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, December 5, 1961, at 10:00 a.m.

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

Messrs. Ellis, Johns, 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. Furth, Adviser, Division of International Finance, 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

Mr. Hickman, Senior Vice President, Federal Reserve Bank of Cleveland
Messrs. Coombs, Eastburn, and Tow, Vice Presidents of the Federal Reserve Banks of New York, Philadelphia, and Kansas City, respectively
Mr. Anderson, Financial Economist, Federal Reserve Bank of Boston
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta
Mr. Abbott, Adviser, Federal Reserve Bank of St. Louis
Mr. Litterer, Assistant Vice President, Federal Reserve Bank of Minneapolis

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period November 14 through November 29, 1961, and a supplemental report covering the period November 30 through December 4, 1961. Copies of both reports have been placed in the files of the Committee.

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

> As the written reports have indicated, the money market was quite firm up to the Thanksgiving weekend, with Federal funds at the 2-3/4 - 3 per cent rate on most days. After that weekend conditions eased a bit, particularly at the close of the statement week ended last Wednesday. The important change in the money market during the period reflected the change in the position of the Government securities dealers over the period since we last met. Early in the period, dealers were using nearly $4-1/2 billion in credit, of which $2.6 billion was being supplied by the banks. This was about $2 billion more credit than was being utilized a year ago.

The credit bulge stemmed from the dealers' underwriting of the Treasury's November refunding operation and their support of the auction of the strip of Treasury bills. As you may remember, they were awarded something over $500 million of the $800 million involved in that auction. The pressure of dealer financing was, of course, felt mainly by banks in the major financial centers and was fully reflected in the money market. The technical position of the dealers was in far better shape towards the close of the period: Dealers had reduced their use of credit from $4-1/2 billion to about $3 billion, of which banks were supplying $1.3 billion. Their positions were still large, particularly in Treasury bills over 92 days, where the reduction has been small. Nevertheless, they are far more manageable from the standpoint of financing their "carry".

The market has tended to be somewhat nervous, as is probably inevitable in a period following such a large Treasury refunding operation with an environment of improving business conditions, deteriorating balance-of-payments developments, and considerable uncertainty as to whether there has been a shift in monetary policy. As a result, the market has been especially susceptible to new developments and to rumors of them. We have had more than our fair share of these over the past three weeks.

First of all, there was the newspaper story--Slevin in the Herald Tribune--of excessive speculation in the Treasury refunding, which led to a flurry of activity early in the period but which was set to rest by Treasury statements about the absence of speculation and by statements attributed to both the Treasury and the System that there had been no change in monetary policy. This was followed about a week later by the announcement of a $300 million gold loss during the week of November 22, and by rumors of a still greater loss in the following week. Finally, the news of the change in Regulation Q broke over the past weekend, with many in the market interpreting this move as an indication that the System has concluded that generally higher interest rates are inevitable. The decline in market prices yesterday was quite sharp, and it seems evident that the market is questioning whether it is experiencing a major adjustment in rate relationships which will gradually become more clearly defined over the coming weeks.

During the period, the three-month Treasury bill rate moved within a 2-1/2 - 2-5/8 per cent range. In yesterday's auction, average issuing rates of 2.625 per cent and 2.87 per cent were set for three-month and six-month Treasury bills, respectively, the highest level since October 10, 1960. Dealer awards were not heavy and, as might be expected, the major impact in this area of the change in Regulation Q appears to have been felt by the longer bills. However, as indicated in the supplementary report, the weekend announcement again focused attention on the further improvement of the economic outlook and in the likelihood that System policy might have to be tightened. This of course affected all maturity areas of the Government securities market.

With the market so susceptible to new developments, it is difficult to predict what the immediate future holds in store. One would expect that the usual year-end churning--particularly with no December tax anticipation bill outstanding--would keep the money market firm and put pressure on short-term interest rates. Although dealers have reduced their inventories substantially, as I mentioned earlier, they are scarcely in a position, given all the environment, to absorb readily heavy selling by corporations to meet tax and dividend payments.

There is one other thing. As you all know a new position--that of Deputy Under Secretary for Monetary Affairs--has recently been created at the Treasury. Dewey Daane has moved into the new spot and has been replaced as Assistant to the Secretary by Frank Morris. I should like to ask the Committee to approve the addition of the Deputy Under Secretary for Monetary Affairs to our distribution list for the weekly report of the Manager of the System Account.

Without objection, the addition of the Deputy Under Secretary for Monetary Affairs to the distribution list was approved.

Thereupon, upon motion duly made and seconded, the open market transactions during the period November 14 through December 4, 1961, were approved, ratified, and confirmed.

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

I think a relatively brief report on the economic situation is in order this morning. Data that have subsequently become available generally confirm the impression of developments in October reported to you by Mr. Koch at the last meeting. At the same time, we have practically no firm figures yet for November, but we should have a good many of them in time for the meeting two weeks from today.

Regarding October, we do know now that the 1 or 2 point advance in the index of industrial production, that Mr. Koch mentioned, rounded out at one point--the figure was 113.1, to be exact. This means that only .4 of 1 per cent further advance would carry the index to 114 for November--an increase that is practically assured on the basis of weekly data already available. The more likely possibility seems to be that the index for November will gain 2 points, rounding to 115, although this is by no means assured.

The steel production and auto schedules already announced for December suggest that the chances are for further gain this month--perhaps another point. One way or another it seems a good bet that the index will be up to 116 by year end.

Another October figure that has recently become available is the over $100 million expansion in consumer credit, and there seems to be every indication that it will be followed by a further increase in November, in view of the high rate of auto sales last month.

Further improvement at the retail level is also indicated by department store sales, which we are now estimating at 153 for November--up two points from October.

Manufacturers' sales and orders were both up about 2-1/2 per cent in October--maintaining the margin of orders over sales that has developed since mid-year. Inventory accumulation in October continued at about the third-quarter rate.

The new series on housing starts has been very erratic and it would be a mistake to place much emphasis on the 1.4 million annual rate figure achieved in October--but it is fair to say that it supports the steady upward trend that has been apparent behind the month-to-month ups and downs. The Department of Commerce has estimated that housing starts in 1962 will be up 8 per cent--from an estimated rate of 1.3 million in 1961 to 1.4 million in 1962.

I have just been able to get the November unemployment figure, scheduled for release this Thursday. It shows a substantial decline--about 1/2 of 1 percentage point on a seasonally adjusted basis--for the first time in a year.

With these strong developments in the current figures, I find it reassuring rather than disturbing that recent surveys of consumer buying intentions for the coming six months do not show much gain over year-ago levels. The Quarterly Survey conducted by Census for the Board in mid-October showed that plans to buy new automobiles in the next six months were about the same as a year ago. Plans to buy major household durables were down, and housing and used auto purchase plans just a little higher.

I have not been able to get any specific information about the results of the Commerce-SEC Survey of plant and equipment expenditure plans for the first quarter. The people who are presently tabulating the data seem to feel the figure will be up little, if at all, from the current quarter, however. If true, this also suggests the absence of underlying pressures working in the direction of excessive or unsustainable expansion.

I have much the same reaction to the recently released report of the National Association of Purchasing Agents, which indicates that while orders are up, the uptrend lacks "zip." In my judgment, the prospects for sustained expansion and price stability would not be enhanced by much more zip than is evident in the current data.

This leads me to the concluding observation, which perhaps should have come earlier in this brief report, that prices have continued substantially unchanged--as increases and reductions in wholesale prices since mid-October appear to have just about offset one another. The 1/10 of 1 per cent increase in consumer prices in October was largely attributable to the seasonal cutback in price concessions by auto dealers. As you will recall, however, list prices of the new models are substantially unchanged.

While the continuation of some downdrift in industrial wholesale prices for a month or two beyond the low point of a cycle is not unusual, it is unprecedented for such prices to be lower after 9 months of vigorous recovery. This major difference alone is a sufficient basis for caution in drawing parallels between this and other cyclical upswings. Both with respect to its implications for the prospective course of events and the timing of policy actions designed to promote sustainable growth, this long sought-after price stability poses questions that are unique in the postwar period.

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

Analyses of bank credit developments and liquidity availabilities during the past year support the conclusion that Federal Reserve operations have had the results, whether or not expressed as policy aims, of providing reserves to meet practically all credit and liquidity demands without lowering the level of interest rates. The results have been (1) an expansion in total required reserves at a rate of about 5 per cent a year, supporting increases of 3 per cent in demand deposits and 14 per cent in time deposits and a 7 per cent increase in total loans and investments of commercial banks; and (2) relative stability of interest rates at between 2-1/4 and 2-5/8 per cent for 3-month Treasury bills and just under 4 per cent for long-term Treasury bonds. Although expansion in the money supply has been less than that in GNP, the increase in total liquidity has been commensurate. Yet over-all liquidity is not large by historical standards. Interest rates stayed at higher levels than during previous recessions, but short-term rates are lower than at the corresponding stage of previous periods of recovery, while the current level of long-term rates is comparable to, or perhaps even higher than, that in similar previous periods. Potentials for further expansion in the economy indicate the need for continued increases in bank credit and the money supply, with little or no advance in long-term interest rates, until speculative tendencies or other excesses become evident.

