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 22, 1961, at 10:00 a.m.

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

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

Mr. Bryan, President of the Federal Reserve Bank of Atlanta

Mr. Young, Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Messrs. Coldwell, Garvy, Noyes, and Ratchford, 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. Hilkert, First Vice President, Federal Reserve Bank of Philadelphia
Mr. Hickman, Senior Vice President, Federal Reserve Bank of Cleveland
Messrs. Eastburn, Baughman, Jones, Parsons, and Tow, Vice Presidents of the Federal Reserve Banks of Philadelphia, Chicago, St. Louis, Minneapolis, and Kansas City, respectively

Mr. Willis, Economic Adviser, Federal Reserve Bank of Boston
Messrs. Holmes and Stone, Managers, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta
Mr. Runyon, Economist, Federal Reserve Bank of San Francisco

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on July 11 and August 1, 1961, were approved.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period August 1 through August 16, 1961, and a supplemental report covering the period August 17 through August 21, 1961. Copies of these reports have been placed in the files of the Federal Open Market Committee.

Mr. Rouse presented substantially the following statement in supplementation of the written reports:

As indicated in the written reports, the money market has been firm during the greater part of the period since the last meeting, largely in reflection of a persistent tendency for free reserves to concentrate in country banks. In the past few days the money market has eased as free reserves increased, and the market may ease further--despite our large sales of yesterday--if country banks move large amounts of funds toward the money centers with the approach of their reserve settlement date tomorrow.

The market has been influenced by the same background factors that were affecting the market at the time of the last meeting. The major influences continue to be rising business activity and the prospective budgetary deficits associated with the accelerated defense program. These factors, together with the reduced free reserve levels of the August 2 and August 9 statement weeks--due, as you will remember from the weekly reports, to the necessity of dealing with unmanageable numbers--led to a feeling in the market that the System may already have made at least a slight move away from the degree of ease that had been maintained in recent months. This feeling, which was partly reversed by the appearance of free reserves of $547 million last week, in turn played a role in the increase in yields that occurred during the period. In the case of three- and six-month Treasury bills, these yield increases amounted to about 20 basis points. The average rates in yesterday's auction, for example, were 2.50 per cent and 2.79 per cent, against average rates of 2.30 and 2.56 three weeks ago. Incidentally, dealer awards of six-month bills in the auction yesterday amounted to only $27 million as a large New York bank won $250 million of the six-month issue on a bid at a single price. Dealer awards of the three-month bills were about normal at $342 million.

Looking ahead, there will be a heavy schedule of Treasury financing over the balance of the year. The Treasury is considering a $2 billion cash issue shortly after Labor Day, and is also contemplating an additional cash issue toward the end of September. Also, the possibility of an advance refunding in this period cannot be ruled out. In October, the Treasury will have to roll over the $1.5 billion maturing annual bills, and it looks as though an additional $500 million cash will be raised at that time. The Treasury will announce tomorrow that it will raise an additional $100 million in the regular bill auction next Monday (thus bringing the total amount of that auction to $1.7 billion); and it is likely that the Treasury will raise an additional $200 million through two regular weekly bill auctions in October, which will bring all issues maturing within three months to $1.7 billion. Finally, the Treasury will be announcing in late October the terms of its November refunding, and following that there will be another billion or two of new cash to raise before the end of the year.

The 1/8 per cent increase in bankers' acceptance rates last Thursday reflected in part expectations on the part of dealers in acceptances of an increase in the supply of these obligations that would be coming into the market. With summer loan demand not especially robust, and with Treasury bill rates well below acceptance rates earlier in the summer, there had been a tendency for accepting banks to hold the bills they had accepted as investments rather than to sell the bills into the market (indications are that the amount of acceptances involved is about $750 million). There have been recent indications, however, that these banks will move their acceptances into the market as their loan demand picks up, and the increase in supply from this source would come at a time when the volume of acceptances would be increasing seasonally in any case.

Thereupon, upon motion duly made and seconded, the open market transactions during the period August 1 through August 21, 1961, were approved, ratified, and confirmed.

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

You will recall that at the last meeting I reported that it was too early to tell whether the heightened international tensions, and the steps proposed by the Administration to deal with them, might impair what seemed otherwise to be an exceedingly satisfactory recovery. Most of the statistical information that has become available since the last meeting still relates to the period prior to the President's July 25th address, and, of course, the recent developments in Berlin. It confirms that recovery was proceeding at a rapid rate, but generally without overtones of an inflationary character.

Despite its rapid increase to a new record rate of 112 in July, production remained well below capacity levels. Both the consumer and wholesale price indices were generally steady, and even sensitive industrial materials leveled out after a 2-1/2 per cent rise early in the recovery period.

New orders at durable goods manufacturers rose further in July, especially for aircraft and electrical machinery. Sales also rose, but remained below new orders, thus adding to the backlog of unfilled orders.

Further information on labor market developments confirms the earlier observation that employment has been expanding rapidly by any historical standard, but that even so the level of unemployment has remained near the recession high.

Total retail trade was down 1 per cent in July, due largely to a 5 per cent decline in the automotive group, which is probably related to the earlier model changeover this year.

Consumer spending for housing and durable goods as well as consumption items and services has, of course, risen as the recovery has progressed, but it has shown less than a typical upsurge for this stage of the cycle. For example, while industrial production has increased 10 per cent from the February low, retail sales are up only 1-1/2 per cent. Furthermore, buying intentions, as measured by surveys taken in mid-July, appeared to be relatively weak. The Board-Census survey showed some slight improvement in auto demand, as compared to a year ago, but nothing of substantial proportions, while expressed intentions to buy houses and most household durable goods continued to lag behind relatively depressed year-ago levels.

One independent survey, of untested reliability, has shown a dramatic decline in combined buying plans for housing and durables throughout the whole first half of 1961, to well below year-ago levels.

This absence of strong demand in any important area of consumer expenditure is in sharp contrast to the two preceding recoveries. You will recall that in 1954-55 the strong surge in automobile purchases by consumers played a key role in the early stages of recovery, and that residential housing played a similar part in the 1958 recovery.

It is especially difficult to generalize about an area where the normal problems of economic analysis are overlaid with special conceptual difficulties, as they are in the case of consumers' attitudes toward spending and saving. Nevertheless, this area commands attention in the present circumstances. All of the evidence seems to suggest that, up to the present, consumers have been willing--in fact, even anxious--to devote a large part of their increasing incomes to saving, in the form of debt repayment and the acquisition of financial assets, rather than increased current consumption or the accumulation of physical assets.

There is evidence of this development in the flow of funds accounts. Most striking perhaps is the growth in so-called fixed value redeemable claims--savings accounts, savings bonds, and the like. Using rough, but conservative, estimates for the second quarter of this year, it appears that for the twelve months ended June 30, consumers' holdings of such claims increased by over \$17 billion--\$8.2 billion in the second half of 1960, and \$8.9 billion in the first half of this year. This far exceeds any previous twelve-month period on record.

At the same time, while they are above the very low rate of growth in late 1957 and 1958, consumers' financial liabilities have expanded less than in other recent periods. The net increase in financial investment for the consumer sector; that is, their acquisitions of assets less their increase in liabilities, was about $3 billion in the first half of the year. While there is, of course, no single or simple explanation of these developments, the fact that the $17 billion increase in fixed value redeemable claims that I mentioned is twice the amount for the preceding twelve months suggests the extent to which the inflationary psychology of late 1959 has been liquidated.

It is an interesting sidelight that our data also do not seem to support the commonly held view that there has been a substantial increase in holdings of equity securities by the public at large in recent months. Our estimates are too rough to be precise, but it appears that the increase in outstandings was just about matched by the increase in institutional holdings.

For whatever reasons, people in the United States do not seem to have been behaving as if they expected inflation, up to the end of July--and there is not yet any evidence that they have shifted their behavior since then. The one private intentions survey I mentioned does show a rise in buying plans since the President's address, but not to extraordinary levels. Department store sales are likely to be down, if anything, from July to August--although up, of course, from a year ago. There is no doubt that expectations of inflation can be created, and created quickly, but it does not seem that the deed has yet been done.

Mr. Holland presented the following statement on financial developments:

As has already been indicated, the signs of business recovery continue to be strong and broadly spread throughout the economy. Thus far, however, this renewed business expansion has had little counterpart in accelerated demands upon the financial system. Loan demand, while perhaps not quite as soft as in some earlier months, has nevertheless lacked the vigor usually associated with this stage of cyclical expansion. Such bank credit expansion as has occurred has been chiefly in purchases of Federal and municipal securities, the usual recessionary pattern. The trend of the money supply has been phlegmatic at best, with net deposit expansion being channeled by the public into time deposits. About the only aspect of financial markets which has responded to recent economic events has been the pattern of interest rates, and even here the response has appeared to be more a product of adjustments in expectations than of change in current needs for, and supplies of, funds.

Since the last meeting of the Committee, the predominant movement of yields on U. S. Government securities has been upward, as the market continued to reappraise the interrelated implications of the improved economic outlook, the higher defense expenditures triggered by the Berlin situation, and the anticipation of new and larger Treasury borrowing. Such upward rate movements were reinforced, particularly in the short end, by the reduced free reserve pattern of the banking system in the first part of August. Toward the middle of the month, however, first in longer-term issues and then in the short-term market, some buying interest appeared and yields recovered a portion of their preceding advance. In part, this recovery may also have been technical. In any event, it was fostered by the easier bank reserve position which became apparent after midmonth.

