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, September 12, 1961, at 10:00 a.m.

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

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

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

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

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

Messrs. Eastburn, Hostetler, Parsons, and Tow, Vice Presidents of the Federal Reserve Banks of Philadelphia, Cleveland, Minneapolis, and Kansas City, respectively

Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta
Mr. Bowsher, Economist, Federal Reserve Bank of St. Louis

Chairman Martin noted that Mr. George W. Mitchell, who took his oaths of office as a member of the Board of Governors and as a member of the Federal Open Market Committee on August 31, 1961, was today attending his first meeting as a member of the Committee.

Chairman Martin also noted that according to his present schedule he would be absent from the next two meetings of the Committee. For one of those two meetings, Vice Chairman Hayes also expected to be absent. Accordingly, in the anticipated absence of both Mr. Hayes and himself, Chairman Martin suggested that it be understood that Mr. Balderston would preside at the Committee meeting in question. No objection being indicated, it was so understood.

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meeting of the Federal Open Market Committee held on August 22, 1961, were approved.

Upon motion duly made and seconded, and by unanimous vote, Mr. Ernest T. Baughman was elected to succeed Mr. Mitchell as an Associate Economist to serve until the election of a successor at the first meeting of the Federal Open Market Committee after February 28, 1962, with the understanding that in the event of the discontinuance of his official connection with the Federal Reserve Bank of Chicago, he would cease to have any official connection with the Federal Open Market Committee.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period August 22 through September 6, 1961, and a supplemental report covering the period September 7 through September 11, 1961. Copies of these reports have been placed in the files of the Open Market Committee.

In supplementation of the written reports, Mr. Rouse made the following comments:

> Open market operations supplied a large volume of reserves to the market--$699 million on a delivery basis--since the last meeting of the Committee. These reserves offset heavy drains stemming from changes in currency, float, and gold and foreign accounts.
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> All of these reserves were supplied through outright purchases of securities, and by last Wednesday the System Account portfolio amounted to $27.8 billion--the highest it has ever been. Of the $699 million increase in System holdings since the last meeting, $660 million was in Treasury bills. This brings the bill portfolio to $2.8 billion, $166 million above the level of last February 17, the day prior to the beginning of operations outside the short-term area. Our purchases were partly responsible for bringing bill rates down to about 2.30 per cent in the case of the 91-day issue. However, our bill portfolio will decline by $144 million on Thursday, since we bid in the auction yesterday to run off our holdings of this week's bills. In addition, if reserve projections are borne out we will have a sizable amount of selling to do in the next statement week, but we hope to sell as many coupon issues as we can, while holding our bills. These sales should result in higher bill rates, which might well be helpful in view of our deteriorating international position. However, as a more general matter, I doubt whether such higher bill rates can be maintained if free reserves should remain in the $500-$600 million range.
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> The approach of the Treasury's financing program, and later the program itself, were the center of attention in the market during the recent period. The terms of the advance refunding are regarded as generous by the market and the program as a whole has received generally favorable comment. Although ideas have not yet begun to jell as to how many of the $7.6 billion of the "rights" outstanding might be exchanged,

there is no reason, barring some unforeseen development, why the size of the turn-in should not be satisfactory. I might point out, in this connection, that in the advance refundings held last March and September, about 31 per cent of public holdings of the "rights" were exchanged.

The System's holdings of the two "rights" total $700 million--$562 million of the 2-1/2's of 1965-70 and $138 million of the 2-1/2's of 1966-71. We hold $10 million of the 3-1/2's of 1980, $41 million of the 3-1/2's of 1990, and $5 million of the 3-1/2's of 1998. I see no reason for the System to exchange any of its holdings of the "rights", and plan no exchange. We have been informed, incidentally, that Treasury trust accounts, which currently hold somewhat over $1-1/4 billion of the "rights", plan to exchange up to $1 billion of such holdings.

The balance of the Treasury's financing program calls for the raising of $5 billion in cash between now and mid-October. This came as no surprise to the market, except perhaps for the size of the June tax anticipation bill, which some had expected would be larger than $2.5 billion. The Treasury indicated to the press that except for the possibility of borrowing small amounts from time to time, the program announced last Thursday may be sufficient to meet the Treasury's cash needs for the remainder of the calendar year. Whether events will turn out this way depends upon a number of factors, including the Treasury's decision as to whether it will handle the $7 billion November 15 maturity on a cash or an exchange basis. Even if additional cash financing this year is avoided, indications are that the Treasury will be in the market shortly after the new year begins. Our own projections, for example, show a need for about $3 billion in new cash by mid-January. The heavy schedule of Treasury financing over the balance of the year thus affords only brief intervals for overt policy action by the System.

In response to a question, Mr. Rouse said there should be a period in the latter part of October when the Treasury financing schedule would permit overt policy action if the System so desired. There might also be such a period in the Thanksgiving-Christmas area.

Chairman Martin said he thought the only completely clear period might be in late October. The Treasury apparently could delay until November 2, if it wished, the announcement on its November refunding.

Mr. King inquired concerning the yields available under the terms of the advance refunding, to which Mr. Rouse replied that the cost of the extension to the Treasury would be in the range of 4-1/4 to 4-3/8 per cent. The yield to the present holders of securities eligible for exchange would be in the area of 4.16 to 4.20.

> Thereupon, upon motion duly made and seconded, the open market transactions during the period August 22 through September 11, 1961, were approved, ratified, and confirmed.

Mr. Noyes presented the following statement on economic developments:

> Economic developments, such as current movements in things like retail sales, production, employment, and prices, seem relatively unimportant in the total complex of events of recent weeks. The resumption of bomb testing in Russia, the continued tension in Berlin, the labor negotiations in the automobile industry, and the prospects for a price increase in steel all seem to loom much larger than the fact that unemployment remained at 6.9 per cent of the labor force, department store sales were substantially unchanged from July to August, production was probably up another point on the index, or that wholesale prices have continued their sidewise movement, as consumer prices rose, due largely to an increase in food costs. Even our estimate of GNP for the current quarter, at around $527 billion, seems stale as Government officials and others focus attention in their public statements on such figures as a $540 billion GNP by year end, or $575 billion by the end of next year. The Federal deficit for fiscal 1962 even seems to have become yesterday's news as public discussion focuses more and more on whether we are likely to achieve the balance predicted by the President and the Secretary of the Treasury for fiscal 1963.
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> While it goes without saying that one must avoid being unduly influenced by the dead hand of the past, it is equally important not to lean too heavily on projections and forecasts--no matter how carefully contrived--in shaping current policy. It is perfectly proper to speculate on the future course of economic events and to project, either by highly technical mathematical manipulations or long practice, past experience into the future. For some sorts of policy planning, estimates

or projections of this kind are unavoidable. However, it takes only a little familiarity with the heroic assumptions involved to make clear that it is futile to speculate now as to whether or not a GNP of $575 billion in the fourth quarter of 1962 is "inflationary", and it certainly would be foolhardy to be influenced in current policy formation one way or the other by such an exercise.

All this is by way of a rather lengthy prologue to, and apology for, a very brief and undramatic report on current developments. Frankly, there is nothing in current data, most of which relates to the month of August, which calls for modification of the earlier generalization that the recovery has progressed rapidly, carrying almost all indicators to above their previous peaks but without evidence of excessive exuberance. Some stimulation from added defense expenditures appears to be just about offset by a lower level of consumer spending than might ordinarily be expected at this stage of the cycle.

In addition to the facts about production, employment, prices, and retail sales that I have already mentioned, further evidence of this rough balance can be found in the rise of both exports and imports in July, in the Commerce - S.E.C. report, released today, of a very moderate upward revision of plant and equipment expenditure plans, and in the strong but not atypical behavior of manufacturers sales and orders.

The likelihood that labor negotiations in the automobile industry will be settled without a prolonged strike adds to the stability of the current situation, whatever the longer-run implications of the settlement may be. In addition to the wholesale and consumer price indexes already mentioned, sensitive industrial material prices have shown little change recently. Consumer credit outstanding, which declined in July, appears likely to decline again in August.

At the same time, the Treasury has announced, as was anticipated, a program to borrow over $5 billion of cash in the next month or so. Looking further in the financial area for clues, the situation is much the same, with bank credit expansion just about seasonal. Stock prices have been fluctuating in a relatively narrow range, after their rapid run-up in the spring and early summer. With the money supply remaining almost constant, seasonally adjusted demand deposit turnover has declined a little since May, which is quite unusual for a period of vigorous expansion in GNP.

One might argue, on the one hand, that were it not for the increasing stimulus provided by the public sector, the recovery might be less vigorous--perhaps even in jeopardy. On the other hand, it is argued that the vastly increased liquidity of the economy, especially in the hands of consumers, constitutes a sort of powder keg of potential spending, which could be touched off by a very slight shift in peoples' psychological attitudes. My point, in summary, is that up to the present time there is no evidence to suggest that stimulus from public sector will be withdrawn, or even reduced, nor of a dramatic increase in consumers' spending or expressed intentions to spend. Hence, it appears that the precariously balanced upward movement in the economy, which has prevailed for some months, is being maintained.

Mr. Koch presented the following statement on credit developments:

Outstanding commercial bank loans and investments declined somewhat in August. This followed a large increase in July, due in the main to Treasury financing operations. The course of bank credit developments over the summer months is always greatly affected by the size and timing of Treasury financing operations, since loan demands normally show little seasonal change on balance.

Business borrowing from banks, however, the most volatile element in the loan portfolio, normally begins to pick up in August and early September, and this year's rise has thus far been of about seasonal proportions or possibly a little less. The heavy seasonal borrowers like food processors, commodity dealers, and trade outlets are beginning to come into the banks.

One aspect of the business loan picture that has struck me these last few months has been the large amount of gross new borrowing despite the relatively moderate change in the net volume of loans outstanding. Whereas many firms are borrowing from banks, a large number of others are repaying bank debt, to some extent in the case of the larger firms with the proceeds from security financing. This large volume of gross new business borrowing from banks probably reflects in part the larger than seasonal increase in inventories that has occurred since March.