Turning to the immediate situation, although the pace of economic expansion appears to have accelerated somewhat in November, the rate of bank credit and monetary expansion may have slackened, following a pronounced increase in September and October. Reserves were made available as the month progressed in amounts adequate for continued bank credit increases, but they were not as fully utilized. Nevertheless, money markets were relatively tight until the end of the month, and interest rates generally rose somewhat.

Some upward pressure on interest rates is to be expected at this time of the year when credit and liquidity needs are at a seasonal maximum. Monetary transactions are large, and the shifting of funds from one use to another places strains on the banking system. Reflecting these shifts, borrowing by individual member banks was frequent even though member banks as a group had an increase in excess reserves during November. In addition there were sizable operations in Federal funds among banks.

An important special influence on money markets in November, as pointed out by the report of the Account Management, grew out of the exceptionally large shifts in dealers' positions. Dealers, who had earlier built up rather large positions in longer-term bills, partly in connection with Treasury offerings, added on a sizable volume of short bills offered in a strip by the Treasury in mid-November, and also took on through market acquisitions considerable amounts of the new medium- and longer-term issues involved in the refunding. In addition they showed a seasonal, or greater than seasonal, increase in their long-term repurchase contracts. As a consequence, dealers' commitments and borrowings had risen to an exceptionally high level by mid-November. They were subsequently reduced with exceptional rapidity and by the beginning of December were back close to the level of early October. In most categories, however, positions are still much larger than a year ago, and the task of meeting the large December liquidity needs, which usually requires a large increase in dealers' positions, still lies ahead. In any event, they are now much better prepared to meet this task than they were three weeks or a month ago.

Reflecting market pressures, Treasury bill yields rose in the latter part of November to or slightly above previous peaks reached at various times of seasonal pressures during the past 15 months. Yields on medium- and long-term Treasury issues also rose, but generally did not quite reach earlier peaks recorded this year. Under the pressure of a sizable volume of new issues, offering rates on new issues of corporate bonds have been raised somewhat and market yields on State and local government bonds have risen. At the same time, yields on seasoned high-grade corporate bonds declined somewhat in November. Averages of common stock prices rose to new high levels in November, but have tended to level off during the past two weeks. Trading on the stock exchange has been in large volume.

New capital issues by corporations continued in comparatively large volume during November and are expected to be substantial in December. An unusually large portion of the

December financing will consist of private placements, rather than public offerings. New bond issues by State and local governments were also large in November, though not up to earlier estimates for the month, as one large issue was deferred. Issues scheduled for December are in much smaller aggregate volume than in November, though somewhat more than in December of 1960 and 1959.

Cash raised in past financing operations, together with December tax receipts, will cover Treasury cash needs during December. A new financing operation to raise $2 to $3 billion will be needed early in January. The Treasury will be limited in its borrowing during the months ahead by the debt ceiling and may at times find it necessary to operate with a lower cash balance. Current estimates of receipts and expenditures indicate an over-all net balance of receipts and expenditures for the remainder of this fiscal year, but borrowing will be needed to cover retirement of maturing tax bills in March and June.

Total loans and investments of city banks showed only a small increase during the five weeks ending November 29. Holdings of Government securities and loans on Governments to dealers declined by a substantial amount, while other loans and investments increased about as much as in the same period of any other recent year. The increase in business loans was only moderate and that in loans to finance companies very small, but loans to other financial institutions, those on real estate, other loans to consumers, and holdings of other securities by city banks all increased by relatively sizable amounts. These changes would indicate that, in the absence of business loan demand in amounts adequate to use funds available, banks are seeking other uses for their funds.

Deposits at banks showed little or no expansion in November. Private demand deposits seem to have declined on a seasonally adjusted basis, resulting in a decrease in the money supply for the month. There was little change in U. S. Government deposits on balance for the five weeks as a whole, though some fluctuations within the period. Time deposits in the aggregate changed but little, with savings deposits continuing to increase while other time deposits declined. Some net withdrawal of time deposits usually occurs in November.

As a result of the slackened growth in deposits, following the sharp increase in October, required reserves of member banks did not show the customary seasonal increase in November. They remained, however, close to the projected expansion level of 5 per cent per annum since February. Total reserves, after a sharp decline in the first week of the month, increased more than required reserves and continued slightly above the projected level. Reserves were abundantly supplied by System operations in amounts adequate to offset drains from other factors, to cover seasonal needs for required reserves, and to provide for some expansion. Free reserves rose from the temporary low average of $385 million in the first week of the month to a preliminary estimate of $569 million in the last week.

Estimates of reserve drains during the current week indicate that, in the absence of further System operations, total reserves available are likely to decline by more than the estimated seasonal amount. At the same time required reserves may decline less than seasonally, and net free reserves may fall to below $500 million. There are, however, some elements of uncertainty in the estimates, and the level of reserves may turn out to be somewhat larger than indicated.

During the remainder of December, many of the factors affecting the availability of reserves will show very wide variations, which on balance will be largely offsetting but are difficult to estimate with any degree of precision and can at times have significant net effects on reserve availability. Operations therefore will need to be adjusted to current market developments and tone. Although net changes in System holdings may be relatively moderate for the remainder of December, there are likely to be large reserve demands in the first week or ten day of January, particularly if a Treasury cash financing operation occurs at that time. After that, the post-holiday return flow of currency and usual seasonal liquidation of bank credit will release large amounts of reserves, aggregating close to $1.2 billion by the latter part of February.

Thus, although System operations during the next two months will necessarily be very large, they will mostly cover purely temporary variations in the availability of and the need for reserves. Cyclical factors will be small relative to these wide temporary fluctuations.

Since economic expansion seems to be progressing satisfactorily, with no evidence of speculative tendencies in the use of credit or of excess liquidity, it seems appropriate to continue the policy of making reserves available for further credit and monetary expansion, abstracting from seasonal variations. Because of the international balance-of-payments situation, it may continue to be desirable to avoid causing a decline in interest rates. However, if economic expansion continues, with commensurate credit demands, the avoidance of interest rate declines, while still permitting moderate monetary expansion, may cease to be a problem.

Mr. Furth presented the following statement on the balance of payments:

Preliminary reports on the U. S. balance of international payments for November suggest that the deficit, as calculated by the decline in U. S. official holdings of gold and convertible foreign currencies plus the increase in foreign official and private liquid dollar claims, was again in the neighborhood of $400 million, nearly the size of the October and September deficits.

In October, the deficit was caused to a large part by an extraordinary transaction (the U. S. subscription to the Inter-American Development Bank of $110 million) and by an outflow of short-term U. S. funds, mainly to Canada, movements which are not customarily considered part of the so-called basic deficit. In November, there was another extraordinary transaction (the U. S. subscription to the International Development Association of $62 million); but available data do not yet permit any estimate of the volume of short-term capital movements.

Economic developments abroad likely to affect U. S. exports continue to follow the line discussed in previous reports. There has been a definite downturn in the United Kingdom, and the upswing seems to have lost momentum in some countries of Continental Europe, and according to reports not as yet supported by statistical evidence, also in Japan. Developments in Canada were similar to those in the U. S. domestic economy.

International capital movements still are dominated by the continued flow of funds to the United Kingdom, not only from this country but also from Continental Europe. The resulting increase in U. K. reserves has induced the United Kingdom to repay nearly 30 per cent of its recent drawing from the International Monetary Fund, and to purchase a substantial amount of gold from the U. S. Treasury. This gold transaction in turn has led to some unrest on European foreign exchange markets.

Last week saw bear attacks on the dollar (in Germany) and on sterling, as well as a bull attack on the Italian lira on rumors of a lira appreciation. While these flurries soon died down, they indicate the nervousness of the international financial community.

The London gold price was maintained at a few cents below the level of $35.20 that has prevailed in recent months.

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

It seems to me that the domestic business and credit situation remains about what it was three weeks ago. The more complete statistics now available for October, together with such fragmentary data as we have for November, support the impression of a continuing strong, but not overly exuberant, expansion. Sentiment appears to have swung further in the direction of optimism. As we compare the course of business since the February trough with the two preceding postwar recoveries, we find roughly comparable trends in production, manufacturers' sales, and personal income; but in retail sales, despite the good gain in October, there is a considerable lag as compared with the earlier upswings. Since the key to the pace of further business expansion may well lie in the area of consumer outlays, it is not particularly encouraging to note that the most recent survey of consumer buying intentions shows little change as compared with earlier this year, or a year ago. On the other hand, the very fact that consumer expenditures have not risen as rapidly as personal income certainly suggests a favorable atmosphere for a higher rate of buying in the future.

The prospect of an upward movement in business expenditures for plant and equipment has found some further confirmation in the N.I.C.B. third-quarter survey of capital appropriations in manufacturing. Residential construction appears to be holding up well.

It is interesting to observe the role of the Federal Government with respect to the entire spending outlook. Although defense spending is rising, the Government is unquestionably making a very strong effort to limit the rise next year and to achieve economies elsewhere in the interest of a balanced budget in fiscal 1963. At the same time, the

Administration hopes to stimulate private capital spending through this very restraint in Government outlays and through special tax incentives. Whether these good intentions can be put into practical effect of course remains to be seen.