Other securities markets were more quiet in tone, with yields on seasoned corporate and municipal issues showing modest net changes. New issue flotations in the corporate market were quite light, as is often true in August. In the municipal market, what first appeared to be a fairly large volume of financing scheduled for the month assumed more moderate dimensions with the cancellation of more than half of the large California package of bond issues.

At banks, both business loans and total loans declined less in July than in some earlier years, but in part this reflected the weaker increases during the preceding June, with its tax date and other special financial influences. Over June and July combined, total bank loans were up only $400 million, the smallest rise in recent years, while business loans appeared unchanged net. This lack of net change in business loans did offer a slight contrast to the small net contraction reported in the summer months of the recession years of 1958 and 1960. Something of this same pattern also has appeared to continue in the city bank reports for the last three weeks, with the advent of the period of seasonal rise in these credits. Business loans were up some $200 million, substantially more than last year's recession-slowed advance, although less than in the same season of earlier years. Sales finance companies borrowed a substantial sum from city banks during these weeks. This increase was more than offset, however, by large retirements of securities loans, both those secured by Governments (which had bulged over the Treasury financing dates) and those for purchasing and carrying common stocks and other securities.

City bank holdings of Government securities have declined since late July, and banks have sold bills amounting to roughly one-third the amount taken up at the time of the sale of tax anticipation bills last month. On the other hand, average portfolio maturities of these banks were lengthened appreciably by their sizable exchange of maturing issues for the over one-year notes offered by the Treasury on August 1. Over-all, bank credit at city banks has declined since the last week in July. This has been matched by drops in both privately-owned and Government demand deposits. Time deposit totals have shown some further advance thus far in August.

The daily average money supply, seasonally adjusted, is estimated to have dropped $100 million in the second half of July and an additional $400 million in the first half of August. This decline brings the money supply back roughly to the average level for March and only 1-1/2 per cent above the figure for a year ago. Time deposit totals were estimated to have increased as much, seasonally adjusted, in the first half of August as the money supply declined. This continues the strong growth trend shown in the time deposit component in recent months, and imparts an annual rate of growth on the order of 5 per cent to the total of money supply plus time deposits since last winter.

Because of the sharp parallel recovery in national output, however, both the ratios to GNP of money supply and money supply plus time deposits have undergone declines.

The recent contraction in the money supply developed in conjunction with reduced ease in bank reserve positions. Free reserves ranged downward toward the $400 million mark in the first two reserve weeks in August, before recovering to levels in the $550-600 million range in the last statement week and the current week. The reserve decline of early August was partly a reflection of reserve absorption to support deposits created in the Treasury cash financing, and partly also a reflection of large market drains of unforeseen dimensions and of market additions to funds which did not materialize in the full amounts anticipated and allowed for in System operations. As a consequence, available reserves declined even though System open market operations supplied a net $734 million of reserves, on a weekly average basis, to the market over the last four weeks. Data for the last complete reserve week of August show actual reserves falling over $150 million short of the total projected in the staff memorandum as necessary in order to meet seasonal needs, to cover Government and interbank deposit changes, and to provide an annual growth factor of 5 per cent in the reserve base.

The weeks immediately ahead of us will call for heavy injections of reserves by the System. Market factors are expected to drain large amounts of reserves in the next two weeks, including the Labor Day holiday, necessitating net additions of Federal Reserve credit of about $575 million to maintain free reserves unchanged. This reserve injection by the System will need to be reversed in the mid-September weeks. Required reserves are expected to increase substantially later in September, reflecting net expansion in both private and U. S. Government deposits. Smaller net increases are projected for October and November, followed by the usual large expansion in required reserves in December.

Total reserves would need to increase by about $1.1 billion from now to the end of the year to provide for projected seasonal increases in required reserves plus a 5 per cent expansion of private deposits and the maintenance of excess reserves at around $600 million. This increase would include $155 million needed to make up the short-fall of current total reserves below projected levels. During this period market factors may be expected to alternate between supplying and draining reserves in large volume, although they may supply about $400 million of reserves on balance through the end of the year. Most of the net expansion in reserve needs will require System action, as is usual in this part of the year.

The question arises as to the ability of the market to absorb System purchases of securities in the dimension implied by these projections without a resulting undesirably low bill rate. Some offsetting upward pressure in the short-term rate structure will be created by prospective Treasury financings. Earlier this summer the Treasury had announced that its financing for the remainder of the calendar year would range between $5 and $6 billion. The latter figure now appears to be more appropriate and could be exceeded, inasmuch as present projections suggest a Treasury cash deficit of as much as $9 billion for fiscal 1962. Present tentative plans call for the Treasury to provide for its remaining 1961 cash needs in several trips to the market, as Mr. Rouse has outlined, beginning with an announcement shortly after Labor Day.

As this prospective schedule suggests, the Treasury will be contributing some pressure upon the short-term market this fall. But this Treasury schedule poses other problems for the Federal Reserve, since it provides only a few short gaps, chiefly in October and December, during which System policy could be altered without risking adverse consequences for debt management operations. Even the range for immediate adjustments in reserve availability is limited, since it would be desirable to move into an "even keel" reserve position by early September.

Thus, in contemplating immediate reserve recommendations, attention must be given as well to shortly attaining levels of reserve availability which would be appropriate for some span of time. Looking ahead to the fall, thoughts of appropriate monetary policy for that stage of economic recovery may be influenced by anticipated lags in the effect of monetary actions. Depending upon the strength of expected developments, the possibility might be raised of early monetary action, in order to forestall the ramification of maintained monetary ease and prevent its spreading well beyond the spans of time for which it would be regarded as appropriate. On this point, however, it might be noted that the documented evidences of lags in monetary effects pertain primarily to markets for capital goods, in which considerable slack for future expansion currently exists. Lags are much less apparent in the financial markets, and probably least apparent of all in the short-term interest rate structure. If, therefore, the concerns of monetary policy through the end of the year are with potential problems which could be dealt with by upward short-term rate adjustments, anticipatory actions in this direction by the System would not seem to be required.

Mr. Young presented the following statement regarding the United States balance of payments and related matters:

Major international financial markets continue in a highly sensitive state, reflecting in part investor disquiet over the Berlin crisis and in part a lack of firm confidence in the future relation of international currency values.

The Berlin crisis generated a large flow of funds from Germany into other currencies. The main beneficiaries of the outflow of funds were not the reserve currencies but rather Switzerland, the Netherlands, France, and Italy. The most recent news from European markets indicates some quieting of financial fears. This is attributed to market response to last week's show of strong U. S. position, with the concurrence of other NATO powers, regarding a Berlin settlement.

The British program of financial retrenchment has apparently halted the flight of funds from sterling, but there are few signs yet of a large reflow to London. While the spot pound has strengthened some, the forward discount on sterling has widened, thus offsetting the incentive effect of the higher short-term yields in London. British bond yields, which rose sharply following the discount rate increase, have since declined moderately but hold at a level close to that for Treasury bills. The high British bond yields, it is reported, have been attracting some, though not large, foreign buying.

Recent developments regarding the U. S. balance of payments can hardly be described as cheering. Preliminary data on gold and dollar transfers to foreigners for July would indicate a July payments deficit about twice the monthly rate of deficit for the second quarter. The July deficit reflects in part temporary and seasonal influences, but over-all payments tendencies would suggest a real worsening of the U. S. deficit position.

Imports, as shown by June data, are beginning to rise, as they should be expected to do in a period of vigorous cyclical recovery. On the other hand, exports in June were up only a little and there is small hope for much rise above recently prevailing levels over the balance of the year. With the trade balance thus tending to deteriorate, the main area for compensating payments adjustment would have to be the long-term capital outflow. Balance-of-payments data for the first two quarters of the year fail to show any contractive tendency in the long-term capital outflow, although such contraction might be expected on cyclical grounds. Currently available data, moreover, give no indication that this outflow is presently tending to abate.

It may be concluded, therefore, that the short-run outlook for the U. S. balance of payments is one of continuing and somewhat worsening deficit, with the deficit for the whole year possibly in the neighborhood of $2 billion. In addition, payments flows among European nations are currently altering the ownership of foreign dollar deposits, particularly in the direction of ownership likely to convert them into gold.

In the light of these circumstances, and barring uncertain repercussions of an unforeseeable mishap in overcoming the Berlin crisis, we must be prepared in the months ahead to see some further reduction in the U. S. monetary gold stock. A resumed gold outflow of moderate volume should not be alarming as long as renewal of large outflows of volatile funds is avoided and as long as there remain good grounds for belief that real progress is being made towards better basic equilibrium in international payments.

Mr. Treiber presented the following statement of his views with respect to the business outlook and monetary policy:

On the domestic scene, the economy continues to move forward. Industrial production has attained a new high. Consumer spending is moderate in the light of record personal income. So far, prices have continued relatively stable, but there are a few signs of upward pressures. We are moving from a period of recovery into one of expansion. Nevertheless, there is a good deal of unused resources, both men and plant capacity, and the high level of unemployment continues to present a challenge.