Turning to the capital markets, new corporate bond financing fell off sharply in August, more than would have been expected seasonally. The September calendar has also been light so far, but it is expected to pick up later in the month. Stock financing in recent months has been low in dollar volume but high in number of participants, indicating the increased availability of equity money to smaller, and possibly newer, concerns. New municipal and mortgage financing has continued in fair volume throughout the summer months.

As for the nation's liquidity, the money supply, narrowly defined to include only currency and demand deposits, changed little in August for the fifth straight month. The rise in time and savings deposits at commercial banks, particularly that in time certificate form, slackened slightly in August after having maintained a sharp 15 per cent seasonally adjusted annual rate of increase earlier in the summer. You may also have noted that withdrawals in savings and loan associations were particularly heavy in July, the latest month for which such data are available, and that outstanding shareholdings declined for the first time in several years. Withdrawals are normally heavy in July, however, so on a seasonally adjusted basis the drop merely meant that the rate of growth of savings and loan shareholdings dropped off somewhat.

Insofar as the liquidity of financial institutions is concerned, I was struck, on reviewing financing developments again after several weeks away from the data, by the recent sharp increase in the secondary reserves of commercial banks, by which I mean their holdings of Government securities maturing under a year. The ratio of these holdings to deposits has increased to over 12 per cent, up sharply from earlier in the year and now at the highest level since mid-1954.

Entering as we are on a period of at least 18 months of large-scale Treasury financing, a large part of which will of necessity have to be in short-term form, the liquidity of commercial banks would likely increase considerably further in coming months unless bank credit expansion is restrained. In that case, somewhat higher short-term interest rates would no doubt be needed to induce a larger volume of nonbank investment in short-term Government securities. The loan-deposit ratio of all commercial banks considered as a group continues quite high and at 55 per cent is still only two percentage points below its recent high reached in the middle of last year.

Turning to bank reserve positions, free reserves averaged about $475 million last week after three weeks during which they approximated $550 million. Last week was a week of low float, however, so the lower free reserve average was accompanied by as easy money market conditions as had characterized the earlier weeks.

In terms of total reserves, or more precisely seasonally adjusted reserves available for private deposit expansion, the situation has not changed materially over the three weeks since the Committee last met. Such reserves have shown practically no change on balance over this period, averaging about $19.2 billion in both of the weeks ending August 16 and September 6.

Looking ahead, the projections of both the staff of the Federal Reserve Bank of New York and that of the Board suggest free reserves between $550 and $600 million again this week. In the following two weeks, market forces, unless their effect is offset by System action, would tend to increase such reserves markedly, mainly as a result of the mid-month rise in float. Only in the final week of the coming interval between meetings of this Committee will the Desk be likely to have to supply reserves to the banking system. Late in September and early in October, market forces, including payment for purchases of the new tax anticipation bill, could utilize as much as $700 million of bank reserves.

In considering what open market operations would be most appropriate for this Committee to adopt for the coming three-week period, it is of relevance to note that since mid-June and possibly since even earlier in the spring, we have experienced a rather sustained, if slight, downdrift, or at least sidewise movement, in most broad banking and money measures, that is, in total commercial bank credit outstanding, total deposits, money supply narrowly defined, and total reserves regardless of how defined. This has happened with average weekly free reserves varying in a range of between $400 and $600 million, with the feel of the market being generally quite easy, and with the Federal funds rate below two per cent most of the time. On the face of it, these developments might call for some further easing in policy in the weeks immediately ahead.

Two circumstances have to be weighed before reaching such a decision. In the first place, international developments are in a state of crucial flux, domestic economic conditions are on a steady rise, and Government fiscal policy is adding materially to expansionary market forces. Seasonal private loan demands and Government short-term borrowing will be potent factors for bank credit and monetary expansion throughout the rest of the year, particularly in the next few weeks. These developments all call for caution in easing credit and monetary policy further at this time.

Secondly, the fact that the Treasury will be in the market with new cash and refinancing ventures throughout the entire three-week period prior to the next meeting of the Committee normally calls for maintaining an even keel in monetary policy. Some slight easing action, however, has occasionally been followed in periods of Treasury financing in the past and such action would not likely be either unfair or misleading to market participants or the Treasury if adopted currently.

All this adds up in my mind to maintaining the status quo in open market policy over the next three weeks, but being especially alert to the fact that market developments, particularly on the expansionary side, could develop quite suddenly, thus requiring prompt re-evaluation of the appropriateness of current policy.

Mr. Young presented the following statement on the balance of payments and related matters:

The disturbingly large transfer of gold and dollars from the United States to foreigners in July, reported to you at the last meeting, now appears to have been mainly accounted for by temporary factors. These include an extra large outward capital movement, a reduced trade surplus, reflecting especially a big, contraseasonal rise in imports, and the seasonal increase in tourist expenditures.

It is all too easy to over-emphasize and over-rationalize the temporary causes of any swing in our payments balance from the less adverse to the more adverse, and to conclude that the payments balance is really not so grievous a problem after all. The fact of the matter is, however, that our background is one of a decade of sizable deficits and, in consequence of the cumulation of these deficits, a diminishing margin of monetary reserve protection. Accordingly, any swing from smaller to larger deficit, even if temporary, must be viewed with concern.

At the same time, the balance-of-payments situation must not be allowed to get out of focus. According to very preliminary indications of the New York Reserve Bank's flash report on U. S. transfers of gold and dollars to foreigners for August, the U. S. balance of payments for the latest month must have been in close balance. Projection for September and the remaining months of this year is nothing but guesswork. As of the moment, our best guesses suggest further deficit, but not of alarming size unless aggravated by adverse confidence developments that activate outflows of short-term funds.

The reduced trade surplus mentioned above was the result of a rise in imports more than offsetting a marked recovery in exports. Imports on a seasonally adjusted basis rose a full 16 per cent, the largest rise in any single month in the postwar period. It seems doubtful that a rate of increase of this size can be sustained. Exports also rose significantly on a seasonally adjusted basis, and regained a $20 billion annual rate, about $1/2 billion higher than in April and May. The demand situation continues favorable in Europe and elsewhere for U. S. exports, and while the gains ahead may fall well behind those of imports, they should still contribute positively to holding down our balance-of-payments deficit.

It is too early, of course, to evaluate the recent measures taken by the United Kingdom to correct its chronic deficit in its basic balance of payments. The spot pound has strengthened considerably but the forward pound remains at a sizable, though moderately reduced, discount. In July, the trade deficit decreased modestly further, but mainly because of reduced imports. In August, curbs on outward capital flows showed signs of taking effect. In addition, the IMF drawing strengthened U. K. reserves and made evident to those short of sterling the risks in their positions. In August, some inflow of investment funds and reflow of short-term funds to London apparently occurred to take advantage of the high levels of British interest rates.

The wage pause that the British are endeavoring to enforce is of particular interest. So far, its strict enforcement has been limited to the public sector and to the minimum wage categories of the private sectors which have to have Government approval. A major test looms up later this year when wage claims for railway and mining workers in the public sector and for the engineering trades in the private sector will come to a head.

In August, the monetary reserves of Germany continued the decline which had set in in July. Since the basic balance on current and recorded long-term capital account remains in surplus, the main influence appears to be the withdrawal of foreign funds invested in Germany on a short-term or on a speculative investment basis.

The Bundesbank, despite the outflow of foreign funds, has pressed ahead with an easy, or still easier, monetary policy. Comparable money rates recently have either been as low or only moderately higher than in the U. S. Meanwhile, commodity prices in German wholesale and retail markets have remained fairly stable, but wage costs have been showing marked increase--about twice that of the increase in labor productivity.

The French accumulation of gold and foreign exchange reserves has been on an ascending scale--amounting to nearly $900 million for the first seven months. Since the trade account has been in approximate balance or moderate surplus, an exceptional capital inflow and, more recently, better than usual tourist receipts appear to provide the explanation. Because of the large foreign exchange accumulation, the French authorities repaid in August the remaining debt to the European Payments Union creditors amounting to a little over $300 million.

Resurgence of Canadian economic activity and decline in Canadian unemployment is now well confirmed by current economic data. In recent months, the Bank of Canada has aggressively promoted easy credit conditions, including active purchasing in the long-term sector of the market. Bond yields have been held stable at just under 5 per cent and money rates have declined to levels close to those in New York. In the meantime, monetary expansion has attained a pace that appears very rapid by Canadian historical standards--an annual rate of 15 per cent or so. The Canadian dollar has been showing only slight variation around the level of 97 cents. Apparently this level has been holding without official support. At the bargain rate for Canadian dollars, there has apparently been active buying of Canadian securities by Americans.

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

Since the last meeting of the Committee the international political situation has worsened. This development implies still further increases in spending for defense. It increases the possibility of a more rapid step-up in business and consumer spending; it increases the possibility of the emergence of a speculative psychology. So far, however, there is no discernible evidence that the trend of the economy or of public psychology has changed significantly.

While the over-all expansion of economic activity is continuing at a healthy rate, there are no clear signs of an acceleration in pace. Consumer spending is still lagging and surveys of consumer buying intentions point to a continued cautious attitude. Business inventory building appears to be moderate and in line with the current stage of the business cycle, and there is nothing in current loan data or in reported inventory plans to suggest a very rapid inventory build-up in the immediate period ahead. The economy is still operating considerably below capacity in terms of both labor force and physical plant.

What is the probable trend of prices? The increases in July in the consumer price index and the wholesale price index were dominated by seasonal advances in the prices of food and farm products, and do not seem to reflect a sudden shift in the forces of supply and demand. The expansion in over-all economic activity that now appears in prospect is unlikely to create any strong and general price pressures from the demand side in the immediate future. Yet we cannot be complacent about prices. There is the highly important question as to whether there will be a strong upward push on prices from the cost side, resulting from wage increases in the steel and auto industries and other wage increases growing out of wage negotiations in other industries.