The price situation in general remains rather satisfactory. Both sensitive commodity prices and the broader wholesale price index are below their levels at the trough of the recession in contrast with increases in the comparable periods of the two preceding postwar recoveries. It wouldn't be surprising, however, to see some signs of price strength in the months ahead for cyclical reasons. There is perhaps a basis for mild uneasiness in the fact that consumer prices of goods other than foods have been moving up moderately.

Despite the drop in the unemployment rate in November, the unemployment problem obviously remains severe.

It is interesting to compare changes in commercial bank credit since the February trough with earlier postwar cycles. We find that whereas total loans and investments increased to about the same extent as in 1958 and 1954-55, total loans lagged somewhat behind 1958 and far behind 1954-55. However, a closer examination suggests that this loan showing is less disturbing than might be inferred from the current complaints of various New York bank lending officers. It is well to remember that business loans rose in the recent recession period, whereas they had declined in the two preceding recessions. Also, the relative levels of various interest rates have encouraged a larger proportion of borrowing outside of the banks, and corporations appear to have larger internal funds relative to their investment needs than in the earlier periods.

The banks remain highly liquid, and both the money supply and total liquid assets held by the public have been showing substantial gains. Such gains have not been excessive in relation to the strong business upswing of recent months.

Unfortunately the balance-of-payments position has not improved at all since our last meeting and has probably deteriorated further. The rate of deficit since July has been far higher than we can afford to contemplate for many months ahead, if confidence in the dollar is to be preserved. Although the Administration is taking effective steps to reduce the net drain of military expenditures abroad, measures along these and related lines may be fully offset by an adverse trend in the trade balance induced by the relative timing of cyclical business swings here and abroad. A great deal will depend on the willingness of American business and labor to take seriously the vital need for keeping down costs and exporting more, and on the rapidity with which appropriate moves to step up export volume can become effective.

The $300 million gold outflow of two weeks ago has fortunately not led to any convulsive movements in the gold and foreign exchange markets. However, it has undoubtedly increased the general feeling of uneasiness about our balance of payments which was already widespread in European countries. Various press articles abroad placing erroneous interpretation on the Government's recently announced movements with respect to silver have not improved this atmosphere. The dollar remains in a delicate position.

It is not easy to tailor a suitable monetary policy to fit this complex pattern of circumstances. The domestic situation would seem to call for no appreciable change in policy. On the other hand, there seems to be enough strength in the outlook and enough liquidity available so that we need not be unduly solicitous about maintaining free reserves as high as they have recently been. It has been interesting to note that, according to our calculations, total reserves have lately been running somewhat above the Board staff's suggested target of a 5 per cent rate of gain over the February level. Also, if expansion continues we must sooner or later break down the increasingly widespread notion that we are wedded to a $500 million free reserve target.

The level of short-term interest rates must remain a matter of deep concern to the Committee. Even though the present differential between our bill rate and the U. K. bill rate is negligible on a covered basis, we cannot be completely indifferent either to the uncovered spread or to the psychological value of maintaining a reasonably firm rate level here. Fortunately a combination of circumstances, including heavy dealer positions in bills and the attendant pressures on the money market, Treasury emphasis on short-term financing, and the imminence of the usual December period of seasonal pressures, has brought about a considerable firming of bill rates without any change in monetary policy. I would hope that a continuation of similar "natural" influences would sustain bill rates for the next two weeks with a minimum of effort on our part. Clearly we should do everything we can to prevent the 90-day rate from falling below the 2-1/2 - 2-3/4 per cent range, and if it should prove necessary to let free reserves drop to around $400 million to accomplish this I would have no objection. It would be preferable if the rate were to move closer to 2-3/4 than 2-1/2. There is perhaps reason to hope that last Friday's announcement with respect to time and savings deposit interest rates may help to bring about fairly firm bill rates. I think we should welcome the Board's move on several counts, and especially because of the longer-run beneficial effects it may well have on our balance of payments and the gold outflow.

Unless the Treasury intends to attempt another advance refunding in the near future, it could be argued that any real change in policy we might have in mind for the next few months might best be accomplished in the very near future, before the Treasury must again come to the market for cash in January and for a major refunding in February. However, on balance, I am inclined to feel that we should pass up this opportunity in the hope that market conditions, together with the recent revision of Regulation Q, will operate in the direction of our rate objective, with the possibility that we may have to lower our free reserve figures slightly to assist in this process. It would probably be best to avoid any overt move at least until we have had a chance to observe the market effects of the revision of Regulation Q and to avoid exaggerated expectations of a tightening of credit. The avoiding of an overt move on our part seems especially justified at a time when the dealers will probably continue to be under considerable pressure in any case and when this factor, together with normal seasonal influences, could easily make for considerable market instability. Thus it would appear that the feel of the market should be a particularly important criterion for the next two weeks, with ample leeway for the Manager to exercise his best judgment. It would seem advisable to make no change in the discount rate or directive at this time.

I am inclined to think that unless we can see genuine and substantial progress in the next few weeks toward reducing the balance-of-payments deficit by nonmonetary means--an area in which the Administration apparently feels rather optimistic--we may well have to consider decidedly overt moves in the area of monetary policy within the fairly near future. We would be in a better position to make such moves, if and when necessary, if there had previously been some gradual firming of market

> rates. Finally, I do not think we should dismiss from our minds the possibility that our balance-of-payments difficulties could bring on a serious situation.

Mr. Ellis expressed agreement with the view that the consumer was the major question mark in the recovery movement at the present time. However, to judge from the current evidence in New England, he felt it must be concluded that the doubts were being resolved favorably, for consumer spending was rising markedly. In this connection he cited statistics on department store sales, which showed substantial recent gains, and noted a consensus among department store operators that the Christmas trade was going to be most satisfactory. Stocks were reported adequate to meet the demands. Also, reports from dealers as to automobile sales were very satisfactory. While current registration data were not available, evidence of good sales could be found in bank financing figures. Thus, accepting the reservation that one could not be sure how long the current trend of consumer spending would continue, it seemed that this question mark in the analysis of economic recovery was being resolved. Manufacturing activity was expanding, mostly in the durable goods sector, and manufacturing employment showed a modest year-to-year gain for the first time since August 1960. Improvement in the unemployment picture was reflected in the most recent figures on initial unemployment compensation claims as well as total claims, the latter being down substantially from year-ago levels.

Credit conditions reflected both the recovery in business and the monetary policy of ease. Demand deposits were up considerably from year-ago levels and were holding at the peak, while time deposits showed steady growth. Loan-deposit ratios were a shade higher than a year ago and several points above the national average. Loan demand was still somewhat disappointing, and city banks were shifting to Government securities in the one-to-five-year category. During the past 10 weeks District banks had been net sellers of Federal funds, and increasingly so.

Turning to policy, Mr. Ellis said that clearly the posture must continue to be one of monetary ease in support of the recovery. However, it seemed illogical to continue the same degree of ease that had been considered appropriate for the past 10 months. If the recovery continued and gained further momentum, it could logically be anticipated that credit demands would strengthen and the market would tighten itself. His reaction would be to let it do so. While he would provide reserves for seasonal needs and steady growth, he would settle for something less than a 5 per cent annual rate of increase in total reserves. He would allow free reserves to fall, banks to borrow some reserves, and rates to rise as the market tightened itself.

Mr. Ellis suggested that this would be a good time to have a two-part directive, for that would permit the Committee to record the changes in economic conditions and a gradual shading in the degree of encouragement given to credit expansion. Encouragement was still needed, but less of it. However, pending further discussion of the form of the directive, it would probably be best to leave the existing directive unchanged.

As to targets, Mr. Ellis suggested total reserves steadily expanding, perhaps at a 4 per cent rate after seasonal adjustment, free reserves in the $400-$500 million range, the bill rate in about the same range as recently (above 2-1/2 per cent), and the Federal funds rate close to the bill rate. He would renew the special authorization covering operations in longer maturities.

Mr. Irons reported that business conditions in the Eleventh District were showing satisfactory progress. The industrial production index rose to a record high in October, and additional gains seemed to have occurred in November. Petroleum output showed a modest gain in November, and a nine-day allowable basis had been established for December. Employment conditions were improving and could be said to be fairly strong. Unemployment had declined further; in Texas, at 4.4 per cent of the labor force, the rate dropped below the year-ago level for the first time in 1961. There was strength in construction activity during October, and department store trade appeared quite satisfactory. The agricultural picture continued to be good.

As to the banking picture, loans had continued to move up and investments declined a little more than the increase in loans. Federal funds purchases had increased but sales moved up more, so on balance purchases were further below sales than three weeks ago. Borrowing from the Reserve Bank was negligible, with no borrowing on a number of days. Reserve positions seemed satisfactory. Deposits rose a little during the past three weeks, demand deposits being down a bit and time deposits up.

Generally speaking, Mr. Irons said, there was a good feeling as to the outlook, and optimism prevailed regarding the Holiday trade volume.