Bank credit has been expanding moderately with some signs of renewed strength discernible during the last week or so. Business loans made by banks this year have been offset by a larger than usual amount of repayments, presumably as the result of the sale of large amounts of refunding capital issues by the borrowers. Viewed in this light, the record of business loans by banks has been good. We may expect substantial bank credit expansion during the remainder of the year not only because of the increased seasonal need for bank loans but also because of large borrowing by the Federal Government. The general liquidity position of the economy is good.

In the period since the last meeting of the Committee the money market has been less easy than in preceding periods, but it has not been tight. In the preceding period the unexpected confluence of several market factors brought about a condition of greater ease than was expected. Conversely, in the last couple of weeks several market factors worked in the opposite direction more than was expected.

More Federal Government spending seems to be in prospect, throwing the budget more out of alignment and requiring more Treasury borrowing. People are raising questions here and abroad as to the potential danger of the prospective deficit spending to economic stability and confidence in the dollar. As greater deficit spending further stimulates the domestic economy, there will be less need for a policy of monetary ease.

Within the next few weeks, possibly before the next meeting of the Committee, the Treasury may announce new cash borrowing and perhaps also an advance refunding. The latter would afford the Administration an opportunity to underline its concern for fiscal responsibility in a period of a rising deficit. Since the Treasury will need to borrow shortly, it is desirable to avoid upsetting developments in the securities markets in the next few weeks.

Our international financial position has been deteriorating. Our balance of payments is worsening. In the first quarter of the year we did well, but since then the deficit has progressively widened despite heavy outflows of funds from London. Our trade surplus has declined as exports have fallen off and imports have increased. With further economic expansion at home, imports are likely to rise further. We have made little progress toward a long-run solution to our balance of payments problem. Failing that, we continue to be vulnerable to shifting winds of sentiment which could eventuate in a substantial demand upon us for gold.

The demand for gold has been increasing and the price of gold has been rising gradually in the London gold market. The price at the fixing on Friday was the highest since February. Some of the demand is due to international political tensions. The aggravation of these tensions will likely raise the demand for gold still further. Climbing gold prices stimulate speculation. Some European central banks are concerned about the possibility of a run-up in the price of gold such as occurred last October. They fear that such a development would be interpreted as a first step toward the devaluation of the dollar and other currencies. People abroad are watching carefully developments in the United States. They are watching our monetary policy and fiscal policy, and especially the way in which we handle the Federal deficit. It behooves us as a nation to do everything we can to promote sound policies and to demonstrate to the world our resolution in this respect.

The domestic business and credit situation still calls for a policy of monetary ease. We must be alert, however, to the possibility that stepped-up defense spending and related expansion in private spending may place excessive pressures on the price structure and endanger economic stability. Large wage increases growing out of wage negotiations now under way or in the offing could also put pressure on prices. The international picture also calls for continuing alertness. We should seek to avoid any substantial decline in short-term interest rates.

We believe that in the coming period the System should continue to follow about the same monetary policy it has in the last period. Doubts should be resolved on the side of less ease. The so-called "feel" of the market is especially important. It would seem desirable that the effective rate on Federal funds be a bit below the discount rate, ranging between 2 per cent and 3 per cent, perhaps averaging about 2-1/2 per cent. We think that it is desirable that the rate on three-month Treasury bills continue within the range of 2-1/8 to 2-5/8 per cent which has been in existence for about a year. In the light of both domestic and international conditions it is desirable that the rate be in the upper part of the range.

We believe that the authority to engage in transactions in longer-term securities should be continued and that the discount rate should not be changed. At the last meeting of the Committee it was suggested that the time was approaching when a change in the directive would be in order. As we move now from recovery into expansion, we think a change would be appropriate, and we suggest that clause (b) be revised so as to read as follows: "to encouraging credit expansion so as to promote fuller utilization of resources, while guarding the international position of the dollar."

Mr. Johns commented that Mr. Holland had covered in such detail the facts pertaining to the behavior of reserves, total and otherwise, in the recent past as to permit proceeding at once to what seemed a reasonable conclusion; namely, that total reserves had not been expanding rapidly enough to allow for the continued expansion of total deposits at about a 5 per cent annual rate. The rate of expansion of total reserves had been so slight recently that bank credit expansion had been dependent to some extent, perhaps primarily, on a decline in excess reserves of about $80 million in the past four weeks. He would not want to depend on a further reduction of excess reserves as a basis for continued deposit expansion; therefore, he would suggest that the Committee be diligent about increasing total reserves in an adequate amount to continue deposit expansion at at least the rate that had prevailed since March. He had some doubt whether it could be assumed that the rate of expansion of time deposits would long continue. If this doubt proved valid, he thought it was unquestionably true that the System would have to provide more reserves in order to support an expansion in demand deposits, and there had been no such expansion in recent months. In the circumstances, he was inclined to recommend that total reserves be increased about in line with the staff projection set forth in the memorandum that had been distributed under date of August 18, more particularly in the column of total reserves projected found in table 3 of that memorandum. This would include a $15 million weekly increment in order to provide for expansion in demand deposits adjusted and time deposits at an annual rate of 5 per cent, and it would also make up the short-fall of total reserves that had occurred recently. With alternating periods of about two weeks each in which the projections contemplated the necessity of buying heavily, then selling heavily, and then buying heavily again, it appeared that there should be possibilities of catching up the short-fall without dire repercussions in the market, and he would like to see this done.

Mr. Johns said that he would not recommend a change in the discount rate at this time. Although he had not come to this meeting prepared to argue for a change in the directive, he was attracted to the suggestion made by Mr. Treiber and thought it was a good one.

Mr. Bryan said there had been no developments in the Sixth District that seemed worthy of a detailed report at this time. The District seemed to be going along about the same as indicated by the national figures, and in any event only fragmentary new data had become available since the August 1 meeting.

As to the national picture, it seemed that the recovery was going ahead. It also seemed that the $542 million figure of free reserves reached in the most recent statement week was one that would permit credit expansion. However, as he saw it, the situation actually had tightened rather substantially in a couple of the weeks of the past period. He did not believe that at the moment a tightening in the money situation could be justified; therefore, he would suggest aiming for free reserves between $550 and $600 million. Such a range, he thought, would be compatible with a more than seasonal increase in the total reserve figure.

Mr. Bryan said he saw no reason for changing the discount rate at this time. As to the directive, he would have no objection to changing it in the manner that had been suggested, but he was not sure there was any real point in making such a change.

Mr. Hilkert reported that the pace of recovery in the Third District had quickened in recent weeks. Construction contract awards were now moving up at about the same rate as nationally, steel production had increased, along with output in most lines of manufacturing, and goods were selling well at retail. In July, total bank credit at District banks increased, with loans showing no significant change but investments rising. More recently there had been little change. Reserve positions of District banks were easy. Reserve city banks had been net sellers of Federal funds, and country bank borrowing at the discount window continued to be small.

Mr. Hilkert's appraisal of the national business picture was that, in brief: (1) the rise in business activity was broad-based and was continuing at a good pace; (2) excess plant capacity, a still large number of unemployed, and keen competition, both domestic and foreign, provided fairly strong restraint on any important upward movement of the price level; and (3) although evidence of inventory building and anticipatory buying was not yet seen, the stepped-up defense program and growing international tension had added fuel which, if sparked by a resurgence of inflation psychology, could lead to a boom and rising prices.

Mr. Hilkert expressed the view that recent business and financial developments did not call for any change in monetary policy for the next three weeks. Rising market rates and lower free reserves indicated some tightening in the past three weeks, and he would favor maintaining about the same general degree of ease as had prevailed during this period. More specifically, he would like to see the Federal funds rate comfortably below the discount rate, market rates at about the present level, and, if consistent with these two objectives, reserve positions in the same general range as during the past three weeks. He would favor continuation of the authority to conduct open market operations in intermediate and longer-term securities. With the recent rise in intermediate and long-term rates, it appeared that it might be desirable to supply some of the reserves, when needed, through purchases of the longer maturities. He would not favor changing the discount rate nor would he suggest a change in the directive at the present time.

Mr. Hickman reported that after some hesitation caused by vacation shutdowns in the Fourth District, most economic indicators now showed a resumption of the economic expansion evident since last spring. Steel output was back by mid-August to the highest levels since mid-June, and outbound freight shipments at Pittsburgh and Cleveland had recently moved ahead of year-ago figures, whereas they were still lagging for the nation as a whole. As a result of warm weather and stronger industrial demand, electric power output had risen sharply, and on a seasonally adjusted basis had averaged higher in major centers than at any time this year.

Recent changes in bank credit in the District had been dominated by the July Treasury financing, as banks continued to liquidate bills acquired in the last week of July. Banks generally appeared to be in an easy reserve position, as indicated by the low level of borrowings from the Reserve Bank, although net purchases of Federal funds had increased in recent weeks. Commercial and industrial loans of weekly reporting banks expanded by about $12 million in the three weeks ending August 16, about twice the expansion indicated in the comparable period a year ago, but the general belief among bankers in the District was that the expansion this year will be no more than seasonal.

