard--and it had not at any time to date--in the longer-term area of the market.

Chairman Martin then turned to Mr. Rouse and inquired whether the latter had any comments to make, particularly in the light of his recent trip to Europe.

Mr. Rouse said he had only the comments that he had made previously. The questions that had been asked of him about Governmental expenditures, the Federal budget, and related matters were indicative of a background of concern about possible developments in this country over a period of time. They indicated a feeling that the United States ultimately would have to resolve the same questions that the British were trying to resolve at the present time.

Chairman Martin then stated that the consensus favored no change in the directive at this time and no change in the discount rate. The consensus also favored continuing approximately the same degree of ease that had been maintained to date, along with renewal of the special authorization covering operations in longer-term securities, with the Account Management taking into consideration the comments that had been made around the table.

Mr. Shepardson inquired whether the Chairman had intended to include in his statement of the consensus any reference to the manner in which doubts should be resolved in the operation of the Account. It appeared to him that to this extent there had been a shift since the previous meeting, when it had been indicated that doubts should be resolved on the liberal side.

Chairman Martin responded that this was always a question with which the Committee must deal. He could sympathize with the Management of the Account when it came to operating under specific instructions. It did not seem to him that there was any particular reason to take a poll on the degree of distinction made today, although he would be perfectly willing to consider it.

There being no indication that a poll was desired, it was understood that the Chairman's statement of the consensus would stand and that the special authorization would be renewed. The renewal of the authorization would provide a new limitation of $500 million for transactions in longer-term securities.

Mr. Rouse commented that purchases of such securities in the past three-week period had gotten up to $473 million. However, the bulk of those purchases were in what he thought of as actually short-term securities; that is, securities with a maturity of not more than two or three years. As to securities with maturity over 10 years, the purchases were just $36.6 million, a very small proportion of the aggregate purchases for the Account.

Thereupon, upon motion duly made and seconded, it was 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 encouraging expansion of bank credit and the money supply so as to contribute to strengthening of the forces of recovery, while giving consideration to international factors, 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 accomodation 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.

The Committee then authorized the Federal Reserve Bank of New York, between this date and the next meeting of the Committee, within the terms and limitations of the directive issued at this meeting, to acquire intermediate and/or longer-term U. S. Government securities of any maturity, or to change the holdings of such securities, in an amount not to exceed $500 million.

Votes for this action: Messrs. Martin, Balderston, King, Mills, Shepardson, Swan, Wayne, Johns, and Treiber. Vote against this action: Mr. Allen.

Chairman Martin then referred to a memorandum from Mr. Young dated June 26, 1961, which had transmitted to the members of the Committee a memorandum dated June 15, 1961, from the Steering Group of the Government Securities Market Study with respect to dealer financial statements. In this memorandum the Steering Group requested authority to explore more specifically with individual nonbank dealers the possibility of setting up a more standardized system of financial reporting along the lines indicated in attachments to the memorandum, recognizing that considerable effort by way of negotiation would be required to compose variations arising from the widely different types of business done by the individual dealer firms.

At the request of the Chairman, Mr. Young made a brief statement to the effect that in pursuance of the program of providing more adequate and ample information on the Government securities market, the Steering Group had been looking into what might be done to improve the financial statements of the nonbank dealers. After much work on the part of the staffs of the Board and the New York Bank, a plan had been worked out. However, the work had been carried about as far as it could in this manner, so the Steering Group would now like to go out and discuss the problem with individual dealers. This was the extent of the authorization requested at this particular time.

Chairman Martin inquired whether there were any questions or comments, and Mr. Allen said that although he did not feel strongly one way or the other, he had the general feeling that he would not like to bother the dealers any more than necessary. He noted that at some points the material distributed to the Committee seemed to indicate that the New York Bank had sufficient information for credit purposes. At other points, however, the material appeared to suggest that for credit purposes it would be desirable to get this additional information. As he had said, he did not feel strongly on the matter, but he would hate to bother the dealers any more than necessary, and he would be interested in any comments Mr. Treiber or Mr. Rouse might care to make.

Mr. Treiber said he thought it was the feeling at the New York Bank that from the point of view of the institution's conducting business with dealers there was sufficient information available for credit purposes. The staff material went on, however, to suggest that more uniform statements would be helpful for the purpose of credit analysis to the whole market and might contribute in some small way to the maintenance of a sound financial structure among the professionals in the market. The Government securities business being an activity where risk exposure can and occasionally does change sharply from day to day, annual or even quarterly financial statements could not in and of themselves assure credit-worthiness or financial soundness. The report also noted considerable interest on the part of some members of Congress and some sectors of the general public for periodic consolidated balance sheet and income statement information on the dealer community in the Government securities market, and the report expressed the view that satisfying such public interest could contribute to a better understanding of the functioning of the Government securities market. Thus, the Steering Group was really thinking in terms of the over-all credit situation of the country. There had been various groups that felt there should be more information, and the memorandum was directed mainly toward that aspect of the matter.