Turning to policy, Mr. Irons said that all things considered he was rather well satisfied with the way things had moved during the past three weeks. He would be inclined to recommend pretty much a continuance of the policy that had been followed during that period. At some point the System would need to be firmer, but it did not seem necessary to anticipate that point when there was no real evidence of speculative or inflationary developments. Prices were stable, there was unused capacity, and there was an unemployment problem nationally that probably would continue for some time.

In terms of targets, Mr. Irons said he continued to feel that close attention should be given to the rate structure in light of the international situation. He would suggest a bill rate in the 2-1/2--2-3/4 per cent range, with Federal funds about in the range that had prevailed. He would make reserves available freely to meet seasonal requirements, but beyond that he would be inclined to lean on the side of firmness rather than on the side of ease. As to the level of free reserves, he would suggest the general area of $400-$450 million. In summary, for the next two-week period he would continue pretty much the existing policy, with doubts resolved on the side of firmness. This was not the time to change the discount rate, and he did not feel strongly regarding the directive. It could certainly be continued for two weeks, although he felt there was some merit in the language suggested by Mr. Treiber at the November 14 meeting, which would have denoted a modest shift in the emphasis of policy. He would continue the special authorization covering operations in longer maturities.

Mr. Swan reported that the business situation in the Twelfth District had contirued to improve. In October, nonagricultural employment in the Pacific Coast States rose further, and the rate of unemployment declined to the national average for the first time during the entire recovery. Loan demand apparently continued to show strength in November, and the larger banks had been rather substantial net buyers of Federal funds, although this was related primarily to the situation at one bank.

Mr. Swan then commented on a recent conference on the business situation and outlook which was attended by some 20 businessmen representing a wide variety of interests throughout the District. The participants seemed quite optimistic, perhaps somewhat more so than it had been thought they might be, and it was the consensus that the economy would continue to register fairly substantial gains through all of 1962. Some rise in prices was envisaged, but only to quite a moderate extent. As to unemployment, the participants felt that there would be some decline but that by the middle of 1962 unemployment would still be somewhere in the 5 to 6 per cent range. They anticipated an increase in plant and equipment expenditures, perhaps somewhat more than the 4 per cent indicated by the recent McGraw-Hill survey, but no striking increase. There was quite a definite feeling that inventories would be rather closely associated with sales; there seemed to be no desire to speculate in terms of potential price increases or other factors. The participants were most hopeful regarding consumer spending, much more so than various recent surveys suggested. One factor cited in support of this view was the apparent desire of consumers to buy at the top of the price range in which they were interested. For example, there was a tendency for those interested in compact cars to want many accessories.

Turning to policy, Mr. Swan said it seemed to him there was a continuing expansion in the business situation, considerably stronger than in August and September but certainly not at what might be characterized as an excessive rate. He agreed that the Committee should continue to follow in general terms a policy of maintaining sufficient ease to encourage further credit expansion in support of recovery. However, in the past several weeks there had been a clear indication of some firming, as the result of market developments rather than any positive changes in policy. Taking into account developments in recent weeks, including the revision of maximum interest rates under Regulation Q, and considering the seasonal pressures that lay ahead, he did not think it was necessary to worry too much about sufficient firmness being maintained, at least in the immediate future. In fact, though it might seem paradoxical, he felt that it might be possible to have, on the one hand, somewhat higher levels of free reserves and, on the other hand, somewhat higher bill rates. While he found it difficult to quantify, he foresaw that in the period just ahead bill rates might run around 2.6 - 2.75 per cent with free reserves around or somewhat above $500 million. He agreed with Mr. Hayes' analysis of the reasons for not making any overt change in policy at the moment. This would imply no change in the discount rate or the directive, and he would continue the special authorization.

Mr. Deming said, with respect to recent developments in the Ninth District, that through October iron ore shipments from Lake Superior ports totalled 48 million tons, 25 per cent less than the 64 million tons shipped through October last year. Mining employment in Minnesota in October also was 25 per cent smaller than a year earlier. Cash farm income continued to lag last year's figures as a result of the summer drouth. Industrial electric power use in October was 5 per cent ahead of a year earlier; bank debits were 12 per cent larger than in October 1960; and "help wanted" ads in Upper Midwest metropolitan newspapers were ahead of year-ago levels for the first time this year (plus 9 per cent). District personal income in September and October increased at rates approaching the national average after lagging in the summer. Non-agricultural employment finally passed year-earlier levels in October.

Sentiment among downtown retailers for the Christmas season was only moderately optimistic, Mr. Deming said, but new retail outlets were showing good sales records and total retail sales should be quite good. A new type of retail outlet, a combination food store and department store called the super center, had made its appearance in the Twin Cities. The operators noted that within two years 54 stores of somewhat similar type would be in operation in the Cities, and within 10 years they believed that a very high proportion of retail sales would be made in such stores. There was some question as to whether official retail sales figures fully represented the presence of such outlets and consequently a feeling that the official retail sales figures might understate the volume of consumer takings at the present time. He had some belief that such was the case in the Twin Cities area; he merely raised this point as a question with respect to the nation.

Banking developments in the District continued to run counter to those in the nation, with loan demand remaining relatively weak. District banks had employed their increasing funds in investments, particularly in short-term Government securities. Their loan-deposit ratios were significantly lower than a year ago, or even three months ago, and their ratios of short Governments to deposits were significantly higher. Borrowings from the Reserve Bank were very small. In short, the banks were far more liquid today than seemed likely even six months earlier.

Looking at the national economy, Mr. Deming said it seemed to him that the economy had moved back into high gear in recent weeks. He wished to say again that if this movement continued, he would have difficulty in characterizing the upswing as modest. While unutilized resources of men and machines continued to run higher than in some other upswings, and while wholesale prices and those for sensitive materials showed continued stability, the very fact of movement farther away in time from the trough argued that the period of no or low pressure was shortening, perhaps more rapidly than now seemed likely. Bank credit expansion and growth in the money supply seemed to be proceeding satisfactorily.

Mr. Deming said that although he would favor a mild firming of monetary policy, for the two-week period immediately ahead it might be better to do nothing and let the market digest the recently-announced change in Regulation Q. Looking farther ahead, it would seem desirable to move toward a position of somewhat less ease. In the existing kind of situation, with market forces tightening things up, he felt strongly that the free reserve guide might be quite treacherous. He preferred to look at total reserves, with an allowance for growth of 3 or 4 per cent and allowance for seasonal needs, as a guide to policy. This, he thought, would produce a lower level of free reserves. It would almost imperceptibly exert some dampening influence on undue exuberance in the economy and on bank credit expansion. He saw no reason to change the directive or the discount rate, and he would continue the special authorization.

Mr. Baughman reported that business activity in the Seventh District had continued to improve, with the strengthening demand for autos and trucks playing a key role. Consumer purchases of goods other than automobiles probably were rising only slowly, if at all, and total loans at District banks had declined somewhat in recent weeks. However, employment was continuing to improve and new orders for steel had risen sharply.

Retail deliveries of new automobiles in November, nationally, were at a record high for the month. Industry spokesmen were increasingly optimistic and had raised their estimates of sales and increased production schedules. While employment in the industry was rising, efforts would be made to avoid hiring workers for temporary periods; this might cause large amounts of overtime. More than half of the nation's assembly plants were now on six-day schedules.

Production of passenger cars in the fourth quarter was now estimated (by some analysts in the industry) at 1,800,000--3 to 4 per cent above the corresponding period in 1960. The same volume was projected for the first quarter of 1962 and a somewhat larger volume for the second quarter. If these estimates should be realized, production in the first half of next year would be about 3,800,000 units, or 40 per cent higher than in the first half of 1961. It was estimated that the inventory of new cars, 701,000 on November 20, would rise only to 750,000 at year-end.

Both heavy and light trucks had been selling well. One large producer reported sales recently at the highest rate since World War II. Production was running about 13 per cent above the rate a year ago.

While steel production in the nation was virtually unchanged from mid-October through November at just over 2 million tons a week, production in the Chicago area, and particularly in Detroit, rose in

November and it now appeared that output would rise quite sharply in December and January. A large volume of new orders had been placed during the past two weeks, especially by auto manufacturers, but orders from other industries had risen also. Steel warehouses reported an increase in their business, indicating that small users of steel were buying more actively.

Manufacturers of farm machinery reported that current sales were improved from the depressed level in the summer, and they were planning for larger production and sales in 1962 than in the current year. Manufacturers of construction machinery in the District were not participating in the current rise in new orders for durable goods.

Some further improvement in employment in the District was indicated by reports on hiring intentions, with most of the prospective gains being in the automotive and electrical equipment industries. In Chicago newspapers the "help wanted" ads, seasonally adjusted, had risen somewhat in recent months, but the lineage was still below the level of early 1960.

The evidence on consumer spending for goods other than automobiles in the Seventh District was not conclusive. Department store sales in the four weeks ending November 25, while 4 per cent above the corresponding period in 1960 (when sales were depressed somewhat), appeared to have risen less than seasonally. Data on bank time deposits, savings and loan shares, and E and H bonds in the District had given no indication recently of a rise in spending relative to saving.