Despite recent improvements, Mr. Hickman said, there was widespread evidence of excess capacity and high-level unemployment in the Fourth District. Since the District is dominated by the heavy industries, output usually contracts more sharply during recessions than in the nation as a whole, and this had been true in the recent recession. Similarly, the recovery from recession lows is usually sharper than in the nation, since the District starts from a lower base. The recent advance in the Fourth District had conformed to this pattern, but there was still some way to go before previous cyclical peaks were regained.

Using 1957-59 as a base, steel output was still about 5 percentage points below the national average, and was lagging particularly in the Youngstown and Pittsburgh areas. Manufacturing employment also had exhibited the cyclical sensitivity of the District and the slower rate of recovery. Manufacturing employment declined by about 12 per cent between May 1960 and March 1961, against a decline of only 6 per cent nationally. By June 1961, the United States had regained about half of the decline, while Fourth District employment had recovered only one quarter.

Despite the lagging pace of the recovery thus far, Fourth District economists and businessmen were optimistic for the fourth quarter and looked for further improvement in the first half of 1962. Steel ingot production (20 million tons in the first quarter of this year and 25 million tons in the second quarter) would exceed 25 million tons in the third quarter, a good showing in view of the seasonal weakness normal for this period, and would come close to 30 million tons in the fourth quarter, with the greatest strength exhibited toward the end of the year. There was talk of a price increase in the steel industry after wages were adjusted upward on October 1, but feelings were mixed as to whether a general upward price adjustment could be made to stick at this stage of the cycle. It was perhaps indicative that the automotive industry was still buying steel on a hand-to-mouth basis.

In conclusion, Mr. Hickman said that District automotive economists continued to look for production and sales of U. S. built cars of about 5-1/2 million this year, with total sales (including foreign) of 5.9 million; and they were predicting total sales in 1962 of about 6.5 million, roughly comparable to the performance in 1959. The higher level of disposable personal income projected for 1962 was a plus factor for the automotive industry, but sales expectations were tempered somewhat by the relatively small number of cars three to five years old now on the road. Cars in that age group are the best candidates for trade-ins, and the small number now in this age group might retard sales next year.

Mr. King presented the following statement with regard to System operations in longer-term securities:

> It appears that the System has, if for the present only, accomplished its purpose of helping slow the gold flow through purchases of longer-term securities instead of bills. The bill rate has remained slightly above two per cent, and I believe our departure from the "bills only" policy helped reduce downward pressure on the bill rate. This being the case and with the past three weeks' upward trend of the bill rate in mind, it seems this might be an appropriate time to cease operations under the special authorization to the Manager of

> the Account. I do not mean that I would terminate the authorization now, nor does this imply that it might not be reactivated within the next few weeks or months, possibly for selling as well as buying.
>
> As an advocate of a more flexible approach than the "bills only" policy afforded, it seems to me that we have no need at the present time to supply reserves through purchases other than bills.
>
> Disengagement at this time would in no way repudiate our policy of the last six months, nor would it make us appear unsure of ourselves. Rather, it would indicate that we are decisive and have no fear of being bold when circumstances warrant boldness. What better evidence of flexibility could anyone have than to be flexible in two directions instead of only one?
>
> I believe it would not be desirable to make an announcement if this action is taken. If we did, it might be necessary in a few months to make another announcement that we were re-entering the long-term market to buy or to sell. To state now that we are getting out and to possibly reverse our statement in the next few months would be difficult for many to understand. Our withdrawal would become obvious in a matter of weeks, and I believe it would be better to let the financial community draw its own conclusions. Action in this manner should have a healthy effect on our domestic financial community as well as on those abroad who have an interest in our decisions.

In further comments, Mr. King said the rise in the bill rate and the tone of the market as reflected by the Federal funds rate suggested somewhat less ease than he believed desirable. What he had believed the Committee was intending to do was to stay where it was, but in fact it had moved toward less ease. His vote would be to move back to about the degree of ease that prevailed during July and to resolve doubts on the side of ease. A level of free reserves ranging from $500 to $600 million would seem to him appropriate. He would not recommend a change in the discount rate at this time.

As to the directive, Mr. King indicated that he would be inclined toward no change at this time, even though the suggested language might be perhaps more appropriate to the existing circumstances than the present language. The figures, he noted, did not suggest that there had been any great success in meeting the objective, as stated in the current directive, of encouraging the expansion of the money supply. However, he questioned whether the omission of the pertinent words would serve any particular purpose at this stage. He would be inclined to leave them in the directive rather than to have readers of the policy record speculate that the System had given up on that score.

Mr. Robertson expressed the view that the recent record of the Committee in providing reserves had hardly been in keeping with the existing directive, which provided for encouraging expansion of bank credit and the money supply. Therefore, he felt that the directive should be changed or, in the alternative, that the Committee should change its policy and its instructions to the Desk. He had found himself concerned, upon returning to his office yesterday, about the degree of tightness that seemed to have developed in the first part of August, with free reserves averaging $401 and $435 million, respectively, in two of the statement weeks. When he reviewed the record, however, he found himself unable to criticize the Desk; instead, he thought the record indicated that the Committee ought to be more specific in its instructions to the Desk. Also, he realized that some of the tightening had been caused by conditions that could not be completely controlled by the Desk. Still he felt that the amounts of reserves that had been supplied were inadequate to meet the present directive or to meet the needs of the economy.

Mr. Robertson suggested that the System should be acting now, while it still had latitude for action, to increase the money supply. Because of the Treasury operations, there would only be short periods in which the System would be uninhibited during the balance of the year. Accordingly, for the next period he would suggest striving toward a level of free reserves from $550 to $600 million. During the first two weeks that would create what he thought would be a condition of ease adequate to implement the existing directive, the suggested directive, or alternative wording that he intended to suggest shortly. During the third week there would be a rise in float. Thereafter, if it seemed desirable, free reserves could be dropped slightly to a level, perhaps in the $500 million range, that could be held during the Treasury financings in September and October and perhaps over the major part of November and December.

Mr. Robertson then suggested, though not with the thought of proposing action at this time, the advisability of keeping watch on developments in the stock market so that margin requirements could be increased, if necessary, rather than to permit any increased activity or speculative tendencies in the stock market to swerve the policy of monetary ease too far toward tightness. He saw no such indications today, but there had been earlier, and he felt that an eye should be kept on the situation.

Mr. Robertson also suggested that care be exercised to see that the international situation did not panic the System into adopting a tighter policy than called for by the domestic situation. At the moment he saw no immediate prospect of inflationary developments; although there were potentials, there continued to be a large amount of unutilized manpower and productive capacity.

As to the directive, Mr. Robertson expressed the view that the time had come to recognize the change in economic conditions since the directive was first adopted. While he was not opposed to the language suggested by Mr. Treiber, he would like to suggest alternative wording; namely, that clause (b) be amended to provide for operations looking toward the maintenance of economic growth and monetary stability adequate to meet the tensions and strains arising out of the prevailing international situation. In making this suggestion, he was trying to indicate the great need to maintain confidence in the dollar and to act in a manner that would recognize the existing strains and tensions. In his opinion, this kind of language probably could not be carried in the directive too long, because tensions and strains vary. However, he felt it was desirable to amend the directive from time to time in the light of changing conditions, whether international or domestic.

Turning to System operations in longer-term Government securities, Mr. Robertson made the following statement:

> I feel compelled to turn again to the issue of our operations in longer-term securities. These operations pose serious problems, and they cannot be resolved by avoiding discussion of them.
>
> Consider the environment in which these operations are being conducted. Interest rates have risen, and prospects for continuing increases in rates are cited in all quarters. In such circumstances it is difficult for the market, even when operating without Government intervention, to carry through orderly adjustments of prices which will keep supply and demand factors in balance. If Federal Reserve purchases of longer-term securities intrude upon these market adjustments, they are likely to hold prices at an unviable level at which the System will be the only substantial buyer.
>
> Around this table, on a number of occasions, critics of the special operation (myself included) have endeavored to express the logic of adverse market effects which could flow from these activities. Let me call to your attention this morning some of the concrete evidences of such ill effects which have begun to emerge.
>
> Some Government securities dealers tell us that it is becoming common practice for them, whenever they are offered longer-term bonds by a customer, promptly to make a corresponding offer to the Desk. By this means dealers check to see if the bonds can be passed to the System, before they themselves will buy any substantial amount. Thus, System Account buying, and the prices at which it is or is not done, have become an immediate market influence.

Statistics reported by dealers indicate that private buying interest in the long-term Government market has shrunk drastically. Buying of over-10-year issues by commercial banks and nonbank investors, which was averaging nearly $10 million a day in the latter part of 1960, dropped to a $7 million average in the first quarter of this year, to under $4 million in the second quarter, and to only $2.4 million thus far in this quarter, barely one-fourth of the rate less than a year ago. In the weeks around the turn of this month, precisely when the last System purchases of any consequence were made in this area, total purchases of over-10-year issues by nonbank investors dwindled to an average of only $100,000 a day. To be sure, current figures could be expected to be lower than average because of the season of the year and the stage of the cycle. However, after all reasonable allowance for these factors is made, I think one still finds the decline in investor demand proceeding to such low levels as to display a baleful influence from Operation Nudge.