Mr. Rouse said that, as indicated by Mr. Allen, the New York Bank did have adequate credit information regarding the dealers in Government securities. The statements of the nonbank dealers varied in form to a considerable extent, but the Bank was able to obtain audited statements and interim data, if desired. This applied not only to the Bank but also to other customers of the dealers; the dealers' statements were readily available. A customer doing a substantial business with a dealer would want to know the dealer's financial situation, and that information was available. The only reason he saw for going further was that, as indicated in the memorandum, some members of the Congress had expressed an interest. The information was wanted by the staff of the Joint Economic Committee, apparently, and possibly by some of the members of the Committee. Personally, he did not see any other reason for going ahead with this project. It would be asking a good deal of the dealers, and he did not feel that the System should put itself in the position of taking the onus upon itself.

Mr. Fulton said that this was his own reaction. If the New York Bank was now getting adequate information and the Congress wanted more, the Congress might be expected to ask for it. He felt that the System would be putting itself at the end of a limb if it tried to read the mind of the Congress and badgered the dealers to the extent that it could not have amicable relations with them. A request might be looked upon by the dealers as forcing them to comply because of their relationships with the System.

Mr. Johns inquired whether this was not a joint effort of the Federal Reserve and the Treasury, so that the System would not take the onus entirely upon itself.

Chairman Martin confirmed this statement. He added that he thought a good point was being made as to whether the dealers were being harassed too much. In point of fact, however, the dealers had been relieved of a good deal of harassment by virtue of the manner in which the study of the Government securities market had been handled by the Treasury and the Federal Reserve.

Mr. Swan commented that in the longer run there might be some advantage in doing some further steering, both from the standpoint of the Federal Reserve and from the standpoint of the dealers. Therefore, he would be inclined to favor the current proposal, but with the understanding on the part of all concerned that this was in the public interest rather than in the immediate interest of the System. If the dealers did not want to go along on that basis, he would not want to force them, but he felt that it would be possible to explore the matter with the dealers without the System taking too much onus on itself.

Mr. Young expressed agreement with what Mr. Swan had said. This was a matter of the public interest. There had been a good deal of criticism about the market from time to time, and in part this criticism had arisen because of the inadequacy of information. The Joint Economic Committee had asked the assistance of the System in getting financial statements of the dealers over a number of years. The System was unable to provide the information, and the Joint Committee then went out and got the information itself. Thereafter, one of the points that the Committee staff was prepared to formalize through a letter from the Chairman of the Committee was specifically along these lines; that is, a request for the development of standardized financial reporting on the part of the dealers. However, the Treasury and the Federal Reserve indicated to the Committee staff that they were willing to try to work out something in cooperation with the dealers. If the matter were to be dropped, it was likely that a letter would be received.

Mr. Thomas commented that it had been said to the Joint Committee that the dealers' statements were satisfactory for the System's purposes. However, the statements were in such varied forms that probably nobody but the System could understand them, and this attempt to get on an organized basis could be justified from that standpoint. It was difficult for the System to justify the point of view that it had enough information, because it could not present the information to the Joint Committee when asked.

Mr. Wayne inquired whether it was not true that the System and the Treasury would be approaching the dealers on a cooperative basis as an alternative to some other approach that the dealers might like less. If so, he saw no reason not to enter into exploratory discussions.

Chairman Martin and Mr. Young confirmed that this was the intent.

Chairman Martin also expressed the view that it would be advisable to go ahead and explore the subject with the individual dealers. He would not want to impose an undue burden on the dealers. However, the System needed all of the information it could get as to what was going on in the Government securities market. Some day it would be necessary to have more information than was available at the present time.

Chairman Martin then said if, in the light of this discussion, there was no objection, the Steering Group would be authorized to explore the matter with the nonbank dealers, and no objections were heard. The Chairman added the comment that he would not want the dealers to obtain any impression that the Committee was not taking this matter seriously because it might involve some added work for the dealers. The matter should be explored in a serious manner to see whether the problem could not be worked out without subjecting the dealers to undue hardship.

It was agreed that the next meeting of the Committee would be held on Tuesday, August 22, 1961, and it was understood that the next succeeding meeting would be scheduled for Tuesday, September 12, 1961.

The meeting then adjourned.

Ralph A. Young

Secretary