The harvesting of corn and soybeans had been delayed in some areas because of muddy fields but crop losses were not expected to be widespread. The favorable level of farm income and reduced purchases of feeder cattle in the eastern Corn Belt had reduced the demand for agricultural credit in most of the District below the year-ago levels. In the western portion of the District, however, cattle feeding was being expanded and the volume of new agricultural loans made by member banks was about one-fourth above the volume last fall.

Total loans at District weekly reporting member banks, after rising in September and October, declined $21 million in the three weeks ended November 22. Paydowns of commercial-industrial and security loans were only partly offset by modest increases in loans on real estate and loans to consumers and to financial institutions.

The basic deficit of Chicago central reserve city banks was reduced from about $190 million in the week ended November 8 to $90 million for the week ended November 29, and probably had improved further in recent days. The modest improvement in position was due mainly to sales of Treasury bills and partly to a decline of loans. Aside from one large bank that borrowed at the discount window over the Thanksgiving holiday, Chicago banks had covered their reserve needs largely by borrowing Federal funds. In other major District cities, banks remained in easy reserve positions. The leading banks in Detroit, Milwaukee, and Indianapolis had continued to lend substantial amounts in the Federal funds market, and these banks, for the most part, had not reduced their holdings of securities.

Mr. Clay commented that the economic developments of recent weeks had been encouraging in that they had indicated a resumption of the upward movement of economic activity. The underlying strength of the movement was not yet apparent. Moreover, the developments had a long way to go in terms of aggregate demand, the level of industrial production, and the employment of manpower and other resources before attaining a satisfactory level of economic activity. Accordingly, whatever encouragement might be derived from recent developments was not justification for a change in monetary policy to a lesser degree of ease. Rather, the state of the domestic economy continued to call for a monetary policy that would encourage credit expansion with a view to promoting the fuller utilization of resources--a policy essentially in line with that of recent months.

The international balance-of-payments situation remained a problem, Mr. Clay noted, as it probably would for a long time to come. Action to deal with the basic problem was urgently needed, and it was to be hoped that such action would be successfully pursued by those in a position to deal with it. The Open Market Committee had been concerned with the threat of speculative developments against the dollar resulting from the balance-of-payments situation. In an endeavor to ameliorate that threat, the Committee had maintained the Treasury bill rate at a level that would be reasonably favorable relative to comparable interest rates abroad. Such action continued to be in order. It must be recognized, however, that policy action designed to meet the international situation by maintaining higher interest rates tended to reduce monetary ease and the stimulus provided to the domestic economy. Thus, such action must either be defensible in terms of domestic needs or the effect on the domestic economy should be offset by other means.

At the November 14 meeting of the Committee, Mr. Clay recalled, it was suggested that the emphasis of monetary policy be shifted so as to give greater weight to international factors and less weight to the domestic economy, and it was further suggested that the Committee's directive be changed accordingly. Adoption of this change in monetary policy would be a step in the direction of less monetary ease and presumably would be predicated on a judgment that domestic developments no longer required the stimulus of monetary expansion to the same degree as heretofore. Domestic developments to date and the requisite expansion in economic activity did not appear to support this premise. If, on the other hand, the need to give greater weight to international factors was advanced on the ground that they merited greater consideration even though domestic factors were somewhat subordinated, such an approach would appear to be unnecessary as well as inappropriate in terms of the domestic situation. To the extent that the maintenance of the Treasury bill rate at the proper level for international considerations might interfere with the appropriate monetary policy for domestic purposes, reserve objectives should be attained by conducting operations in longer maturities to the extent necessary. Domestic objectives should not be sacrificed in order to maintain the desired Treasury bill rate.

Accordingly, Mr. Clay recommended that the Committee renew the directive in its present form. No change was required in the discount rate, and the special authorization for operating in longer maturities should be continued.

Mr. Wayne reported that business recovery in the Fifth District had accelerated since the preceding meeting of the Committee, but probably not as much as in the country as a whole. As to business sentiment, a recent survey by the Reserve Bank showed general improvement. The respondents expected increases in manufacturers' new orders and shipments, although those were already doing well. They also foresaw further gains in factory employment and hours of work, but there were somewhat divergent views with regard to the outlook of profits.

The farm outlook was favorable. District money market banks had been net sellers of Federal funds, and borrowings from the Reserve Bank were at minimum levels.

Prior to last Friday, Mr. Wayne said, it had seemed to him that this might be an appropriate time to review monetary policy. However, he felt that it would be advisable to let the market digest the effect of the new maximum rates established pursuant to Regulation Q and not to add further pressure. He would let the feel and general tone of the market be the principal controlling factor. He would be somewhat reluctant to attempt to suggest a free reserve goal. However, if the level of free reserves should be somewhat less than it had been, out of necessity to maintain the bill rate in the range of 2-1/2 - 2-5/8 per cent, he would accept the lower levels. He would not change the discount rate or the directive at this time, and he would renew the special authorization.

Mr. Mills said that in his view the Committee's immediate objective should be to focus attention on the supersensitive state of the Government securities market and the foreign exchange markets rather than on domestic economic developments. His comments today would be confined to Government securities market considerations and would be frankly critical. Mr. Mills then presented the following statement:

> The following is quoted from the November 30th issue of the Bankers Trust Company's "Monetary Indices":

"There is some evidence that the Federal may want to ease this seasonal squeeze. A generous amount of free reserves has been maintained in the banking system this week. They averaged $569 million, the largest since September 27. However, this easier condition must be continued in order to permit the market to absorb some of the expected selling due in the next two weeks."

Monetary and credit policy-making has been reduced to a sad state of affairs when outside parties can presume to dictate policy actions and when newspaper articles declaiming a change of policy or new losses of gold can seriously unsettle the market for U. S. Government securities. The prodigal policy actions that have been taken since the last meeting of the Committee, and before, are to blame for this unfortunate situation in which the initiative for policy decisions has been lost to the market.

A kindly Providence may see the rest of the year through free from the dangers that are inherent in a policy that has over-emphasized the importance of increasing the money supply and which has largely disregarded the necessity of utilizing the monetary weapon to combat our adverse balance-of-payments problems. In the meanwhile, the perils of permitting a continuously high level of free reserves will be mitigated by the need of affording market relief over the December tax, dividend payment, and window-dressing periods. Needed reserves should be supplied as far as possible through direct open market purchases of U. S. Government securities that will serve to reduce the unwieldy positions of the U. S. Government securities dealers, and actions should be avoided that would tempt the dealers back into a new speculation in U. S. Government securities via the avenue of a favorable interest carry on their positions.

It is to be hoped that control over the market can be regained after the turn of the year when it is customay to withdraw reserves, and that the initiative will pass back to the System Open Market Committee. A resumption of actions at that time that would produce excessive credit ease through the failure adequately to withdraw surplus reserves, or through renewed support of the long end of the U. S. Government securities list, would be steps along the path toward price pegging and toward again making the Federal Reserve Systen an "engine of inflation." It can also be hoped that whatever is done in the sphere of international monetary and fiscal affairs between now and the new year will bear fruit and thereby lighten the responsibility of the Federal Reserve System in the balance of payments sector of finance.

Stock market speculation, abetted by the use of funds withdrawn by nonfinancial holders from investment in U. S. Government securities that have in turn gravitated into commercial bank portfolios, and an incipient upward price excitement in the commodity markets are sensitive economic areas that are subject to the current Federal Reserve System monetary and credit policy which must be put under strict surveillance.

Mr. Robertson said that since there was still a high rate of unemployment and no evidence, at least that he could detect, of speculative or inflationary tendencies, he could see no basis for changing the direction of policy at this time. He was becoming increasingly wary of overstaying the policy of ease, but not so much so he would want to change policy at this particular juncture. The time would come when the System would have to make a change, and it should keep its sights set on opportunities for gradual and inconspicuous shadings of policy. For the next two weeks, however, he would stay put.

Mr. Shepardson said he had somewhat the same concern that Mr. Mills had expressed. However, his analysis at this time was almost identical with the analysis presented by Mr. Deming, and he would follow the policy suggested by Mr. Deming.

Mr. King said that he would agree substantially with the statements of Messrs. Swan and Deming, which he interpreted as essentially a ratification of the suggestions made by Mr. Thomas. The points made about natural tendencies in the market at this time of the year were good ones. He would not like to see any material tightening at this time, and for that reason would suggest a free reserve target in the area of $500-$525 million.

Mr. Mitchell said that Mr. Clay's remarks expressed his own views precisely with regard to the relationship between foreign and domestic considerations and also the need for monetary expansion. The prescription for the immediate future had, he believed, been quite well expressed by Mr. Thomas. It did not seem to him that this was a period when the free reserve level was a very practical target; the Committee should be more concerned about the trend and level of short-term rates and the feel of the market. The Desk should be instructed to accommodate itself to the churning in the market that was in sight for the next few weeks, and protect itself as well as possible. It seemed especially important to him to avoid, as far as possible, speculation about a change in policy at this time. Nothing would be more destructive to Committee objectives than to get a speculative upheaval in motion. The position of the dealers today was much sounder than a month ago, and he would not want to see them get into a position that reflected speculation that monetary policy was going to be changed.