If there were some major offsetting advantages being obtained through our purchases of long-term securities, perhaps there would be some grounds for arguing that the Committee should risk the ill effects I have mentioned. But there are no clear economic gains which are being realized. System purchases of long-terms in recent months have been so modest as to have had no reserve effects of consequence. Our entire special purchases of issues maturing in beyond 10 years have aggregated only $79 million. If, alternatively, we had endeavored to provide this amount of reserves through bill purchases, it is inconceivable that any perceptible further downward movement in bill rates would have resulted; yet this is the rationale on which we undertook the special operation.

In summary, our continuing to buy dribbles of long-term issues cannot be justified on the grounds of the balance-of-payments situation, the need for additional reserve inlets, or any salutary influence exercised on the market. I think we would be well advised to recognize this evidence produced by our own operation, and accordingly to withdraw the special authorization to the Account Management to deal in long-term securities.

Although I still feel that prompt cessation of the whole special operation would be the wisest course, I am aware of the desire on the part of some members of the Committee that disengagement be a gradual process. In keeping with that desire, I suggest that the Committee begin by returning to the initial standard set last February in barring Account operations in securities maturing beyond 10 years. It is to operations in the over-10-year area that the arguments I have expressed earlier apply most strongly. Avoiding future System purchases in this truly long-term sector would be a good beginning, and it would lay the foundation for progressively further limitation later as, in the Committee's view, conditions make it appropriate.

Mr. Mills suggested that the Open Market Committee hark back in its thinking to its fundamental responsibility--providing an adequate base of credit availability to the commercial banking system--and that it avoid straying off into other areas and citing objectives on extraneous points as the criteria for policy-making. He noted that in the past a tendency to tie policy judgments to some specific level of positive or negative free reserves had been criticized, and it seemed to him that at the present time the Committee should think twice and avoid taking a new sighting based on some projected level of total reserves as the correct answer to policy-making. It also seemed desirable to remember that an occasional tightening in the market should not throw forebodings and fears into the policy-makers in situations when the supply of reserves remains sufficient to develop and preserve an adequate base of credit availability. He suggested that in such circumstances the Committee should not be either impatient or apprehensive that it had fallen into error and should remember that there is a lag in time before the market can become acclimated to a lower reserve position. The policy considerations that would tie into the kind of reasoning he had outlined were set forth in the following statement, which Mr. Mills then read:

> It is never easy to foresee economic developments from a summer mid-point of seasonal slackness in activity. Despite that fact, a fair estimate of the present position of the economy might be that to date the strength in the recovery movement has been more on the side of production than consumption and, therefore, the test to be met during the fourth quarter of the year is whether enough economic power has been generated at the level of production to carry over into a measure of consumption sufficient to move the expanding plant output into final hands and in that way to insure lasting recovery. A Federal Reserve System monetary and credit policy suitable to this kind of economic situation would supply the commercial banking system with sufficient reserves to permit the further expansion of commercial bank credit. Such a policy, in supplying only enough reserves to permit an expansion of commercial bank credit truly evoked by natural market demands, would avoid the mistake of forcing reserves onto the commercial banks in a superfluous quantity that would result in dragging down the interest yields on U. S. Treasury bills at a time when international considerations demand a Treasury bill rate high enough to hold foreign investment funds in the United States. Moreover, oversupplying reserves at a time of international financial tensions could lead to the impression abroad that the United States was embarking on inflationary programs that would tend to weaken the purchasing power of the dollar. Adoption of the policy recommended would also take into account the fact that under present conditions, the rapid growth occurring in time deposits must be related to the lesser rate of growth that has occurred in the money supply as conventionally defined. The present justification for taking time deposits into partial context with the conventional money supply is that the growth in time deposits is in part a reflection of a slack demand for commercial bank credit, which demand, if it should come to life rapidly, would be accompanied by a conversion of time deposits into more highly charged economic factors having an inflationary bias. It is consequently advisable to combine in view the

growth of the money supply and time deposits as being the foundation on which a massive expansion of commercial bank credit has been built in the past year, whose structural components, in being susceptible to variation and exchange as between the commercial banks and other lenders, are fully adequate to accommodate the growth needs of the economy.

In essence, the kind of monetary and credit policy now called for is one of moderation that will encourage reasonable commercial bank credit expansion and, in so doing, avoid the mistakes of the recent past in overdoing both the supplying and withdrawing of reserves which so disturbed the state of the money markets. To allow reserves to be supplied inordinately at this time would be inadvisable for the reasons previously mentioned, and also because the appearance of a high level of positive free reserves could lead to investor expectations of a steady rise in the prices of U. S. Government securities which, in turn, could incite harmful speculative activity.

No change is necessary in the discount rate and continuation of the special authority is recommended on the basis that it will be used when practicable to reduce the System Open Market Account's portfolio in securities other than U. S. Treasury bills. It is suggested that subsection (b) in the directive issued to the Federal Reserve Bank of New York be revised to read, "to permitting an expansion of bank credit that will serve as a propelling force to the momentum of economic recovery without producing unstabilizing influences in the field of the foreign exchanges."

Mr. Wayne said that the upward course of business activity in the Fifth District had apparently gained a broader footing in the past three weeks. Employment and man-hours were continuing to rise. In the textile industry, cost increases were expected to create a difficult profit situation this fall, and in anticipation there had been small but general price increases. Thus far, demand seemed strong enough to sustain the higher prices and activity had continued at encouraging levels, although this was due in part to Government buying and the placing of orders in anticipation of price rises. The lumber industry seemed rather pessimistic, but a rising level of construction contract awards was noted. In a recent check, Reserve Bank contacts commented favorably on such items as manufacturers' orders, shipments, the trend of profit expectations, and retail trade. In summary, the Bank's contacts were generally optimistic about the outlook for the remainder of the year.

Continuing, Mr. Wayne said that business and other loans at District banks had been unusually strong in the past three weeks and that the agricultural outlook was for further improvement. Early sales of tobacco were marked by price increases above last year. District banking developments, other than as noted previously, had been fairly routine, with gross loans following about the same pattern as in 1958 and investment portfolios moving slightly downward. The larger banks had continued to be heavy sellers of Federal funds and there was little use of the discount window.

Turning to policy, Mr. Wayne commented that developments of note had occurred in two areas. First, the balance-of-payments position had shown further deterioration. Second, there was the substantial increase in short-term rates, especially the three-month bill rate. Although recognizing that monetary policy could make only a limited contribution to the solution of the balance-of-payments problem, Mr. Wayne noted that the System must be alert not to aggravate the situation. The market causes of the sharp rise of interest rates were not entirely clear, but possibly the situation reflected a misinterpretation of System policy by the market. The relatively sharp drop in free reserves in the early part of the month, which reflected mainly unanticipated and uncontrollable market factors, seemed to have been interpreted by the market to mean that the System might be reducing the degree of ease. Perhaps it was only natural that the market should be looking carefully for such evidence at this time. In any event, however, the condition could feed upon itself unless System actions in the weeks ahead clearly indicated no reduction in the degree of ease.

In Mr. Wayne's view, there was no valid basis for tightening at this particular stage. Retail sales lacked vigor, prices remained quite stable, and business orders showed only normal increases. In the circumstances, he felt that any further rise in short-term rates would be unwarranted, and in fact might be harmful, unless there were more signs of inflationary forces or speculative influences, and he would favor a policy that would not encourage any further increase in such rates. In fact, he would not be disturbed if short-term rates tended slightly downward. It would be necessary to inject a substantial amount of reserves in the near future, and he would be inclined to inject those reserves through the purchase of bills, if possible, unless there was some significant shift in market conditions in the meantime. The staff estimates of reserve needs seemed appropriate to him, and he felt that a level of free reserves around $550 million would be desirable.

After stating that he would not recommend a change in the discount rate at this time, Mr. Wayne turned to the directive and said that he was inclined to endorse the change proposed by Mr. Treiber. He would favor renewing the special authorization covering operations in longer-term securities.

Mr. Tow commented that nonfarm employment in the Tenth District reflects the predominance of nondurable goods employment in the region. The composition of employment was an element of resistance to the recession and led to the prerecession level of nonfarm employment being regained earlier than in the country as a whole. This same factor, however, had resulted in little change in nonfarm employment in recent months--though at a level above that of a year earlier.

The agricultural sector of the Tenth District appeared to be having a rather satisfactory year. Farm cash receipts in the first half of the year were well above a year earlier, but at a much reduced rate toward midyear. Lower cattle prices were one factor in this narrowing of the margin over a year earlier. Another was the rather widespread speculative holding of wheat off the market. The winter wheat crop this year was excellent, even though 4 per cent below a year ago, and crop conditions generally were very favorable in the District at this time.

The performance of the domestic national economy in recent weeks had been very good, Mr. Tow felt, especially when account was taken of price behavior since the beginning of the Berlin crisis this summer. While the direction of economic activity might not be in doubt, the pattern and timing of future developments were more uncertain. The situation would require close watching, particularly as to indications not yet apparent of strong anticipatory response on the part of business and consumers.