While we do not know the full import of the proposed arrangements between the United Auto Workers and American Motors Corporation and General Motors Corporation, the settlements related to pay seem generous. Increased fringe benefits add importantly to costs as do increases in direct wage rates. The total increases seem to be well above the average improvement in productivity throughout the economy. Increases of such size tend to lead to increases in wage rates in other industries regardless of the extent to which productivity in those industries may have increased; this is of special significance for the service industries. It seems to me that the cost of living is bound to rise unless some of the benefits of increased productivity are shared with consumers through some reduction in prices or improvement in quality of manufactured goods. The prospects of such sharing are dim. Public and Government pressures in this direction would be welcome.

The bank credit picture has changed little in recent weeks. The large drop in August in loans and investments at the weekly reporting member banks was associated with a large drop in bank holdings of United States Government securities and security loans--a logical aftermath of the upsurge in July in connection with large Treasury borrowing. In contrast, business loans showed only moderate strength. Consumer loans and loans to finance companies increased somewhat in August. Bank liquidity continues to be satisfactory.

The recently announced Treasury financing will result in increased bank loans and investments, and in due course the newly created deposits will find their way into the private spending stream. The Treasury's advance refunding has been favorably received; it has been viewed as tangible evidence of the desire of the Treasury to pursue a conservative debt management program. Since the Treasury is now engaged in a large and complex financing program, an "even keel" in the money market is desirable.

While international political and military tensions have been increasing, our international financial position has been deteriorating. Our trade surplus has declined greatly compared with the first quarter of 1961. With further economic expansion at home and less ebullient economic activity abroad, our imports are likely to rise much more quickly than our exports. Our balance-of-payments problem is as serious as ever. We have two major jobs to do and several minor ones. As a country we must strive with all our power to keep our costs down; success in this respect will promote stability at home and strength abroad. We must persuade the more developed countries of the western world to assume a larger portion of expenditures abroad for defense and economic aid. The solution will not come soon; it will not come easily. Meanwhile, we are vulnerable to substantial demands upon us for gold.

Since the last meeting of the Committee the price of gold has risen further in the London gold market, attaining about $35.20 per ounce. As international political tensions increase, the demand for gold is likely to rise further. Capital flows between foreign centers may increase the demand upon us for gold if the receiving country follows the practice of keeping a larger portion of its reserves in gold than does the country experiencing the outflow. While there is still no great monetary incentive to move funds from New York to London on a covered interest arbitrage basis, the advantage in such a movement may increase. As the British succeed in their present stabilization program--and we hope they will--there will be increased incentives to move funds from New York to London on an uncovered basis. A year of exploratory negotiations on possible ways to strengthen the international financial system has pointed up the many complexities to be resolved. Confidence, especially international confidence, is a fragile flower. We must be constantly alert so to conduct our monetary and fiscal affairs that we provide no basis for those abroad to raise questions regarding the ultimate soundness of the dollar.

A policy of monetary ease is still called for. At the same time there is an intensification of the need for alertness to developments that may call for a shift in policy. The risk that economic expansion will falter has receded further while the danger of rapid deterioration in the international financial position of the United States has increased. Thus it is even more important now than it was a few weeks ago to pay special attention to international considerations and resolve doubts on the side of less ease.

Higher short-term interest rates should be encouraged. The rate on three-month Treasury bills, the bellwether of short-term interest rates, is now below 2-3/8 per cent, the midpoint of the 2-1/8-2-5/8 per cent range that has existed over the last year. We think that domestic and international developments make

> it desirable that the rate be in the upper part of that range. A rise in the Federal funds rate also seems appropriate. 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. To achieve these results, less attention should be given to the precise level of free reserves.
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> 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. Nor would we suggest a change in the directive, which was revised at the last meeting of the Committee.

Mr. Ellis said the few available statistics for August on business conditions in the First District suggested that the recovery was proceeding. However, the trend could not be characterized as vigorous. According to the statistics, there had been an interruption of the recovery trend in July; production figures declined and despite higher electric power output the level was below that of a year earlier. The textile industry appeared to be coming to life, with civilian demand strengthening and military procurement rising, while shoe production was running 5 per cent below 1960. Slower sales had caused some factories to hold back price increases, but it was still hoped that sales would be strong in the fall. A large newsprint producer who had been looking for an opportunity for some time to increase prices so as to catch up with wage increases now found his competitive position affected by the decline in the Canadian dollar. As to construction, July is usually a weak month in New England and this year had been no exception, with the total down 13 per cent from a year ago. Total nonagricultural employment, seasonally adjusted, rose slightly in July and about matched year-ago levels, but most manufacturing industries, along with transportation and public utilities, were employing fewer people than a year earlier. Consumer spending was fairly good, with auto sales fair and department store sales quite vigorous. The latter had exceeded year-ago levels in all but one week since May.

Perhaps the District's recovery movement was showing up best in the financial statistics, Mr. Ellis said. For the year to date, business loans at weekly reporting banks were up about 4 per cent compared with a decline of 2 per cent for the country as a whole. The level of total deposits had held about even during the past four months, with the result that the average loan-deposit ratio was up two points from 64 to 66 per cent, whereas the comparable ratio for the country as a whole showed a drop of two points to 60 per cent. The New England average was influenced somewhat by the fact that one large bank had a ratio of 71 per cent. While the growth of total deposits was disappointing, demand deposits had been doing well. Even since the April peak for the nation, they had continued to grow in New England. The monthly survey of mutual savings banks indicated that 11 out of the 80 banks in the survey reduced their average mortgage lending rate by 1/4 per cent from June to July.

Turning to policy, Mr. Ellis said the reports from the Account Manager indicated that the Desk had succeeded in weathering a period when it was necessary to supply large quantities of reserves without upsetting the market or interest rate levels. Staff projections for the next three weeks suggested that offsetting actions of the kind undertaken in the past period would have to be reversed to avoid developing an excessive degree of ease during the Treasury financing period. He felt that the Committee had established a satisfactory and correct stimulative policy and degree of ease, and that it should endeavor to maintain the status quo during the ensuing three-week period. This would mean preserving the current targets with respect to total reserves, as shown in the staff projections, and maintaining free reserves at existing levels. In his opinion it would be desirable to maintain contact with the longer-term market, and therefore he would renew the special authorization. He saw no need to change the directive or the discount rate at this time.

Mr. Irons noted that, according to current reports, the Eleventh District was sustaining considerable damage from Hurricane Carla. Except for this development, however, conditions in the District had been moving along fairly satisfactorily. Various measures, such as industrial production, employment, and petroleum production and refining, were all moving upward on a satisfactory and sound basis. There had been an increase in retail trade recently, perhaps reflecting to some degree anticipation of the Texas sales tax that became effective the first of September. The damage caused by the hurricane seemed certain to run into large figures; the rice crop probably had been wiped out. A good part of the cotton harvest was probably in, but there seemed some likelihood of heavy damage to the citrus crop. However, agricultural conditions in the western part of the State had been good and the cotton situation in the southern plains area was favorable.

As to District banking developments, there had been an advance in gross loans, some liquidation of investments, and a fairly substantial gain in deposits, both demand and time. From the standpoint of liquidity, the condition of the banks was about the same as it had been, and there was virtually no borrowing from the Reserve Bank. Federal funds transactions had been showing an excess of purchases over sales for District banks as a whole, but the situation in Houston was completely different from that in Dallas, the Houston banks being consistent sellers and the Dallas banks consistent buyers.

Turning to policy, Mr. Irons expressed himself as satisfied with developments during the past three-week period. In his opinion, neither current or prospective economic developments suggested a need for further easing, and the Treasury was in the market. Therefore, he would recommend continuing about the same degree of ease that had prevailed, with any deviations on the side of mild firmness rather than additional ease. This would suggest a bill rate in the range of 2-3/8 - 2-1/2 per cent, with the Federal funds rate running from about 2-3/4 per cent down to about 2 per cent and free reserves in the area of $450-$500 million. He would favor continuing the special authorization covering operations in longer-term securities, and he would not recommend a change in the discount rate or the directive.

Mr. Swan said that he found few, if any, significant changes in the Twelfth District data that had become available since the previous Committee meeting. Nor did there seem to have been any significant change in business attitudes in the District since that time. On balance, there appeared to be some continuing improvement, but it was not notably vigorous. In brief, there had been little or no intensification of the gradual upward movement. In August, employment moved up a little in California, the only State in the District for which August figures were yet available, and based on employer hiring schedules a slightly more than seasonal increase in employment might be expected in September.

There was no particular evidence of pressure on the availability of bank credit at the major District banks, Mr. Swan said. The banks seemed to have funds to offer, and borrowing from the Reserve Bank had been negligible. On the other hand, during the past few weeks two large savings and loan associations in San Francisco found themselves much tighter than they had anticipated due to a somewhat lesser flow of funds from their shareholders during the summer and some pickup in the demand for real estate credit. This was indicated to have been a rather unexpected development, and he was not prepared to say whether it was of general significance.

As to policy, Mr. Swan said he recognized the various possibilities of some increase in credit demands that might have to be checked. It seemed to him, however, that at the moment these remained only possibilities. One indication of such a development would be a surge in consumer spending, but no such surge had occurred as yet. He recognized also that the effects of fiscal policy in all probability would be expansionary in the several months ahead. As to the period immediately ahead, however, even apart from the fact that the Committee would be circumscribed by the Treasury financing program, he saw no reason for positive action to change monetary policy in the direction of tightening. Instead, it seemed to him that the Committee should continue about the present policy. To him, that would mean a bill rate from 2-1/4 to 2-1/2 per cent and free reserves ranging from $500 to $550 million. If doubts arose, they might be resolved on the side of less rather than more ease. He would recommend no change in the discount rate or the directive, and he would continue the special authorization.

Mr. Deming said that a brief statement of recent Ninth District economic developments would be "more of the same." Except for iron mining, general nonagricultural activity was moving about in line with the nation. In July, District nonfarm personal income was 4.1 per cent ahead of July 1960, about the same as the national gain of 4.2 per cent. On the other hand, District agriculture continued to suffer from the effects of drought and net farm income in July was 6.5 per cent below a year earlier. Thus the District gain in total personal income from a year ago had been only 2.8 per cent against the national gain of 4.2 per cent.