With regard to last week's change in Regulation Q, Mr. Mitchell said he gathered from some press comments that because interest costs could be raised, certain bankers felt it would now be appropriate for yields to move up in response to market forces or Federal Reserve action. This, he thought, was not the right kind of speculation to encourage. Therefore, he came back again to the policy prescription that the System ought to be careful to avoid encouraging the speculative reaction that would result if people thought there was going to be the kind of change in monetary policy that had occurred at roughly this juncture in previous expansions.

In concluding comments, Mr. Mitchell noted that the satisfactory expansion of the money supply had been due in part to the accommodating effect of Treasury financing operations. If it had not been for that factor, the curve probably would have been different. As to the business situation, he remarked that the evidence of improvement was still largely tentative from a statistical standpoint. The improvement in psychology seemed to be outrunning the statistics, and he felt this deserved consideration in the formulation of monetary policy.

Mr. Fulton said that business activity in the Fourth District appeared to have shaken off much of the August-September setback and currently was veering to the upside. New car sales were high in November and showed more than a seasonal increase. Department store sales had risen appreciably above the comparable period last year, with indications of a good Christmas season. Electric power output had shifted slightly to the upside, but the sluggishness of this index indicated the slowness of recovery in the District. Unemployment figures were showing a slight upturn because of seasonal factors.

In the steel industry, orders in the past week had been the largest in two years, but they were for January or later deliveries. November deliveries were no better than October, and December would be only slightly better. In the first half of 1962, however, production would be going into high gear. Production last week was up nationally about 2 per cent from the previous week, indicating that the mills were beginning to increase their own inventories in anticipation of later deliveries, predominantly to the automotive field. The industry looked for production of about 105-110 million tons in 1962 against 97-98 million this year. Users of steel would be stocking inventories in anticipation of a strike that seemed inevitable at the end of next June; the industrial production index might be affected by this unusual circumstance, and it should be kept in mind that it was a temporary phenomenon. The first half of 1962 might be of boom proportions and the second half down very considerably.

After discussing further the prospects of inventory accumulation in anticipation of a steel strike, Mr. Fulton said that in 1962 the automobile companies expected to sell about 6.3 million domestic cars and 1.2 million trucks, with foreign imports about 300 thousand. However, their schedules for the first quarter called for production of around 1.8 million cars, a very high figure that would suggest about a 7 million car year.

It seemed inevitable that steel prices were going to be raised, Mr. Fulton continued. There would be an effort made by the unions to get the same type of settlement as with the automobile companies. If that were obtained, the cost to the steel companies would be substantially more, however, because of the differential in the basic wage rate. Also, part of the settlement with the auto companies included almost a guaranteed annual wage, and because of the ups and downs in the steel industry such an arrangement would be quite costly. Further, the mills had to operate at about 70 per cent of capacity to realize a gain from their new and improved facilities, and they had not been doing that well. Except for the first half of 1962, prospects did not augur well for such a level of production. As to employment, the operating rate would be maintained with fewer men because of the large investments the companies had made, so that even at a higher rate of production not much of the unemployment would be relieved. There was less and less need for common labor, machines having taken over much of that type of work.

As to policy, Mr. Fulton expressed the opinion that reserves should be supplied to accommodate most of the requirements for credit.

In the Fourth District there had not been a recovery to former levels. Unemployment was still high and the prospective improvement in activity in the steel industry during the first part of next year could be termed illusory because it would be in contemplation of a strike. While he would like to see the bill rate in about the 2-1/2 - 2-3/4 per cent range, which would assist in preventing a large drop in the rate following the January return flow of currency, he felt that events taking place in the field of labor rates and cost pushes were something that monetary policy could not control. If monetary policy interfered, that could affect the economy adversely. Therefore, he would not be too concerned about price movements resulting from those factors in formulating policy. Until credit demands of individuals and corporations increased actively, no overt action should be taken to restrict credit. In other words, he would not choke off credit until evidences of abuse became apparent. He would not change the discount rate, and he would leave the directive in its present form, for the present at least. He would renew the special authorization.

Mr. Bopp said that despite the continuing improvement in business in the Third District, as well as nationally, he would be inclined not to make any major change in policy until evidence of the strength of the expansion and its inflationary implications, if any, became clearer and until the change in Regulation Q was absorbed. Moreover, this was a period when unexpected tightening could easily develop, and the market would seize on any major deviation in reserve figures and other indicators as an indication of a change in policy. While he certainly would not be in favor of more ease and would not want short-term rates to decline significantly, he believed that approximately the present degree of ease should be maintained. He would continue the present discount rate, the directive, and the special authorization.

Mr. Bryan said there was nothing significantly different in the Sixth District from the national figures, with perhaps one exception, namely, that District city banks seemed to be experiencing a somewhat sharper increase in business loan demand in November.

Continuing, Mr. Bryan said that, although not wholly on the same grounds, he was generally sympathetic to the point of view expressed by Mr. Mills. He believed that the System would be running into danger if it tried to feed the boom--and he thought it was a boom, with some structural defects that were causing unemployment--by pressing reserves on the banking system. As he saw it, the System had made, by and large, the contribution that it might be expected to make to recovery. Total reserves were above the long-term 3 per cent growth rate. In the circumstances, his inclination would be to meet seasonal needs and to reduce the projection of desirable growth in total reserves from a 5 per cent annual rate to some lesser figure, perhaps 3 or 4 per cent or something in that range. He agreed with the view that the free reserve situation was especially treacherous at the present time. He would let the free reserve figures fall where they might, after allowing for a seasonal adjustment in total reserves and a very small growth factor.

Mr. Bryan said he wished very much that in the next few months the market could be detached from its preoccupation with the free reserve figures. He did not know how that could be done, but he believed that this preoccupation had become dangerous at the present time. What he feared, Mr. Bryan said, was an international situation that would require the System to take large and overt monetary actions in order to try to correct a situation for which it was not responsible. Accordingly, he would favor a gradual shifting of posture.

Mr. Johns said the position he had come prepared to express today was very much along the lines he had expressed three weeks ago. In order to be as brief as possible, he would say simply that he would be prepared to adopt almost without change the statement made by Mr. Deming, which in turn included most of what had been said by Mr. Ellis and by Mr. Bryan. He was inclined to believe that the rate of increase of reserves and money that had occurred, say in the period since August, was too rapid. In saying that, he did not overlook the fact, as disclosed in the staff memorandum on member bank reserves, that there had been some fluctuating of that rate in the most recent weeks. For the immediate future, he would suggest that the rate of increase of reserves and money be at no more than a 5 per cent annual rate and in all probability something less. Although he did not propose to state what would be exactly the right rate, he would not quarrel with 3 or 4 per cent. In his opinion this was a situation in which the Committee must be most attentive to the decisions made by others, including the demands made upon banks by their customers and the decisions of bankers with respect to lending and investing. The Committee should be prepared to alter its course quickly if necessary.

Mr. Johns also said that he would like to underscore the caveats that had been expressed regarding the treacherous nature of the free reserve target in the present circumstances. He was aware of the preoccupation of commentators and others with the free reserve figures. However, if the current economic movement should continue, there was no escape from the fact that free reserves were going to decline if the Federal Reserve followed an appropriate monetary policy. How to get rid of the preoccupation with the free reserve figures, he did not know, but it should be done.

Mr. Johns commented that if the resurgence of business activity continued, with intensification of the demands for credit, the inevitability of rising interest rates must be recognized. He would not do anything to prevent that from occurring. If bill rates rose to the area of 3 per cent, he felt that the System should be prepared to give prompt consideration to an increase in the discount rate.

Mr. Balderston said that he had two observations of a technical nature. First, the chart appended to the staff memorandum on member bank reserves afforded a person who had been out of the country for a period a quick view of what had happened in the way of open market operations. He found that chart satisfactory. Second, on the third page of the New York Bank's report on open market operations there appeared a comparison of actual total reserves with the "target" figures found in column 3 of table 3 of the memorandum from the Board's staff, which were based on a 5 per cent annual growth rate. This comparison provided an indication of the degree of coordination between the policy decisions of the Committee and the implementation of those decisions by the Desk.

As to the next two weeks, Mr. Balderston said he found himself in sympathy with the position expressed by Mr. Swan. In view of the seasonal character of the period, he felt that the Committee's goal, expressed in free reserves, might somewhat be higher than otherwise. For reasons that had been mentioned around the table, including the recent change in maximum rates on time and savings deposits and the unsettlement in the Government securities market, this was no time for any overt change in policy. In order to continue the existing policy, he would suggest free reserves of $475 million for the week ending December 13 and $550 million for the week ending December 20, this differentiation being made in light of the point brought out over the last few months that the target for a high float week should be somewhat higher than for a low float week.

Chairman Martin said he subscribed to the view that it would be desirable to de-emphasize the free reserve figures. The market's preoccupation with those figures had been a handicap for a long time, and he hoped some means of de-emphasis could be found.