Mr. Tow noted that the changes in the level of interest rates since the last meeting of the Committee indicated greater tightness in the money and capital markets. In part, this reflected an expectational response on the part of those markets. It also reflected, however, more restrictive System open market operations, for various reasons already mentioned at this meeting, and it would not appear to him appropriate to add to this restrictiveness at this time. Rather, he felt that the Committee, for the present, should provide reserves for bank credit expansion at a seasonally adjusted rate about in line with the first half of this year. Or, if the statement was made in terms of recent operations or in terms of free reserves, operations should be conducted more nearly in line with the most recent week rather than the two previous weeks. In view of the international flow-of-funds problem, it would seem well to maintain the Treasury bill rate within the range of recent weeks, and in his view purchases of longer-term securities should be undertaken to the extent necessary to maintain the bill rate within that range.

Accordingly, he felt that the special authorization with respect to operations in longer-term Government securities should be renewed, and without restriction as to maturities. No change would appear to be called for in the discount rate. While the directive apparently would need to be changed presently, he did not consider that any particular importance attached to whether the change was made at this meeting or the next. If a change should be made today, he would be inclined to favor the New York proposal.

Mr. Allen said the rapidity of the economic upswing had seemed to him impressive, more so than to those who were saying that this year's rise was about in line with those of 1949, 1954, and 1958. He believed that those judgments understated the vigor of the uptrend. Although he agreed that there was more elbow room in the economy, more potential for expansion, in 1961 than in those earlier years, this did not justify underrating the movement thus far.

To elaborate in terms of the Seventh District on what he had called elbow room, 11 of 23 District centers remained in the "substantial labor surplus" class with six per cent or more unemployed. In the four weeks ended August 12, District department store sales were just even with last year, compared with two per cent higher for the nation. Steel production was running below the June level, although production would increase if auto firms ordered in line with their anticipated fourth quarter production of 1,800,000 cars. A fourth quarter of that dimension would mean total 1961 auto production of 5,600,000 cars, compared with 6,700,000 in 1960.

The automobile labor contracts would expire next week, Mr. Allen noted. The most important information--what the companies would give and the union take--should become clearer soon. As of the contract termination date, August 31, it appeared that about 150,000 1962 models, an average of five cars per dealer, would be on hand. Twice that number, or 300,000, was considered the minimum for so-called proper new car announcements. On August 31 there would be 500,000 to 600,000 1961 models on hand.

Bank credit, as shown by the figures of Seventh District weekly reporting banks, expanded substantially in July, when acquisitions of Government securities and increased loans on securities far more than offset a decline in other types of loans. In the two weeks ended

August 9, however, the pattern was reversed. Total credit declined as the security loans made in July were paid down and the Government security portfolios were reduced. But loans except on securities rose in this latter period, and Chicago and New York banks reported further loan growth in the week ended August 16. Thus the weekly reporting member bank figures suggested that business loan demand was strengthening, and it seemed likely that both seasonal influences and the increasing pace of business activity would bring a continued uptrend through the rest of 1961.

Mr. Allen pointed out that it was too early to judge the vigor of the loan demand he had mentioned. And there was still the elbow room in the economy to which he had referred, as evidenced by unused resources, both human and material. Under the circumstances he felt that it would be advisable to carry along for the next three weeks as the Committee had been doing and continue to supply reserves necessary to accommodate seasonal credit expansion and maintain about the existing degree of ease. He would not change the discount rate. He did feel, however, that the time had come to delete the words "strengthening the forces of recovery" from clause (1)(b) of the directive. The suggestions made thus far, particularly those of Mr. Treiber and Mr. Robertson, seemed to him to imply a responsibility in the foreign area which the Committee should not accept. He would favor the first clause of Mr. Treiber's suggestion, "to encouraging credit expansion so as to promote fuller utilization of resources," but he would prefer at that point to use the "while" clause in the existing directive, namely, "while giving consideration to international factors." As in the past, he would like to see the special authorization discontinued, and for the same reasons.

Mr. Deming said that he saw no significant change in the Ninth District economic picture over the past three weeks, which meant that mixed trends continued. The drouth had cut and would continue to cut farm income; at a guess, the cash income loss from the damaged small grain crops would approximate $350 million, and the effect of this loss would be felt over the course of the next twelve months. Iron mining also continued weak. Perhaps the best way to picture this weakness was to note that the number of small centers with substantial unemployment increased to 21 in July from 9 in June. Most of these were in the mining areas, but some were in lumbering and trade centers.

On the other side, there had been continued general improvement in manufacturing and trade. While total nonfarm employment continued to run behind year-ago levels, manufacturing employment was higher than a year ago and industrial use of electric power was up.

The net of those contrasting trends in the District could be expressed in capsule form through the personal income series. The

July figure was just equal to the January figure (both seasonally adjusted), but it was 3 per cent ahead of July 1960. Looking ahead, some gain could be seen in personal income, but a much smaller increase than probably would occur in the nation.

In banking, a contraseasonal decline in loans in July continued into August. This movement was evident in both city and country banks, and in each of the States of the District. No other July since 1946 showed such a weak loan picture. Relative to a year ago, however, city and country bank loan movements differed. Both total and business loans of city banks were below comparable 1960 levels, while country bank total loans were significantly higher than at the same date in 1960. Deposit behavior had been about normal. With weak loan demand and normal deposit trends, loan-deposit ratios had improved and general bank liquidity had improved, particularly at city banks.

The Ninth District, Mr. Deming observed, obviously was not typical of the nation at present. But the national economy, while expanding significantly, was still far from operating under the pressure of full resource utilization. On the national evidence, he would advocate staying "just about where we are" in monetary policy posture for the next three weeks. By that, he meant providing reserves adequate to maintain a free reserve level of about $500-$550 million, and a Federal funds rate significantly below the discount rate, while at the same time continuing to be concerned over the bill rate. On this latter point, however, he would not be worried about a bill rate that ran somewhat below 2-1/2 per cent. He saw no reason to change the discount rate, nor would he favor discontinuance of the authority to operate in longer-term securities.

The foregoing, Mr. Deming pointed out, was obviously a continuation of "wait and see." Consistent with this, he would not change the directive at this meeting, although he did agree that the wording of the present directive seemed somewhat dated.

Mr. Swan commented that the extent of the upward movement noted in the nation as a whole in July did not seem to have been paralleled in the Twelfth District. He could summarize by noting simply that nonagricultural employment, seasonally adjusted, in the Pacific Coast States, which represents a major part of total District employment, appeared to have been down slightly in July from June. This was only a small fractional decline, and to some considerable extent it was related specifically to labor stoppages. However, the fact remained that employment, after going up in June, did not increase further in July, and the drop extended to every major industrial group except finance and Government.

In the banking picture, Mr. Swan said, the demand for bank loans still appeared to be quite weak. However, the large banks were still anticipating a pickup in the fall. The major city banks were under some pressure in early August, but in the week ended August 16 and in the current statement week they became net sellers of Federal funds on a rather substantial scale and seemed to be in a relatively easy position currently.

Turning to policy considerations, Mr. Swan said he felt that one must be cognizant of the inflationary overtones in the present situation. However, they did not seem to be imminent. The speculative outlook generated in late July did not seem to have intensified in the past few weeks. Consequently, it seemed to him that the results of the latest statement week, and apparently the current statement week, were in accord with the kind of policy that would be suitable for the period ahead, rather than the results of the second week of the past period. He would recommend aiming at free reserves of about $550 million, with the definite hope that the level would not go below $500 million, and he would not like to see the bill rate above 2-1/2 per cent. If the rate were a little below that, he would not be concerned. Reserves would have to be supplied in rather substantial amounts in the next few weeks, especially the week ending September 6, and it would seem desirable not to fall as short as in early August. Although he recognized that in the first week of each month reserves tend to be somewhat lower in relation to the previous week or the following week, it seemed to him that the experience in the first two weeks of August should be given consideration and that it would perhaps be even more important in the period immediately ahead than in the past to offset the factors absorbing reserves.

Mr. Swan stated that he would not favor a change in the discount rate at this time and that he would favor continuing the special authorization covering operations in longer-term securities. If there was any hesitancy about supplying the substantial amount of reserves that would be needed through the purchase of bills because of excessive pressure on the bill rate, then he would certainly go into the intermediate-term area to supply those reserves.

With regard to the directive, Mr. Swan said he did not feel strongly on the matter. He thought a change would be desirable at some point, and if the directive were to be changed at this time he would agree with Mr. Allen's suggestion. On the other hand, in terms of timing he would be a little hesitant about making a change at this particular point, after a period in which some tightness had occurred, because of the inferences that might be drawn at a later date. On balance, therefore, he would be inclined to suggest letting the directive stand until another meeting.

Mr. Irons said Eleventh District conditions could be summarized by saying that economic expansion was going on, but not at an excessive rate. Probably the picture in the District was not too much different from the national picture, with most of the major indicators moving upward. The components of the industrial production index were up generally. Construction activity was good and improving, and one factor in the picture was the release of highway money that the Government was going to turn loose a little ahead of schedule; the State of Texas was ready to use the money for highways and roads. Employment had moved up; unemployment, not seasonally adjusted, stood at 5.5 per cent for the District. Income and trade were up a bit and the agricultural situation looked quite good. Thus, the District picture was generally satisfactory.