One indication of somewhat lesser strength in the District than nationally was to be found in the forecast of the Minneapolis employment authorities for employment in the Twin Cities area, which showed an estimated gain of 5,500 jobs from July to November. In the same period last year there was no gain, but in 1958 the gain was 12,000 and in the like period of 1954 the gain was about 18,000.

Mr. Deming commented that the District banking situation remained about the same as it had been. During the past three weeks, he said, the Reserve Bank had been doing some intensive work on bank loan prospects over the balance of 1961. Loan officers saw loan demand as being no more than normal during this period, although some of them believed there might be some shift to direct bank loans from commercial paper financing. Thus far, they saw little borrowing for inventory.

As to policy, Mr. Deming said that for the next three weeks he felt that quite obviously the Committee should go along on an even-keel basis. Even so, however, he agreed with those who had suggested that any doubts should be resolved more on the side of tightness than additional ease. Also, he would agree that the System must be alert to developments. Particularly during the past three weeks, he had been disturbed by having heard more and more comments from the people with whom he talked about the certainty of price increases. It was being said, for example, that if one was going to build, obviously that could be done more cheaply now than two years hence. Altogether, there seemed to be more signs in the air suggesting some increase in belief in the inevitability of more inflation.

While bankers apparently did not foresee any particular increase in loan demand, Mr. Deming commented that he did not see how a GNP figure of $540 billion could be attained by the end of this year without some increase in bank loans. Accordingly, he felt that there would be a strengthening tendency for such loans to increase. At least, it would seem that the rate of bank credit expansion during the latter part of this year, while perhaps not explosive, might be stronger than generally expected. Looking ahead, therefore, the System should be alert to do whatever it could so as to be in a position to move to a more restrictive position, if necessary, particularly since the periods when there was an opportunity to move would be limited. The quality of alertness that had been mentioned might be even more important in the latter part of this year than it would normally. As he had said, however, for the next three weeks there did not seem to be much to do except to proceed along the same pattern as now being followed, although being careful not to be any easier. He would not recommend changing the directive or discount rate, and he would favor continuing the special authorization.

Mr. Allen reported that developments in the Seventh District were for the most part, but not altogether, of an encouraging nature. In the four weeks ended September 2, Seventh District department store sales were 3 per cent higher than last year, an improvement over the earlier part of the year. Manufacturers' shipments of virtually all types of appliances rose substantially in June and July, and local manufacturers advised that this reflected higher consumer sales rather than inventory building. Furniture manufacturers had not participated in that trend, however, new orders having been substantially below a year ago throughout the first seven months. Reports from the vacation areas were that spending had been disappointing. Although total employment in Seventh District centers was about equal to last year in July, employment in manufacturing was lower in virtually all categories. Most employers expected a moderate increase in September.

District steel makers expected production to reach an annual rate of 120 million tons in the fourth quarter compared with about 100 million tons at present. The talk had been that selective price increases of 4 to 5 dollars per ton of finished steel would be made effective after the wage boosts in October. Since the last general price increase in August of 1958, it was said that employee costs had risen $8 per ton, or about 10 per cent, and that effective prices had declined slightly.

Excellent corn and soybean crops and favorable price trends for cattle and hogs had improved farm income prospects in the District, Mr. Allen said.

Turning to automobiles, he commented that the low sales in August were attributed to dealer hesitation because of strike possibilities and to inventory shortages of some models. On August 31 the stock of new cars was 663,000--530,000 1961 models and 133,000 1962 models. It was now expected that 520,000 cars would be produced in September and 1,800,000 in the fourth quarter, which would mean total 1961 domestic production of 5,651,000 automobiles. The sales forecasts now were 400,000 in September and 1,600,000 in the fourth quarter, and if those figures were realized the year's sales would total 5,581,000--close to the year's expected production. Sales of foreign-made cars were not included in the figures he had quoted, but they were estimated at 375,000 for 1961 compared with 499,000 in 1960.

Seventh District weekly reporting banks showed a relatively stronger rise in business loans than all such banks in the country. Over the past three weeks commercial loans at those banks rose $54 million, more than half of the total expansion reported by all leading city banks together. This experience was attributable to an increase in loans to metals firms. However, the figures were not large, and available indicators of bank liquidity suggested that the banks were in position to handle considerable loan expansion. For the money market banks, short-term liquid assets averaged 20 per cent of deposits compared with 10 per cent a year ago. The large Chicago banks had had a basic surplus position of about $30 million for the past two weeks.

Continuing, Mr. Allen commented that the rise in business activity was slower in the June-August period than in the previous three months, but that this was not surprising for a summer season and there was much to support the view that activity would continue to rise, and possibly at a faster pace, in the remainder of 1961 and in 1962. However, the developments which were likely to accompany such an increase in activity and which would call for a shift in monetary policy were not yet in evidence, in the Seventh District at least, and for that reason, and also because of the Treasury's program, he would favor continuing for the next three weeks that degree of ease which had prevailed for some time now. He saw no reason to change the discount rate or directive and he continued to oppose the special authorization.

Mr. Clay reported that since midyear, loan volume at Tenth District weekly reporting banks had shown an increasingly strong performance. Loan demand was comparatively weak at District banks, especially city banks, during the first half of the year, although the recession-induced decline in business and consumer loan volume was not as pronounced as in the country as a whole. During August, total loans of weekly reporting banks, other than money market and Commodity Credit Corporation loans, registered the largest increase for the month of any recent year. Real estate loans advanced for the fifth consecutive month. Consumer loans, however, continued to contract moderately. Increased credit requirements of seasonal borrowers appeared to have been the chief factor in the rise in business loans. While the largest increase was in loans to commodity dealers, gains were registered in all classes of business loans except trade firms.

Mr. Clay characterized developments in the domestic national economy as continuing to be very encouraging. While the cyclical weakness in credit demand might be over and substantial credit expansion might appear before the end of the year, bank loans had not yet entered the period of major cyclical advance. This was evident from the fact that the classes of business whose bank indebtedness tends to show the greatest sensitivity to cycles in economic activity decreased their loan volume during August.

In view of the desired expansion in economic activity and the needed credit availability for economic expansion, Mr. Clay felt that it would be appropriate, so far as the private economy was concerned, for monetary policy to continue in approximately the same posture as during the period since the previous meeting of the Committee. This policy would provide about the same degree of monetary ease as in the past three weeks. In view of the international flow-of-funds problem, it also would call for the maintenance of the Treasury bill rate within the range of recent weeks. In other words, open market operations that he would consider appropriate would implement clause (b) of the directive, as adopted at the August 22 meeting, by "encouraging credit expansion so as to promote fuller utilization of resources, while giving consideration to international factors." The dominant factor during the period ahead, however, would be the recently announced Treasury financing program. For that reason, the maintenance of what had come to be referred to as an "even keel" policy was indicated. This phase of operations need not interfere, however, with the pursuit of the Committee's basic policy objective of encouraging credit expansion for the private economy.

Mr. Clay expressed the view that no change was called for in the discount rate or in the directive. He felt that the special authorization with respect to operations in longer-term securities should be renewed.

Mr. Wayne said that Fifth District business conditions continued to improve, with little deviation from the pattern of recent weeks. Nonfarm employment, seasonally adjusted, had climbed above the pre-recession high. Manufacturing man-hours also had moved up, but fell short of last season's high. Textile prices were generally firm, and the demand for bituminous coal appeared to be a little stronger to judge by production and shipments. Reports from businessmen revealed more confidence than previously. They were appraising the near future with considerable optimism, they commented favorably on the trends of employment and trade, and they reported substantial recent increases in manufacturers' orders and shipments. Farmers had been favored generally by good growing conditions, and tobacco prices were at record levels. District banks continued in an easy position, and business loan growth was stronger than in the nation as a whole.

As to policy, Mr. Wayne expressed the view that the course followed during the past three weeks had been appropriate. In the face of wide swings in market forces, the Desk had done a good job in holding close to the targets suggested three weeks ago. Personally, he was glad to see the bill rate decline moderately after the previous rise, although he would not care to see it go significantly lower.

Mr. Wayne said he felt that during the past year System policy had accomplished about all that could have reasonably been expected. Bank credit had increased something like $13 million during the past year, which apparently was adequate to meet the needs of the economy. Over the same period the money supply also increased, but only a little more than $2 billion. During the past six years, he noted, the increase in demand deposits adjusted was only about one-sixth as much as the increase in bank credit over the same period. The fact that more deposits had not remained in the form of demand deposits seemed to him to indicate that the public did not need more demand deposits. It was illogical to assume that the System could bring about an increase in the money supply by forcing more bank credit on the public unless it was prepared to pay a price that would be unjustified, particularly in relation to the international position of the dollar. The economy was now more liquid than a year ago, and money could be obtained by reversing the process that had been going on and converting liquid assets.

In conclusion, Mr. Wayne said that he would not favor changing the discount rate or the substance of the directive, and that he would continue the special authorization.

Mr. Robertson said that both prevailing economic conditions and the Treasury financing program seemed to dictate an even-keel policy for the next three weeks. In the circumstances, he did not consider it necessary to comment further at this time.

Mr. Shepardson expressed the view that the general economic situation called for a continuation of present policy. On the other hand, he could not help but be concerned about the present and prospective levels of Government expenditures and about the continuing and possibly increasing international tension. Within the limits imposed by the current Treasury financing program, it seemed to him that the Committee should lean somewhat toward a little less ease. Also, it should be alert to changes that could develop on rather short notice. He would favor no change in the directive at this time.

Mr. King noted that the balance-of-payments problem was still serious, but that it could not be solved by monetary policy alone. In saying this, however, he did not mean to infer that the confidence factor was not important. Confidence in some currency was not only a psychological necessity but almost a spiritual necessity to an alliance of countries that believed in free markets. Any such alliance seemed bound to erode unless there was some currency in which the countries involved could have reasonable confidence.