The Chairman went on to say that he thought the market was setting the pace for the System at the present time. His view was that there would be lower levels of free reserves, and probably higher interest rates, as a result of market forces. It would be unfortunate, however, if the System created those higher rates or lower free reserve levels at the present time. The System had been pursuing a policy that had been effective; whether the policy of ease had been extended longer than would have been desirable was another question. Having gone this far, however, the Committee should be very certain, before taking overt action to lower the level of free reserves or to raise interest rates, that market forces had been the generating factor. In June, he recalled, he had thought that market forces were going to create a situation such as now appeared about to occur, but there was no follow-through. Possibly there would be none now. In any event, he felt that the System should not fight a declining free reserve level when it was trying to pursue approximately the same policy that it had been pursuing. This could not be put in terms of either total or free reserves accurately. However, there should be a posture that the System had been contributing all it could to the growth and development of the economy, without producing inflation, but that the System had not taken upon itself the role of changing interest rates or the reserve pattern. A problem of judgment was involved, but in essence this was where he came out.

Chairman Martin then said that by and large he felt the Committee was rather close together today. The consensus was clearly for no change in the directive or the discount rate. A majority favored no change in the general over-all policy of supplying reserves until the next meeting of the Committee. A minority favored some slight reduction of the pressure to keep up the level of reserves. By and large, however, it seemed to him that the Committee favored reaffirming the policy that it had been pursuing for the past three weeks for another two-week period.

At this point the Chairman asked Mr. Rouse whether he would like to make any comments on the problem in the market as he saw it, to which Mr. Rouse replied that he thought it would be necessary to play by ear to a large extent in the light of developments. The reserve picture appeared to be adequate. Since there would be a long period of continuing float, he felt the comment made by Mr. Balderston was not as appropriate as under normal conditions.

Chairman Martin said he understood that the Committee favored continuing the special authorization covering operations in longer-term maturities, with one dissent, and there was no comment to the contrary. As to general policy, he inquired of Mr. Mills whether the latter wished to dissent and Mr. Mills replied in the negative, stating that he thought the general policy was correct. It was not by his own choice but by necessity that he agreed with it.

The Chairman inquired whether anyone wished to place further views on record at this point, and there was no such indication.

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 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, Hayes, Balderston, Irons, King, Mills, Mitchell, Shepardson, Swan, Wayne, and Fulton. Vote against this action: Mr. Robertson.

At this point Mr. Hexter, Assistant General Counsel, entered the room.

Referring to the subject of Federal Reserve operations in foreign currencies, Chairman Martin noted that since the discussion at the Committee meeting on November 14, certain additional material had been distributed. This included a new set of the previously distributed staff documents relating to foreign currency operations, the revisions having been mainly editorial. Also, in addition to the letter from Mr. Wayne referred to at the November 14 meeting, letters from Messrs. Fulton and Swan had now been distributed.

The Chairman then turned to Mr. Young for introductory remarks to a general discussion of the subject.

Mr. Young said that this was a serious problem for the System and a difficult one, views on which would necessarily differ rather widely. He wished to direct his introductory remarks to the broad problem as he saw it. Mr. Young then made substantially the following comments:

> What the Western world has been striving for since the war is the reestablishment of a stable world payments system with major currencies inter-convertible at negligible cost and risk. That objective has been pursued because such a system would enable international trade and investment decisions to be freed of currency risk, and this in turn would promote both economic efficiency and economic growth in which all would share.
>
> But the convertibility we have attained has been subject to volatilities, and appears susceptible to vulnerabilities, and the public has become sensitive to these matters. Curing of these problems takes time, especially since they arise partly out of an uncertain equilibrium of the Western alliance and the financial costs for the United States of maintaining a reasonable semblance of Western unity, including unity with the outer and less developed areas.
>
> We are now in a critical phase, with the risk that gains made will be lost. A breakdown in the payments system would be a major setback, recovery from which would take years. The

number one danger is that of a confidence fission; once set off, the chain reaction would have to run its course. The only solution is to brace the foundations of the payments system wherever possible and feasible, so that public confidence in it will recover and gain strength.

The major steps in bracing the foundations at this time are two. The first is the IMF borrowing arrangement. The second is extension of central bank cooperation--with Federal Reserve participation--to deal with the developing problem before resort to a Fund drawing or borrowing.

The problem is nonpartisan. At stake in the end is the faith and credit of the United States Government, because a dollar of stable international value is the external symbol of this faith and credit. An enduring solution will have to be along nonpolitical lines, and its administration will have to be as free of political bias as it is practicable to make it. Some financial risks are involved, but these are small in terms of the stakes.

The plan for foreign currency operations emphasizes counter-seasonal and perhaps cyclical aspects of the problem because experience shows that it is at points of seasonal and cyclical strain that market doubts and protective actions become acute. Reactions in exchange markets to uncertainty are volatile but not necessarily speculative in the invidious sense of the word. Disturbance becomes accentuated because participants in international trade and investment, activated by doubts and uncertainties, engage in protective operations. In the light of these actions, the professional bear or bull enters to capitalize on the situation and to aggravate it.

Various details of the foreign currency operations plan are debatable, but any final tailoring of the plan can be made in the light of the Committee consensus. If the Committee wishes to consider an approach to operations through amendment of the Federal Reserve Act, a very preliminary draft of possible amendment is available for exploratory discussion.

Chairman Martin commented that such doubts as might exist regarding the legal basis for System operations in foreign currencies had been focused clearly in Mr. Hackley's memorandum and in other comments. In the event of an emergency the System probably would have a basis on which it could act. However, the holding of foreign currencies would place the System in a stronger position to handle an emergency than if it had to start from scratch, and that would require moving forward in advance of the emergency, which was something the Committee might or might not want to do. The framework had been set up, and he would suggest that there be expressions around the table. Messrs. Fulton, Swan, and Wayne had of course already expressed themselves in writing, and Mr. Hayes had commented briefly on the proposal at the last meeting.

Mr. Ellis said he had considerable sympathy with the views expressed by Messrs. Swan and Fulton. There was general recognition of the problem, he noted, and the concern was with the locus of responsibility for action to meet the problem. The question was whether delegation of that responsibility by the Treasury or the Administration to the Federal Reserve should not be sought and obtained in writing before the System undertook any operations without legislative action. While he saw a need for this kind of activity, he would not want to proceed until the System had in writing some agreement with the Treasury as to procedures and the System's degree of responsibility, both in a geographical context and as to the extent of operations and objectives. If legislation was sought, it might be expected that the legislation would clarify the locus of responsibility, whether in the Federal Reserve or in the Treasury. He was not sure what procedural steps should be followed, but he felt it would be desirable to move in one of two directions, or perhaps in both directions simultaneously. The System should negotiate with the Treasury as to what function the Administration would like to have the Federal Reserve perform and, perhaps simultaneously, an approach should be made to the Congress for additional legislation.

Mr. Irons noted that in his study of the problem he had been looking at the matter from a distance, on a theoretical basis, so to speak, as contrasted with the position of those who were closer in touch with the situation. He would not want to underemphasize the importance of central bank cooperation or the importance of the problem under discussion. However, there were certain aspects of the matter that bothered him somewhat. First, there was the question of the legal basis for System operations in foreign currencies on the scale envisaged by suggested holdings in the area of $500 million or perhaps $1 billion. Recognizing that there could be varying judgments, it seemed to him upon reading the legal opinion that one could build almost as strong a case that the System did not have full legal authority, and that it had not been the intent of Congress to give such legal authority, as it was to build a case on the other side. In his opinion this aspect of the problem ought to be thought out and worked through carefully with the Treasury and the Administration. He would like to have the legal authority given specifically, but he was not sure whether a request should more appropriately come from the System or from the Treasury and the Administration.

Mr. Irons said he also had been somewhat concerned about the impression gathered from the staff documents that the range of System operations would be rather extensive, including the cushioning of seasonal and cyclical swings, in contrast with operations to meet temporary disequilibria. The impression was given of a continuous operation, which he doubted would be desirable. He wondered whether the proposal contemplated operations to such an extent that the System would not be permitting market corrective forces to have their place. In his opinion this point deserved thought and consideration.

As to the subcommittee proposal, Mr. Irons said he had some qualms although he did not feel too strongly. If the special operations were directed primarily toward the correction of temporary disequilibria, he wondered whether such events appeared so suddenly or unpredictably that the situation was not comparable to operations in the Government securities market. In the latter respect it had been possible to operate through the full Open Market Committee and the Manager of the System Account. Therefore, his question was whether disorderly conditions in the foreign exchange market actually developed with such suddenness as to require a different set-up, one that would involve a significant delegation of authority to a subcommittee. If the subcommittee concept was used, however, he felt that the subcommittee ought to report to the full Committee as frequently and as completely as the Manager of the Open Market Account reported to the Open Market Committee on operations in the Government securities market.

Mr. Irons went on to say that he would prefer to have legislation enacted before any operations were undertaken. Recognizing, however, that this might involve a long delay, he raised the question, without suggesting that he would necessarily favor such an approach, whether it would be desirable for the System to operate in the capacity of fiscal agent of the Treasury in respect to foreign currency operations, in view of the legal background, the uncertainty as to the type of intervention in the foreign exchange market that might be required, and the uncertainty as to the System's basic responsibility. As he saw it, this was a basic responsibility of the Treasury unless the Congress assigned the function to the Federal Reserve. Further, on at least a theoretical basis, he raised the question whether the undertaking of these operations would not bring the System up against problems of the kind that were essentially State Department problems.