Turning to policy, Mr. Irons expressed himself as quite pleased with what had been going on in the past few weeks. He felt that the System had been about as nearly right as one could reasonably have expected. In his opinion, what had been going on could not be characterized as firming or tightness, for he could not associate those terms with a situation where there was virtually no borrowing at the Federal Reserve Banks, the Federal funds rate was under the discount rate, the bill rate was well under the discount rate, and free reserves averaged $500 to $550 million. There might have been a move from aggressive ease to ease, but the System was still providing reserves to the banking system in reasonable accordance with the demand for loans. Banks in the Eleventh District were in a fairly liquid position and were not borrowing from the Reserve Bank, all of the recent borrowing being of a seasonal nature and on the part of smaller banks. District banks had been net purchasers of Federal funds, but this was because of the activity of two banks. In talking with bankers, he heard that loan demand was off a little, but the bankers were not concerned about being in a tight position. They could make loans as needed because the banks were reasonably liquid.

Mr. Irons commented that three notable forces had developed. First, there was the improvement in the domestic economy. Second, the international situation was still uncertain, with a slight deterioration. Third, a month-to-month increase in Federal deficit spending had been occurring. Each of these forces suggested to him the same sort of credit policy; namely, less ease. If they continued, sooner or later the System would be moving in the direction of more firmness. For the period immediately ahead, however, he would think in terms of continuing about what had been done, on average, over the past three weeks. He hoped that the Federal funds rate would move at about 2-1/2 per cent, give or take something, with the bill rate in the area of 2-1/2 to 2-3/8 per cent, and he would watch loans and investments closely to see what the banks were doing with the funds that the System made available to them. He would favor renewing the special authorization covering operations in longer-term securities, with no specific limitations placed on the Account Management. In his opinion the Committee should leave considerable discretion to the Desk, with the understanding that the Manager would be governed largely by the feel of the market.

In summary, Mr. Irons said, he would maintain the status quo for the time being, watch closely for the rest of the summer period, and see what developed with the advent of the fall season.

As to the directive, Mr. Irons said he had no strong feeling. On balance, he would be willing to wait another three weeks, with the thought that perhaps the suggestions already made, and any others that might be submitted, could be studied by the Committee Secretary and blended into a suggestion that the Committee could consider when it met three weeks hence.

Mr. Ellis commented that the broad upward trend in New England that he had reported in June may have moderated somewhat in July, although the July figures were not yet firm enough to be sure. Some industries, including apparel, jewelry, and silverware, had not shown the recovery that seemed typical of the area in general. Production, construction, and total employment had yet to regain 1960 levels, so there was still a process of recovery in New England rather than a movement into a period of expansion. In the past two weeks, in particular, loans of weekly reporting banks improved noticeably. Demand deposits had increased 7 per cent since the start of the year, and time deposits also had shown some further advance. District banks were still expecting a vigorous loan expansion in the fall and perhaps they would be selling off some of their short-term Governments.

Mr. Ellis expressed agreement with the view, stated by Mr. Balderston at the August 1 meeting, that the Committee should follow total reserves as a basic guideline unless there was some reason to diverge one way or the other. The projections that the staff had presented for the Committee's consideration at this meeting involved a steady expansion of reserves in response to cyclical and seasonal patterns that would obtain in the coming months, and he would accept the projections as an appropriate goal for policy, especially during the next three weeks. He would favor a free reserve target of around $500 million, resolving doubts on the side of restraint, but with the hope that there might not be as many doubts as in the past three weeks.

Mr. Ellis expressed the view that it was time to change the directive. The version proposed by Mr. Treiber, as amended by Mr. Allen, had for him the most appeal; he thought it was something the Committee could appropriately adopt as a guide.

Mr. Ellis commented that as he looked ahead to the fall and saw a need to supply $1.1 billion of reserves for seasonal needs, he would expect that most of them could be supplied through the bill market. Yet it might be desirable to supply some through participation in the longer end of the market, and with that in mind he would renew the special authorization. In fact, he would want the Desk to continue its contacts with the longer-term sector of the market so that if it was necessary to put funds into the market in this manner in the fall, that would not cause unusual speculation or concern. He would not recommend a change in the discount rate at this time.

Mr. Balderston presented the following statement:

> Before giving you my views as to the monetary policy appropriate for the next three weeks, I shall ask you to bear with me long enough to deal with two matters pertaining to Committee practices and methods. The first of these is the pattern of thinking, or the long-term philosophy, that should guide the Committee's determination of policy actions. In discussing its decision-making, I shall be using the language of total reserves, adjusted to eliminate both Government and interbank deposits, and corrected for seasonal. I shall then turn to the second matter: the translation of Committee decisions from the language of total reserves into that of free reserves, so that the Committee's instructions to the Desk may be couched in language that is not only definite, but of practical usefulness.
>
> The guiding philosophy that I favor for the Committee's decision-making is to proceed steadily, week by week, toward whatever goal seems appropriate at the time for the fostering of recovery and economic growth without inflation. On the chart that is before you, a consistent pattern of policy decisions might be guided, for several meetings, by a straight line like those labeled "5 per cent" and "3 per cent".1/ The particular phase of the cycle will influence

1/ A copy of the chart is appended to these minutes as Attachment A.

the Committee's choice of such a guide. The Committee may follow a certain growth rate for a considerable time, as was the case for some four months last spring, and then veer gradually to another guideline considered more appropriate.

The point I am making is that monetary policy should be flexible but not erratic. To be administered with consistency, changes in the guideline should not be violent but gradual. The chart portraying what has actually taken place in recent weeks indicates to me that the Committee may have changed its long-run objective from a 5 per cent growth rate to a 3 per cent growth rate without full realization as to what had happened, and that since the last meeting the implementation of Committee policy has resulted in a radical departure even from the lower growth rate.

If an analogy be permitted, we should have been operating in recent weeks as if we were driving a truck across the desert on a straight course toward a goal that we had picked out in the distance. We should have departed from such a direct course only to avoid obstacles or depressions in the sand, and should have waited for any obstacle or depression to become actually visible before deviating. In short, we should let the forces of the market indicate when departure from a direct course is appropriate and necessary.

How can such a guiding philosophy of steady consistent forward movement toward an agreed-upon goal be brought to bear upon the Committee's decision-making? Perhaps its goals and its progress toward them will stand forth in clearer relief if one cuts through the blurring influence of changes in Treasury and interbank deposits, and purely seasonal shifts in privately-owned deposits. These changes tend to hide what we really care about, namely, the cyclical expansion of bank deposits in the hands of the nonbank public.

To appraise its performance, the Committee may well ask: how well have we been doing in providing reserves for these cyclical needs? The decision-making of recent months may be appraised by reference to the chart. As mentioned already, the reserve figures used in it are adjusted to exclude the effects upon required reserves of changes in interbank and Government deposits and seasonal patterns in private deposits. The chart shows the actual movements in total reserves, so adjusted, since the end of February 1961 compared with two growth lines. One of these embodies a steady 5 per cent annual growth rate; the other, a 3 per cent rate. It is not suggested that either of these percentages represents revealed truth. They are used simply to compare what we were doing earlier in the year with our performance in recent weeks. The line of actual reserves portrays the vacillating nature of our provision for cyclical expansion; and, since early July, the slowing down, and indeed the net contracting, of reserves made available for such purposes.

We have lost, since the week preceding our last meeting, the equivalent of 10 weeks' growth at the 5 per cent rate and over 16 weeks' growth at the 3 per cent rate. Even if the Committee now resumes the supplying of total reserves in accordance with a 3 per cent growth line, it would not restore the $120 million difference between the actual at this moment and the 3 per cent growth line on the chart.

Now I turn to the problem of translating policy decisions expressed in total reserves into the language of free reserves. Such translation cannot be precise. It is affected by the rate at which bank deposit expansion proceeds, and this in turn by the impact upon bankers of customer demands, ease of reserve positions, and appraisals of the future course of events. The best that can be done is to rely upon norms derived from experience. Since the end of February, the free reserve figures associated with weeks of net monetary expansion have averaged about $540 million. Thus the market place supplies a crude measure of the free reserves needed for private monetary expansion during an average week.

But in reality, weekly conditions differ from the average. Some refinement of this measure is called for to deal with those weeks containing bulges in float. Generally speaking, a dollar of reserves supplied by float has a less expansive effect than a dollar of reserves from other sources. For example, during the weeks of net monetary expansion since the end of February, the free reserve figure characterized by high float averaged $625 million; in weeks without a float bulge, $480 million, or a difference of $145 million. (In contrast, there have been other high-float weeks within this period that have been associated with net monetary contraction, even though the free reserves of these weeks averaged about $520 million.)

At long last I add my view as to policy for the next three weeks. To promote moderate monetary expansion between now and our next meeting, I recommend a target of about $500 million for the two-week interval ending September 6, and above $600 million for the week ending September 13 when the

> reserve figures will be more influenced by float. If pursued for perhaps 6 weeks, these targets should restore total reserves (adjusted) to the 3 per cent growth line portrayed in the chart. They have been stated in round figures to avoid "false accuracy," like that introduced when the value of pi is carried out to many places, even to 3.1416, when some figure in the computation, such as the price of copper, can only be approximated. Nonetheless, I am deeply concerned that the course of action determined by the Committee should be clear cut and should be adhered to as closely as possible by the Desk.