As to current policy, Mr. King expressed the view that a continuation of the current degree of ease was in order. He would visualize maintenance of the bill rate in the same area as at present and would consider any rise unnecessary. Even though prospective selling operations out of the Open Market Account might produce some tendency in that direction, he hoped any increase would be as small as possible. Likewise, free reserves should in his opinion be maintained in the same vicinity as at present. He thought this was not a time to start moving toward a more restrictive position. The Account Management, he commented, had proven capable in the past year of operating without too much instruction on the manner in which to resolve doubts, and he questioned the need of giving this type of instruction to the Desk. There was a tendency, he thought, for the Committee sometimes to feel that at least some minor change in instructions should be made over a period of a few weeks. However, the present situation was one in which he felt that the less the Committee did, the more likely it was to obtain a satisfactory solution.

Mr. Mitchell commented that he thought there was some uncertainty about the course that the economy would follow. It seemed to him that the thrust obtained from the change in inventory policy on the part of American business had been largely exhausted. This was the reason, apparently, that the index of industrial production probably would not continue to rise as rapidly as it did this spring and early summer. What was really expected in a recovery was that some generative force would get other things started, namely, consumer and business spending, and it still seemed a little uncertain whether consumers were going to spend to the extent needed to keep the recovery moving. Thus far, there was no convincing evidence from consumer spending or expectations that a second stage of the recovery was going to eventuate. Then, too, a little uncertainty was being evidenced by businessmen in terms of inventory policy; in fact, operations were still on close to a hand-to-mouth basis. Further, pricing policies were not as aggressive as one would generally expect at this stage of recovery. It might be that businessmen were alarmed by the antitrust activities of the Government, particularly in the electrical industry, but it might be also that businessmen themselves did not have confidence in the recovery. He did not pretend to have the answer, but it seemed fairly clear that there was not the buoyancy and ebullience in businessmen's attitudes that might be expected at a time like this. It was quite true that Government policies were on the expansionist side and that they might become more so. Also, it might be that the current wage settlements were going to be disturbing as far as price developments were concerned, but again they simply might lead to more mechanization.

For the next three weeks, Mr. Mitchell felt the Committee should not take any action which would indicate that it thought any different type of monetary policy was required. The Desk should not show evidence of resolving doubts on the side of additional ease or of additional firmness; instead, it should try to proceed right down the middle and do nothing to give observers reason to say that the Federal Reserve was either tightening or easing. The uneasiness and anxiety resulting from the cold war was undoubtedly affecting businessmen and consumers, and it should not be augmented by Federal Reserve action. He would not want to try to stimulate the economy by frightening people, that is, by raising fears about disturbances, whether hyperactive or faltering, in the economy. In summary, he would continue very much on an even-keel basis.

Mr. Fulton reported that the heavy industry sector of the Fourth District economy had moved ahead moderately in August. There had been a moderate but more than seasonal abatement of unemployment, which seemed to have gone down at a rate a little faster than the national rate. On the other hand, unemployment in the District was such that the District had a longer way to go than the nation, and it was still a major problem.

Construction had slackened a bit in the past month, Mr. Fulton said, and department store sales were not as good as in July, when they reached an all-time high on a seasonally adjusted basis. For the year to date, department store sales were down one per cent from a year ago. Automobile sales were lower in August, probably reflecting the hesitation incident to model changeovers.

In the steel business, there was a slight downturn in August but there had been a return now to a pretty fair rate of production. People in the steel industry felt that operations at the present level plus about 5 per cent would persist for the rest of the year. There was also a feeling that the first half of next year would show greater improvement. Total output for the current year would probably be about 100 million tons, with production at an annual rate of 120 million tons in the last quarter. No observable inventory accumulation on the part of manufacturing industries was occurring, but it was thought possible that the automotive industry would put in some inventory commencing the first of next year in anticipation of a June strike in the steel industry.

Whether a strike was inevitable could, of course, not be foretold, but at least it seemed to be indicated that the steel industry would try to keep wage increases down. The demand for some types of steel, including galvanized sheets and merchant pipe, had been quite active. Some buyers of foreign pipe were now trying to make domestic connections, but more steel was still being imported than exported. So far as prices were concerned, the steel industry was unanimous in claiming that a price rise was an absolute necessity, particularly in view of the wage increase which would be coming in October. The industry apparently had installed about all of the labor-saving devices that could be put in place. As to tin plate, the price of tin had risen to about $1.25 a pound against $1 last year, thus raising the question how the same price for the product could be maintained in the face of cost increases in both labor and material.

As to the auto industry, the settlement currently in process seemed more inflationary than other recent settlements. Many of the benefits were in the fringe benefit category, but they added to costs. Acceptance of the current settlement now depended on working out many local demands. In 1955, the contract was consummated in about a week, but no one was so optimistic this year.

As far as policy was concerned, Mr. Fulton said he felt that a continuation of the present posture would be quite appropriate. He would not favor a change in the discount rate, and he thought that the special authorization should be continued.

Mr. Bopp stated that business had been good in the Third District, with production and construction both rising. The Reserve Bank had been making some additional studies of the unemployment problem and considered it possible that there might be a break in the persistently high levels of unemployment that had plagued the District for some time.

Mr. Bopp expressed agreement with the view that there should be no change in policy. He would favor no change in the discount rate, the directive, or the general degree of ease in the market.

Mr. Bryan said that the reports and informal comments of the head office and branch directors who attended the meeting of the Atlanta directors last Friday seemed to be quite optimistic. He was not clear as to just why this attitude prevailed because District statistics showed no evidence of exuberant boom. There had been a little improvement in nonfarm employment and in manufacturing employment, and the greatest recent improvement probably was in construction contract awards. Other figures failed to show any boom situation or any rapid rate of improvement. He gained the impression, from conversations with the directors and with persons outside the System, that there was a growing feeling that inflation was again probable or perhaps inevitable. This did not strike him as a good psychological development for the country whatever might be the turn of events.

As to policy, Mr. Bryan said he believed that in view of the Treasury financing the Committee was not in a position to make any essential change in policy at this time. Therefore, he agreed with what he sensed to be the general sentiment around the table. Perhaps the Committee should provide some modest increment factor in supplying reserves, and it should take care of seasonal variations. Other than that, however, it should do nothing.

Chairman Martin noted at this point that Mr. Johns, who ordinarily would have presented his views at this juncture, had been compelled to return to St. Louis this morning for personal reasons.

Mr. Balderston expressed appreciation to the several members of the Committee who had communicated with him concerning the procedure that he had proposed at the August 22 meeting. The points raised had been most helpful to him and also, he believed, to members of the staff who had been working with the problem.

Mr. Balderston then noted that the chart distributed before the meeting this morning differed in two respects from the chart distributed at the August 22 meeting. 1/ First, there had been a change in the base for the two growth lines. This base had been reduced by cutting its excess reserve component from a figure of about $680 million to $600 million. The higher figure had been used originally because it was the actual figure in the week of March 1, which was about the time when the current business upturn was beginning. As some had noted, however, this

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

particular excess reserve figure was atypical. Thus, to the extent that Committee members might wish to use this device for guidance, it would be better to use the $600 million excess reserve figure, which was the same as employed in the data submitted throughout the summer by Mr. Thomas. The logical support for the $600 million base was that it was sufficiently above the fairly consistent figure of excess reserves at country member banks to have provided some expansionary effect during the period since the first of March. Therefore, at the risk of adding an additional adjustment of the chart to enhance its accuracy, he had adopted this assumed, but more typical, base figure for the trend lines. Also, the chart distributed today reflected another kind of change from the previous chart. Consistent rounding down of the growth allowance, along with an error in adjusting the early July data of around $50 million, affected the amount by which the actual reserves had appeared to depart from the two growth lines. The earlier chart reflected fairly accurately the direction that policy took during August but not the degree or amount of departure from a straight course.

Mr. Balderston recalled that the second portion of his suggested procedure three weeks ago had to do with the translation of open market policy, as worked out in terms of total reserves, into the language of free reserves. At that time he had passed on an observation by the staff that it might take almost $150 million more reserves in a week featured by a bulge in float to have the same expansionary effect as a given level of reserves in a nonfloat week. Accordingly, he had suggested two targets for the weeks that had now intervened; namely, free reserves of about $500 million for the two weeks ending September 6, and over $600 million for the week that would end tomorrow. Thanks to the Desk, and perhaps to chance, the actual and free reserve figures for the first two weeks provided a small test of his suggestion. While the week-to-week fluctuation was sharp, free reserves for the two weeks averaged $519 million and, as indicated by the chart, there was some expansion, in the order of $50 million, in the total reserves made available over that period. He hoped that the week ending September 13 would see free reserves moving back to around $600 million, with some corresponding upward fluctuation in the line of total available reserves. The import of such figures was that after some slippage in the rate of reserve growth as the summer progressed, particularly in early August, there had been maintained since the August 22 meeting a reserve position that had induced a resumed rate of expansion of available reserves.

At the previous meeting, Mr. Balderston noted, he had mentioned certain basic factors that could cause the relationship of total and free reserves to vary. In addition, two technical factors must be taken into account. First, the weekly seasonal correction could be relied on less than seasonals developed for monthly or quarterly data. Second, the attempt to distinguish between weeks of float bulge and other weeks involved guessing which weeks in the future would contain such bulges.

As to policy, Mr. Balderston suggested for the two probable high-float weeks ending September 27 a free reserve target somewhere around $600 million, and for the week ending October 4 a target of about $500 million. In short, he would seek to add to total reserves at the same rate that he had advocated three weeks ago, because neither international considerations nor speculative ebullience seemed to call for departure from such a course at the moment. However, he hoped the Committee would be prepared to make a departure at any time if necessary.

Chairman Martin said it appeared obvious to him that System policy was progressing in a satisfactory way at the present time. The Treasury problem would be acute for some time, so there was no particular reason for the System to rock the boat in any way. He took it from the discussion today that the consensus favored no change in the discount rate, no change in the directive, and a continuation of essentially the same degree of ease that had prevailed. He also understood that the special authorization would be renewed, with, he assumed, two dissenting votes. The Chairman then inquired whether it was agreed that this in essence was the consensus, and no comments to the contrary were heard.

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

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of

maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to encouraging 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.

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

Votes for this action: Messrs. Martin, Balderston, Irons, King, Mitchell, Shepardson, Swan, Wayne, and Treiber. Votes against this action: Messrs. Allen and Robertson.

Chairman Martin then referred to a memorandum from Mr. Young dated September 6, 1961, which dealt with the subject of the Open Market Committee's operating procedures and policies and transmitted to the Committee: (1) a draft of standing rules governing Committee open market practice that was first distributed to the Committee early in March of this year, as revised to reflect further suggestions of Committee members and subsequent Committee operations and discussions, and (2) draft wording, in several alternative formulations, to separate the Committee's directive to the New York Bank into two parts, a continuing authority directive that would be adopted once each year and a current economic policy directive that would be adopted at each meeting.

In introducing the subject, Chairman Martin also referred to two papers that were to be distributed to the Committee in the course of this meeting. The first, prepared by Mr. Knipe, was a critique of Federal Reserve policy, and its explanation, over the period 1949-1961. The second, prepared by Mr. Broida of the Board's staff, constituted a critical review of the language of clause (b) of the Committee's policy directives during the period 1957-1960. The Chairman further noted that he understood the Commission on Money and Credit would before long issue a paper containing a critical discussion of the Committee's directives.

Chairman Martin then commented that he thought it would be useful for the Committee to study the distributed material and see whether it could develop a form of directive that would be an improvement, particularly as far as public understanding was concerned. While he was not sure the Committee could do much better than at present, he thought that discussion was always good and he was not defeatist in his attitude. In any event, the Committee should do everything it could to resolve the problem. Although there might be some general discussion of Committee procedures this morning, what he had contemplated was that the Committee as a whole would try to hammer out something over a period of time. He would suggest that this be done beginning at the prospective meeting on November 14, at which time both he and Vice Chairman Hayes would again be in attendance. Otherwise, the Committee might run into the new year before it could reach agreement.

The Chairman then called for any discussion or comments on such a program, and Mr. Treiber commented that the program seemed satisfactory. He indicated that the New York Bank would have some observations to make on the documents transmitted with Mr. Young's memorandum of September 6. Perhaps it would be premature to have a discussion of them this morning but, in general, as indicated on earlier occasions, the New York Bank would look with favor on trying to break down the directive into two parts. As to the economic directive, it was the current thinking at the Bank that alternative "B", as set forth in the attachments to the memorandum, was probably the best of the several suggestions. As to the standing rules, the New York Bank would have some basic comments and some technical comments; it would also have some technical comments on the continuing authority directive to be adopted once each year.

Chairman Martin expressed the view that it would be desirable for the New York Bank to prepare a memorandum that could be distributed to the Committee along with memoranda from others who might care to submit comments or suggestions. He thought it would be advisable for the Committee to study the other two staff documents that he had mentioned before going into the matter too extensively. However, the earlier the Committee started trying to pool its views on the subject, the better off it would be.

Mr. Wayne inquired if he was correct in understanding the Chairman to suggest that if any Committee member had comments they should be sent to the Committee Secretary for distribution, and that the sooner this was done the better, after the Committee members had had a chance to study the staff documents mentioned by Chairman Martin.

Chairman Martin indicated that Mr. Wayne's understanding of the suggested procedure was correct.

Chairman Martin then stated that, if agreeable to the Committee, the understanding would be to proceed on the basis that had been suggested, and no disagreement was indicated.

Chairman Martin noted that there had also been included on the agenda for this meeting, at his suggestion, a discussion of the subject of possible Federal Reserve holdings of foreign currencies. In this connection, there had been distributed to the Committee copies of a memorandum from Mr. Young dated June 16, 1961 (corrected June 26), a supplemental memorandum from Mr. Furth of the Board's staff, also dated June 16, and a letter from the Federal Reserve Bank of New York dated July 21 commenting on Mr. Young's memorandum.

Chairman Martin commented that he had thought it would be desirable to have a general discussion of the subject at this time, particularly in order that he might have some of the thinking of the Committee members before going to Vienna to attend the annual meetings of the International Monetary Fund and the International Bank for Reconstruction and Development. This did not infer that he intended to discuss the matter in Vienna in terms of a commitment of any sort, but he no doubt would be asked questions from time to time. The problem, he thought, had been well stated in Mr. Young's memorandum, which referred, among other things, to the criticism of System foreign exchange operations by Senator Glass in 1932, when the Federal Reserve was concerned more with bolstering foreign currencies than defending the dollar. As the memorandum pointed out, however, this was unquestionably a new period, and the Treasury through its Stabilization Fund had already embarked on foreign exchange operations in defense of the dollar.

As he saw it, the Chairman continued, the handling of external monetary problems of this sort belonged primarily with the Treasury. Thus, there was a question whether the Stabilization Fund should not be enlarged and the Federal Reserve should participate with the Treasury in the handling of that Fund. To him, that was the critical problem. To use the Washington vernacular, he did not think that the System should be seeking "power," or a role that would attract attention to the System. Instead, it should be seeking the best end result. It might be that foreign exchange activities, if handled by the System, would be superior to such operations if handled by the Stabilization Fund. However, any operations would have to be closely coordinated with the Stabilization Fund, so that there was again presented a dual operating problem requiring Federal Reserve and Treasury cooperation.

The Chairman went on to say that in his mind there was no question but that this country was going to be in the business of foreign exchange operations in one way or another. In his opinion the nature of world conditions was such that some activities of this sort unquestionably would be engaged in in some manner.

Chairman Martin then turned to Mr. Treiber, who presented substantially the following statement:

> We welcome the suggestion in Mr. Young's memorandum of June 16, 1961 (corrected June 26, 1961), that the Federal Reserve, in the course of its regular operations, acquire and hold accounts in foreign currencies with major foreign central banks.
>
> Since March of this year the New York Bank, as fiscal agent of the United States, has conducted operations in the foreign exchange markets on behalf of the Stabilization Fund. In addition, as agent of certain foreign central banks, it has conducted foreign exchange operations in the New York market. Such transactions on behalf of the U. S. Treasury and foreign central banks through June 30 exceeded $1 billion.
>
> Transactions on behalf of the Stabilization Fund were undertaken, in cooperation with foreign central banks, for the purpose of strengthening the dollar. Our experience has persuaded us that United States intervention in the foreign exchange markets is a potentially highly effective instrument for defending the international position of the dollar and that further use of this instrument should be explored vigorously.
>
> The volume of foreign exchange that may be acquired by the Stabilization Fund is, of course, limited by the size of the Fund. Its present size is about $1/3 billion, of which a large amount is already tied up by stabilization agreements with certain Latin American countries. The scope of acquisition of hard currencies by the Fund is probably not much over

$100 million. While the Treasury may eventually ask the Congress to authorize an increase in the resources of the Fund, I understand that in any case the Treasury would welcome Federal Reserve acquisition of foreign exchange as a helpful supplement to the Stabilization Fund.

The primary purpose, as I see it, of System exchange operations would be to defend the dollar. Such operations should help to reduce the drain on gold and to influence the rate of the dollar in relation to other currencies, and thus promote confidence in the dollar.

In very general terms, Federal Reserve holdings of foreign exchange might be built up during the fat years of United States balance-of-payment surpluses and be run down during the lean years of deficits. Even during periods of deficit, such as the present, opportunities exist for acquiring currencies of certain foreign countries which may be short of dollars. There are seasonal as well as cyclical swings in our balance of payments that affect our gold reserves and the relationship of the dollar to foreign currencies. The impact of both types of swings might be cushioned by contraction and expansion of our exchange holdings.

Until recent months, the rate of the dollar in relation to other currencies has been determined exclusively by the exchange authorities of foreign countries. Abrupt declines of the dollar to the floor of the foreign exchanges have excited speculation as to possible changes in currency parities. By having in its possession an adequate supply of the major foreign currencies, the United States should be able to resist such pressures upon the dollar rate and thereby restrain a snowballing of speculative anticipations.

It is useful to engage not only in spot operations but also in future operations. Forward sales of German marks initiated by the Stabilization Fund in March, in cooperation with the Bundesbank, proved remarkably effective in restoring confidence in the stability of the dollar-mark parity, as well as restraining heavy German borrowing in the dollar market for hedging purposes. Forward operations in Swiss francs, subsequently initiated, have also had a useful stabilizing effect upon expectations in the face of the sterling crisis and then the Berlin crisis; this success has encouraged the U. S. Treasury to plan to enlarge substantially the volume of forward sales. Plans are also being made for forward operations in Dutch guilders with the hope of stimulating a sizable flow of Dutch short-term funds to New York. In all of these forward operations, arrangements have been made to protect the United States from any risk of loss in the event of a revaluation of the foreign currency involved.

The recent undertaking of foreign exchange transactions by the Stabilization Fund has promoted the development of close contacts and cooperation with officials of European central banks. The very fact of joint operations has required continuing consultations as to policy objectives and techniques. The consultations have been most harmonious; they encourage the hope of achieving the close cooperation of all the major central banks in their exchange markets. The importance of central bank cooperation is well illustrated by the operation undertaken by European central banks to protect sterling after the German revaluation. The European central banks have welcomed United States exchange operations as a vital step toward closing the ring of central bank defenses against speculation in exchange.

Beyond the immediate purpose of defending the dollar, United States operations in the exchange markets may contribute to a partial solution of the longer-term problem of insuring an adequate growth in international liquidity in order to finance the secular expansion of international trade. With the flow of newly mined gold into official reserves tending to lag considerably behind the annual growth of world trade, the growth of international liquidity since the end of the war has relied primarily upon a growth in foreign holdings of dollars. But our ability to sustain a much larger volume of dollar liabilities has now become seriously weakened and a variety of far-reaching reform schemes have been proposed as a solution to the problem of providing for future liquidity needs. System and Treasury officials have effectively pointed up a variety of serious shortcomings in such schemes, and have urged instead that moderate reforms of the present international financial system, such as standby credit facilities of the International Monetary Fund, offer the best hope of taking care of the long-term liquidity problem. While more ample credit facilities at the IMF will unquestionably prove most helpful, growth of official holdings of foreign exchange in currencies other than the dollar and sterling would provide a second important source of liquidity.