In further comments, Mr. Balderston said that he would favor renewing the special authorization covering operations in longer-term securities. He would be inclined not to change the directive at this meeting, with the thought that perhaps some study between now and the next meeting might save time in determining the actual wording. A change at this moment seemed to him relatively unimportant, although he recognized that wording along the lines suggested was probably more appropriate to the current situation than the present language.

Chairman Martin commented that he felt rather good about the way monetary policy was developing. Upon reviewing the minutes for the current year, it seemed to him a policy was gradually evolving that would be understandable to the country and effective in helping the economy. A year ago at this time, he recalled, he had entertained some doubt as to whether those factors were at work.

The Chairman said that it appeared to him that almost all of those who had spoken this morning were in favor of continuing about the same degree of ease that had prevailed, although some questions as to the way to achieve that degree of ease had crept into the discussion. The shades of opinion expressed today seemed really to center around the fact that although the System might be moving, in its thinking, in the direction of a more restrictive policy, the Committee had not yet arrived at the point where it wanted to be more restrictive. That, he thought, was about where the discussion had come out.

Chairman Martin commented, in this connection, that the point had been made well this morning about giving the Desk more precise instructions than in the past. The Committee had not yet arrived at the means of fully achieving that objective, and it would be necessary to continue work on the matter. The minutes of this meeting ought to be read carefully, and everyone should study whether any better means could be devised of stating the Committee's instructions to the New York Bank. Upon reading through the minutes of past meetings and then reading the directives, he must admit to a degree of sympathy with some of the criticisms that had been made by persons outside the System. Unless one had the benefit of the full flavor of the Committee discussions, it must be rather difficult to analyze the decision-making process.

As to the immediate question of a change in the directive, the Chairman expressed the view that the first part of Mr. Treiber's suggested wording for clause (b)--to encouraging credit expansion so as to promote fuller utilization of resources--probably was more appropriate to the present situation than the language of the existing directive. The Chairman added that he was favorably inclined toward Mr. Allen's suggestion for retaining the words "while giving consideration to international factors," since those words would not put the Committee in the guise of alone being able to defend the integrity of the dollar.

Chairman Martin inquired whether such a change would be favored or whether it was the consensus that the Committee should hold the matter in abeyance, with the thought of perhaps obtaining additional suggestions.

Mr. Mills moved the adoption of a revised directive in the form mentioned by Chairman Martin, and Mr. Robertson seconded the motion.

Chairman Martin then inquired whether anyone would wish to vote against a directive containing such language, and there were no indications to that effect.

> Accordingly, 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 credit expansion so as to promote fuller utilization of resources, 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 accommodation of the Treasury, shall not be increased or decreased by more than $1 billion;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate $500 million.

Turning to the question of the special authorization for operations in longer-term securities, Chairman Martin said he felt that everyone, both the proponents and the dissenters, would have to continue to work on the matter and study the available data. A memorandum from the New York Bank had been prepared for the Committee, pursuant to a suggestion at the August 1 meeting, attempting to trace the proceeds of sales of longer-term securities to the System Account. This memorandum had given the Committee some basis to go on, but there was still a lack of real experience on which to make definitive judgments.[1]

[1] The reference was to a memorandum from Mr. Rouse dated August 18, 1961, and an attached memorandum of August 11 from the New York Bank's Market Statistics Department.

Personally, he felt that it would be a mistake to remove from the Desk the discretion it now had under the current authorization. He leaned toward the position that it was not necessary under present conditions that the bill rate be maintained at present levels at all costs. He saw no reason why the bill rate could not fall to 2-3/8 or even 2-1/4 per cent, if need be, provided the Account could obtain bills without seriously upsetting the market. However, he saw no reason at this point for the Committee to get itself back in the box, in which it had been for so long, of being inflexible to the extent of taking a position that it would not deal across the board even though the deals, when available across the board, were in reasonable relation to the market. Everyone, he noted, could take the currently available data and read it differently. Mr. Robertson, for example, had interpreted the information in the memoranda from the New York Bank a little differently than he would have interpreted it, but he (Chairman Martin) may not have read the memorandum correctly. In any event, he felt that everyone should study and evaluate data of this kind very carefully. He had been talking to a number of people in the market, and there were evidently some difficulties in the special operation, but he had not reached the point where he would want to make a judgment. Instead, he would prefer to keep an open mind. He felt, certainly, that the Committee ought to renew the special authorization at the present time and continue the discretion placed in the Manager of the Account. At the same time, the Manager should understand that the intent was not just to engage in operations in longer-term securities for the sake of holding the bill rate up to any preconceived level. That, he thought, was essentially where the majority of the Committee stood this morning.

In response to a question from the Chairman, Mr. King clarified that his position, as stated earlier during the meeting, had not been to terminate the special authorization, but rather to disengage from operations under it for the time being.

Chairman Martin then inquired whether it was agreed that the Committee would renew the special authorization, with Messrs. Allen and Robertson dissenting, and there were no comments to the contrary.

> Accordingly, the Committee 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, Irons, King, Mills, Swan, Wayne, and Treiber. Votes against this action: Messrs. Allen and Robertson.

It was agreed that the next meeting of the Committee would be held on Tuesday, September 12, 1961.

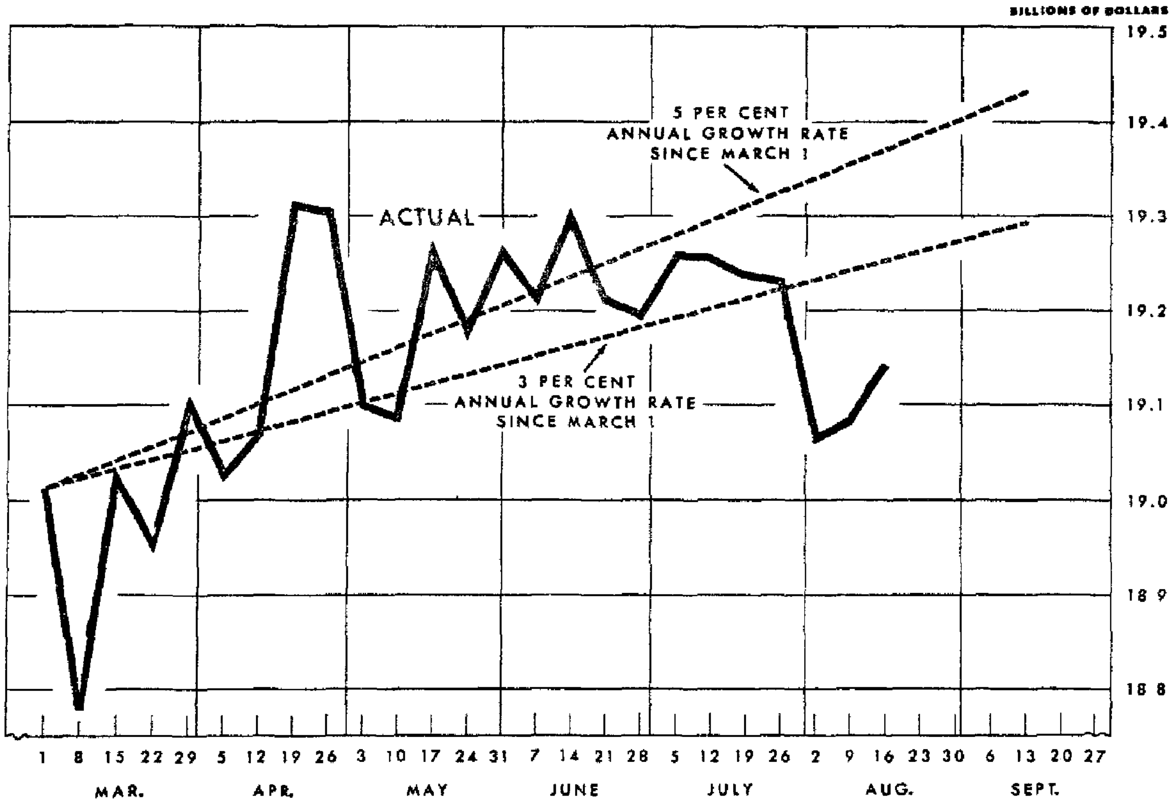
Chairman Martin commented that he would be leaving shortly after the date of the next meeting to attend the Fund and Bank meetings in Vienna, and in those circumstances, particularly, he thought it might be useful to put on the agenda for general discussion at the September 12 meeting the subject of Federal Reserve holdings of foreign currencies. He noted that there had been distributed to the members of the Committee and the Presidents not currently serving on the Committee copies of a memorandum from Mr. Young dated June 16, 1961 (as corrected June 26), along with a memorandum dated June 16 from Mr. Furth of the Board's staff, and that there would also be distributed copies of a letter dated July 21, 1961, from the Federal Reserve Bank of New York commenting on Mr. Young's memorandum.

The meeting then adjourned.

Secretary.

TOTAL RESERVES AVAILABLE TO SUPPORT PRIVATE DEPOSIT EXPANSION, SEASONALLY ADJUSTED*

ACTUAL VS. 5 PER CENT AND 3 PER CENT ANNUAL GROWTH RATES, MARCH 1 - AUGUST 16, 1961



*Data adjusted to exclude the effect upon required reserves of changes in U. S. Government and interbank deposits and estimated seasonal changes in private deposits

Attachment A