On July 21, Mr. Hayes wrote Chairman Martin commenting on the subject of Mr. Young's memorandum. We endorse the suggestion that day-to-day operations in foreign exchange be conducted under a standing directive of the Federal Open Market Committee, subject to the direction of and reporting to a Subcommittee. There is no need for me to review today the other comments and suggestions contained in that letter; all members of the Committee have received copies of the letter.

In conclusion, I would urge that we move forward in plans for the Federal Reserve to acquire and conduct transactions in foreign exchange.

Chairman Martin inquired of Mr. Treiber what limit he would contemplate on operations such as suggested, and the latter replied that he thought the System would have to feel its way along. He envisaged that certainly the amount would be relatively small at the start. In this connection, he noted that total transactions of the Stabilization Fund had involved about $1 billion, but that the holdings at any one time were only a small proportion of that figure. In any event, however, he had not come prepared today to suggest amounts of operations; instead, he had thought the discussion was to be more in terms of principle and whether to move forward with the study of problems such as amounts and the manner of operations.

The Chairman then stated that any other comments or questions would be in order, and Mr. Allen said that he had a question. Just because a thing was legal, that did not mean that he would always want to do it. On the legality of the proposed operations, however, he did have a question. While he had not consulted Counsel for the Chicago Bank, he assumed that the matter had been reviewed by the Board's attorneys. His question, then, was whether it seemed clear that it would be legal for the System to undertake such operations.

Chairman Martin replied that the matter would have to be gone into more extensively than it had thus far. However, in one form or another, he thought it could be said that the operations would be legal. The Chairman then turned to Mr. Hackley, who commented that legal questions had, of course, been raised in the past. Nearly 30 years ago, as indicated in Mr. Young's memorandum, the Board took a position, which it did not publish, that would seem to preclude the implementation of a program such as suggested. However, for reasons that did not need to be gone into today, he felt that the Board could well reinterpret the law in a somewhat different manner, and in his view such a step would be desirable.

In a further comment, Mr. Hackley recalled that in 1954 a review of the matter had been made by the staff. While no formal opinion had been submitted, he thought the views of Counsel for the Board and the New York Bank were in general agreement.

Chairman Martin then stated that he had mentioned this subject informally--not formally--to the Chairmen of the Senate and House Banking and Currency Committees, but without any indication as to whether or not the Federal Reserve might go into this kind of operation. He did not think it would be fair to say that the Committee Chairmen were either for or against the idea, but they were sympathetic to the problem. He had made no effort to press the point, and it would not be fair to say that the Committee Chairmen had given any clearance of any kind.

The Chairman went on to comment that what had been done through the Stabilization Fund was well known; some of the information was now public property. He thought it important to bring out that in the public mind, and in the mind of the Congress, there was a general idea that these were operations of the Federal Reserve. A distinction could be made, of course, in Federal Reserve circles, but in the public mind no such distinction was made. The average commentator and the man on the outside, at least those he had encountered, had the impression that while these things might be done through the Stabilization Fund, the Federal Reserve was involved. However, there was a very real point, as he had already indicated, that the primary direction must come from the Treasury and that anything done by the Federal Reserve must be coordinated with the Treasury.

The Chairman also said he did not think that these operations would involve anything in the way of substantial losses, if one wanted to put the matter in those terms. The Federal Reserve might engage in foreign exchange operations on a fairly substantial scale and actually make some money. Whatever losses it might incur would not, in his opinion, be of any serious nature; otherwise, he would not want to consider the matter at all. Everyone, Chairman Martin suggested, ought to keep in mind what the framework was. Also, before entering into any such operations, the System ought to do as the memorandum from Mr. Young suggested; namely, take the matter up formally with the Chairmen of the Banking and Currency Committees.

Mr. Bopp said that as nearly as he could recall the Stabilization Fund originally was in the order of $2 billion and one reason for its creation was dissatisfaction with the idea of the Federal Reserve handling foreign exchange operations. In many countries, he noted, the central bank does actually deal in foreign exchange, so in a sense the situation in this country was unique. Through the Stabilization Fund, however, the Treasury was to have the authority in case of any conflict. Then, as he recalled it, at the time of the Bretton Woods Agreements the Stabilization Fund was reduced to something like its present size, one reason being to cut down the power of the Treasury. At least, that was the general thinking. In the longer run, he noted, a possible conflict between Treasury policy and Federal Reserve policy in this area could develop. This was a thing to keep in mind in considering the basis on which any program would be entered into; that is, the sense in which the Treasury could direct Federal Reserve operations in this field even though Federal Reserve funds were used.

Chairman Martin called upon Mr. Young for comment in the light of Mr. Bopp's remarks, and Mr. Young noted that the motivations in cutting down the size of the Stabilization Fund had been varied, one reason having been to provide funds to make up the United States contribution to the resources of the International Monetary Fund. He added that there were admittedly various possibilities and hazards in the institutional relations that would be involved. On the other hand, over a period of time the Federal Reserve had had well-established working relationships with the Treasury in the international area through the

National Advisory Council. At times, there might be differences of view that could become rather sharp. However, he felt the whole background was such that these things could be dealt with as they arose, and that solutions could be worked out without any such matter developing into a monumental issue that would become public property.

Mr. Bopp then commented that he was sympathetic to the approach suggested in Mr. Young's memorandum, following which Mr. Balderston asked Mr. Young to comment further on the question that had been raised by Mr. Bopp concerning the direction over the use of Federal Reserve funds.

Mr. Young replied that he assumed the Federal Reserve would have control over its own funds. There would be consultation on matters of policy, but he could not imagine that the Federal Reserve would be confronted with any problem of directives at any time.

Mr. Robertson said that he would not want to leave the legal question in a posture where one could be misled into thinking that the Federal Reserve could just move ahead. While he would not want to argue that the proposed operations would be illegal, he thought that the point was highly questionable. A great deal of work should be done on researching the 1932 period and activities before that date to determine the intent of the statute itself. He then referred to the language of the sixth paragraph of section 14 of the Federal Reserve Act and noted the problem of construction presented by that language. A study of the legislative history, he felt, should help to clarify the point.

In further comments, Mr. Robertson said it seemed to him this whole problem was not fundamentally the problem of the Federal Reserve, but rather of the Treasury. If so, Federal Reserve operations of the kind suggested might be construed as bailing out the Treasury. It might be said that the Stabilization Fund was not adequate and therefore the Federal Reserve was supplying supplementary funds. Accordingly, before any operations were undertaken, he felt that the Congress should have a chance to take a look, at least through the Banking and Currency Committees, to see whether it was felt that the Federal Reserve had the power to proceed. In saying this, he was not questioning the desirability of action, along the lines suggested, by someone, whether the Treasury Department or the Treasury and State Departments or the Federal Reserve working closely with the Treasury. He noted, however, that in other countries there was a much closer relationship between the central bank and the executive branch of the Government than in this country. In short, he would not like to see the Federal Reserve Act hastily. Instead, he felt that the subject should be explored fully to be sure that the Federal Reserve was making whatever contribution it could to a long-term problem. While this problem did exist, he would not want to see the Federal Reserve take the position that it could construe the statute in any way it wished.

Mr. Hackley said he agreed with Mr. Robertson that the legal question involved was certainly debatable. He suggested that it might be advisable to furnish the Committee a memorandum which would deal not only with the question specifically mentioned by Mr. Robertson but also other problems involved in the program, such as the relationship between the jurisdictions of the Board and the Open Market Committee and the delegation of authority to a subcommittee of the Open Market Committee. Several questions were involved that the Open Market Committee might wish to have in mind before consulting committees of the Congress.

Chairman Martin concurred in the view that it would be desirable for the Open Market Committee to have such a memorandum.

Mr. Swan said that he had in mind somewhat the same kind of questions that had already been raised. He did not quarrel with the general approach--the general solution to this kind of problem--but he had some questions about the use of the Stabilization Fund versus Federal Reserve action. One was the question of authority as such, as contrasted with intermediate decisions. Another question related to the amounts involved, and whether the Federal Reserve in effect would be supplementing a limit that had not been raised and would wind up with much larger holdings than those of the Stabilization Fund. Also, in the area of actual operating techniques there was the question whether there would be any differences between operations of the Federal Reserve and the Treasury or whether they would of necessity be consistent. Further, there was the question of any differences in motives. He had noticed, for example, in the distributed material that the Stabilization

Fund had certain amounts committed under existing stabilization agreements with Latin American countries, whereas presumably Federal Reserve operations would not involve such uses of funds. If these various aspects of the matter could be spelled out, he felt that this would help to clarify the issues.

Mr. Wayne commented that perhaps the System could satisfy itself on the legal question. However, he had grave doubts about the desirability of embarking on a program in which the Federal Reserve would attempt to protect itself against the risk of loss. He did not see how the Federal Reserve could operate as an equal with other central banks and stipulate that other countries must protect its holdings against loss or it would not play the game. He would favor moving ahead, however, if the legal and related questions could be resolved.

In response to a request of the Chairman for his reaction to the comment in Mr. Young's memorandum concerning the change in conditions between the time of Senator Glass and today, Mr. Wayne said he thought there was generally a changed attitude. He went on to remark, however, that working relationships with the Treasury were currently of such a satisfactory nature that one might tend to assume their continuation indefinitely. In his opinion, that was a dangerous assumption. Also, he would be rather reluctant to have the Federal Reserve go into foreign exchange operations on the basis of even formal consultation with Congressional committees in any off-the-record session. While it would be unfortunate to have prolonged Congressional debate, at the same time he would feel much more comfortable if the Federal Reserve had an official commitment from the Congress that operations of the kind under consideration were clearly within its power. As he had said, it was his view that the Federal Reserve, if it moved in, would have to accept the inherent risks. As long as the System made money from the operations it would be applauded, but if it should lose money it would be criticized. If it came to that point, he would prefer that the Federal Reserve be criticized for operations that the Congress had determined to be legal.

Mr. King said that, as he saw it, the great danger in the whole process was that people would be likely to put too much reliance on these operations to guard the dollar, thus distracting the attention of the public and the Congress from the need for taking measures that would really do the job. In other words, such operations might provide a false sense of security. However, he believed that such a program was likely to be engaged in, and that the question was who would do the job. On behalf of the Federal Reserve, it might be said that it would be a good thing if the decisions in such a program were removed from politics. On the other hand, the diffusion of responsibility for decisions within the System framework might present a practical problem. In the type of operation under consideration, he envisaged that quick decisions would frequently be required, and that difficulties would arise if it was necessary to offer explanations or seek advice from a large group.

For this reason, he might be inclined to lean toward letting the Congress do what it wanted to do through the Stabilization Fund.

Mr. Bryan said that while he would not want to take a firm position at the present time, it seemed to him this was fundamentally what might be called in another context a price stabilization attempt. One can always win an argument in any price stabilization effort, he noted, by assuming the stabilization procedures to be equilibrating and ignoring the possibility that they might be disequilibrating. Before embarking on a program of the kind mentioned, he would like to see a careful analysis made of the kinds of situations where it was envisaged that the Federal Reserve would or would not intervene. Damage could easily be done in situations that could not be remedied by the same means; and the operations would be essentially disequilibrating rather than equilibrating in their end effects. Therefore, he would urge caution.

Mr. Allen said he thought Mr. Wayne, Mr. King, and Mr. Bryan had expressed his own thinking at the present time. With the world the way it was at the present time, somebody was going to do this. However, he had some doubt about the legality of Federal Reserve operations and, like Mr. Wayne, he would not be comfortable, if he had the responsibility for a decision, about consulting a few members of the Congress. He was inclined to think that the intent of Congress had been, and perhaps was now, to have the Stabilization Fund do this job. He was also inclined to feel that the handling of the matter through that mechanism should be encouraged.

Chairman Martin commented that this was about where he had come out earlier. However, he felt that the Federal Reserve must be positive in its approach to this subject. The present Under Secretary of the Treasury for Monetary Affairs had done some real pioneering work in this field, and he (Chairman Martin) was sure that this kind of thing was going to go forward. One might say that it would be in effect a price stabilization effort. Nevertheless, he felt sure that somebody was going to undertake it, and he would dislike to see the Federal Reserve get in the posture of not contributing what it could in the way of advice and consultation to the development of the soundest possible method of handling the matter. Perhaps the Treasury would want to obtain enlargement of the Stabilization Fund. However, even in his limited contacts thus far, one of the first questions he had been asked by Senators and Congressmen was whether the Federal Reserve approved or disapproved. In other words, they wanted to know the Federal Reserve's opinion. In the circumstances, he considered it vital that the System not just stay on the outside and say nothing. Even if the System should conclude that it was not the proper organization to handle this function and that the matter should be handled by the Stabilization Fund, he would hope that the Federal Reserve could get together material that would support the Treasury in the enlargement of the Stabilization Fund rather than just take a negative position, particularly when the System was already regarded in the public eye as being involved in these operations.

In further comments, Chairman Martin repeated that he thought it was important for the System to reach a position on this subject. The problem must be thought through carefully, and a good start had been made in the memoranda that had been distributed. There was, for example, the question of the prospective magnitude of operations. While he had talked with only a few Senators and Congressmen, that was a question they immediately had asked.

Chairman Martin then suggested that the Committee might want to ask the Board's Division of International Finance to continue the work it had been doing recently under the leadership of Mr. Young, who, he noted, was now representing the System at the working party level of the Organization for Economic Cooperation and Development. If this suggestion were followed, the Division would be expected to go ahead and pull the thing together, with the help of the Federal Reserve Bank of New York and others, so that the System could proceed to take a positive position. This would avoid the criticism that the System never contributed anything constructive, that it was against everything, and that there was nothing positive in its role. The System should not let itself get placed in such a position.

Chairman Martin went on to say that he had had a chance to think on some aspects of the matter during his trip to Europe earlier this year. He expected to attend the meeting of the Organization for Economic Cooperation and Development in the latter part of October and, as he had said, Mr. Young was attending all of the working party meetings. However, the System must try to pull this together in concrete form and if possible make some suggestions to the Treasury as to whether, for example, the Stabilization Fund should be enlarged two or three times. Then the System could determine whether or not it would be desirable for the Federal Reserve to be part of this program. It could let the Congress make that decision, but the System should not just sit by idly and let the problem swirl around it. That, he thought, was what had been happening to a degree.

Mr. King said that he had not intended his comments to be negative. However, he did feel that some person must make the decisions in connection with such a program and that the decisions must be clear-cut and fast. If it were decided to delegate the authority to some one person in the System, he would have no objection to such delegation and would endorse the idea.

Mr. Treiber commented that he thought there were two types of decisions. First, there was the extent to which the Federal Reserve would conduct some operations in a certain foreign currency. Second, there were the day-to-day operating decisions. Essentially, the same thing was involved in the day-to-day decisions of the Trading Desk in conducting open market operations.

Mr. King asked Mr. Treiber if he would not envisage, then, more difficulty than in making open market decisions, and Mr. Treiber replied that he would not.

Mr. Wayne commented, by way of clarification of his earlier remarks, that he would favor entering into such a program, but with full recognition of the risks involved.

Mr. Rouse commented on the degree of urgency that he saw in the matter. With the kind of international tension that existed at present, somebody must do this kind of thing, and he thought there was a time element involved in the sense of being ready, whether through the Stabilization Fund or the Federal Reserve. The Stabilization Fund resources were clearly inadequate to do the kind of job that might have to be done.

Chairman Martin responded that he thought Mr. Rouse's statement was well taken. There was a real question of urgency, and that was why he had suggested that the problem should be gotten in the works. On the other hand, he felt that the System should not move too fast, although it should be on top of the problem. He added the comment that the work done by the Under Secretary of the Treasury in this field had been an excellent pioneering piece of work. The Under Secretary had shown vision and capacity in improvising with the tools at his command; and had demonstrated how real the need was and how effectively, under certain circumstances, the problem could be handled, but only on a bridge of sound policies. In his opinion, the foreign exchange field was one in which the country had been fortunate in having the type of leadership that had existed in the Treasury. He hoped the System would think the problem through and be as constructive as possible.

Mr. King indicated that he had some concern about the idea of operations being conducted in two different forms and raised the question whether they should not preferably be concentrated, with one agency directing the entire effort.

Mr. Young pointed out in this connection that the Treasury has other jobs in connection with the Stabilization Fund. That was one of the reasons why the funds available for the particular kind of operations under discussion were so limited. He gathered that the Treasury might be happy if it were left free to use the Stabilization Fund for the other things with which it had to deal.

Chairman Martin then suggested that the Committee request Mr. Young and the Division of International Finance to work with the New York Reserve Bank and the Board's Legal Division in trying to pull the parts of the problem together, and agreement with this suggestion was indicated.

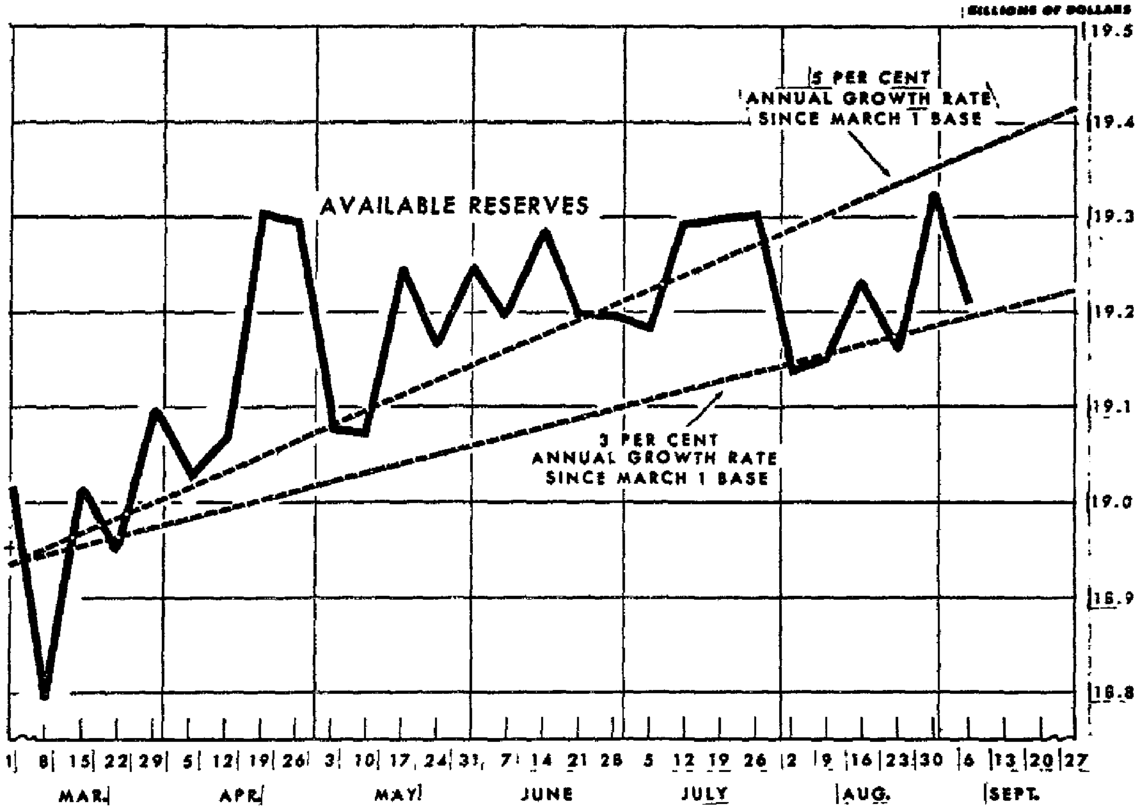
It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, October 3, 1961, and that the next succeeding meeting would be tentatively scheduled for Tuesday, October 24, 1961.

The meeting then adjourned.

Ralph A. Young
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 - SEPTEMBER 8, 1961



†Base for growth lines is total required reserves in week of March 1, 1961 plus assumed excess reserves of $600 million.

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

ATTACHMENT A