Mr. Deming said he shared the concern that had been expressed about System operations to cushion seasonal and cyclical swings. It had been difficult enough to sort out these matters when dealing with the domestic economy. In his opinion, the primary emphasis should be upon dealing with temporary imbalances, lest the System get into a situation where it was attempting to do something that could not be done through this kind of operation. If too much emphasis was put on seasonal and cyclical swings, there might be more risk of overdoing the System's efforts in this field than if it was recognized that some sort of imbalances of that character would occur in any event and that the System ought to deal with temporary disequilibria and not get into the longer-term area.

As to relations with the Treasury, Mr. Deming said he did not feel that he would like to conduct operations in a fiscal agent capacity. However, the System obviously would have to coordinate whatever it did with the Treasury, and it would seem advisable to recognize that point explicitly. There should be a good understanding with the Treasury, but the Federal Reserve would have to expect to be coordinated just as much as the Treasury.

In summary, Mr. Deming said he felt that this job needed to be done and that it was quite logical for the central bank to do it. He shared the concern that had been expressed about the legal basis for the operation and would prefer a more explicit and clear-cut authorization in the form of an amendment to the Federal Reserve Act. He would hope that this could get the backing of the Administration and that legislation could be enacted rather quickly. On the other hand, if the situation was very urgent he would go ahead and conduct operations on the basis of Mr. Hackley's memorandum, even though he would feel a little shaky. While he had the same feeling as expressed by Mr. Irons regarding the subcommittee concept, he was not sufficiently familiar with foreign exchange operations to judge what organizational arrangement would be feasible.

Mr. Clay commented that there seemed to be no prohibition against the System's entering into activities of the kind under discussion. On the other hand, there was no clear authority for such operations and no clear evidence of Congressional intent that the System should have the authority. There was no doubt in his mind but that somebody must get into the business. However, he would not think that this was apparent only to the Federal Reserve; it should be apparent to anyone who was close to international financial affairs.

Mr. Clay commented that there would be many things to learn. While the Federal Reserve probably had as much competence to go about learning these things as any other organization, there could be dangers involved in undertaking such operations. A mistake could be costly to the reputation of the System.

Mr. Clay went on to say that he had a basic feeling against Government agencies taking unto themselves authorities that had never been specifically granted, except in a true emergency. In an emergency he would have no hesitancy about going ahead on the basis of Mr. Hackley's memorandum. However, the emergency did not exist today. Therefore, he felt that the Congress should be given an opportunity, and in fact urged, to assign this authority to the agency that in its wisdom it would choose. Perhaps the greatest service that the Federal Reserve could do to the nation at the present time would be to urge the Congress to go into the problem and consider it. This would also point up a number of other problems that must be faced on a national scale. In summary, he felt that the Federal Reserve should not move forward in this field at this time except to the extent of urging legislation.

Mr. Mills said he believed that the proposal to operate in foreign currencies had proceeded to the point that required an affirmative or negative decision. His own decision would be in the affirmative. He had no great faith that operations of this kind could be conducted successfully or without serious danger to the independent status of the Federal Reserve System. He hoped he was wrong, but the only way to discover the possible results would be to experiment and he would experiment along the lines of the proposal as it had been formulated for the Committee, both as to a subcommittee direction of the operations and in particular to operate over a short-term, fluctuating period in the exchanges. If the experiment moved along to a point where it would require the System to redress a position it had taken, the System should move promptly to do so. On the other hand, if it was discovered from experimentation that these operations were performing a useful service, the System should move more directly into the field. Basically, however, he felt that the System should move. Delay and reconsideration of the matter for an indefinite period would not be helpful.

Mr. Robertson said that he would read portions of a memorandum that he had prepared and would place on file. However, he wished to note that his comments were premised on the absence of a crisis. If there should be a crisis, he felt that the System should act. The full text of the memorandum from which Mr. Robertson then read was as follows:

> Section 14(e) of the Federal Reserve Act (12 U.S.C. 358) authorizes any Federal Reserve Bank (under certain conditions) "to open and maintain accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may be deemed best for the purpose of purchasing, selling, and collecting bills of exchange and the conduct of other open market transactions of the kind specified in section 14 of the Federal Reserve Act..."
>
> I cannot perceive any Congressional purpose (and the legislative history does not indicate one) of qualifying the power to establish "agencies" while not qualifying the power to appoint correspondents or to open and maintain accounts in foreign countries. However, it may be that the statute could be so construed, as indicated in Mr. Hackley's memorandum of November 2, 1961, _if_ it stood naked and one could not look elsewhere for enlightenment.
>
> As a matter of fact, the statute must have been so construed during the late 20's when the Federal Reserve Bank of New York did open and maintain an account with the Bank of England which was clearly not for the purpose of "purchasing, selling, and collecting bills of exchange". However, it must not be forgotten that that action was severely criticized on the floor of the Senate in 1932 by Senator Carter Glass, often

referred to as the father of the Federal Reserve Act. He contended that the actions were contrary to law. Almost immediately thereafter, in 1933, and while the issue was hot, the Board advised the New York Federal Reserve Bank that in its view "...such accounts may be opened and maintained only for the purpose of facilitating the purchase, sale and collection of bills of exchange and the conduct of other open market transactions of the kind specified in section 14 of the Federal Reserve Act..." In 1934 the Board reiterated this view, as set forth on page 8 of Mr. Hackley's memorandum.

Hence, there has been a long continued administrative interpretation by this Board of this statute, originally made at a time, as already noted, when the statute itself and actions thereunder by the Federal Reserve Bank of New York were under severe criticism from an extraordinarily interested member of the United States Senate. Therefore, even if the statute was originally subject to the interpretation now placed upon it by the Legal Division, it is extremely doubtful - in view of this long continued administrative interpretation - that it would now stand up under public and Congressional scrutiny.

As mentioned in Mr. Hackley's November 2 memorandum, there are "uncertainties as to the construction of the law" - that is, as to whether the law authorizes Reserve Banks to open and maintain foreign accounts for the purpose contemplated by this proposal. In my judgment, these uncertainties are substantial indeed and some of the arguments to support the legality of the proposal (such as the "comma" argument) are subject to grave weaknesses revealed by the memorandum itself. This grave uncertainty regarding the proposed statutory interpretation is made even more serious by the fact that the matter was specifically dealt with by the Board - in the early 30's - and on that occasion the Board definitely decided that foreign accounts could not legally be maintained for such broad purposes, and required the correction of a deviation from this principle.

Even if one could accept the interpretation that section 14(e) does not authorize the maintenance of foreign accounts only for the purpose of dealing in bills of exchange, it does not follow that the power to maintain foreign accounts - basically an incidental power - can be regarded as an authorization to exercise the broad policy functions contemplated by the instant proposal. In other words, even if foreign accounts may be maintained in connection with functions other than dealing in bills of exchange, these must be functions that are authorized by the Federal Reserve Act. <u>Nowhere in the Act can authority be found for the stabilization function that is the core of this proposal.</u>

Even if its legality were to be assumed, I think the proposed action would be highly questionable because it is inconsistent with explicit Congressional authority. In creating the Stabilization Fund, Congress made available to the Treasury the sum of $2 billion for the purpose of "stabilizing the exchange value of the dollar." Subsequently, in 1945, Congress reduced the amount to $200 million. For the Federal Reserve to now attempt to augment that $200 million either by purchasing foreign exchange from the Stabilization Fund whenever that fund has been used up <u>or</u> by operating in the same field on its own (which could be in <u>unlimited</u> amounts if the Board of Governors and the Federal Open Market Committee so determined) could be interpreted as circumventing the will of Congress by making available more dollars for the purpose of "stabilizing the exchange value of the dollar" than Congress contemplated.

For the foregoing reasons, it is my view that the Federal Reserve System should not launch the proposed plan without specific legislative authorization. I do not think it would suffice merely to obtain the informal approval of the Chairmen of the House and Senate Banking and Currency Committees.

As for the merits of the proposal, absent the question of legality and the question of circumvention of Congressional will, it is my view that it would be unwise for two separate agencies of the United States Government to be engaged in "buying and selling foreign exchange" - even though at the moment it would appear that harmonious and coordinated action could be expected. Such a function as this is extremely delicate. It involves not only tinkering with what up until now has been regarded as a pivotal currency, around which others have been traded. It also involves very sensitive international diplomatic relationships, with which the Federal Reserve System is not in the best position to cope. The function would seem to be more appropriately one for the Treasury (which Congress has already designated to handle the problem), for it is a part of the Executive Branch of the Government and is therefore in a better position to coordinate its activities with the State Department and the President. Therefore, the best approach to this problem - if a problem it is - would be to submit the entire matter to Congress for discussion.

Although I would not be opposed to Federal Reserve holding of foreign currency (if the Congress directed or authorized us to do so) and although I have great sympathy for the view that foreign countries might be more inclined to hold dollars as a portion of their official reserves if the United States kept part of its official reserves in the currencies of those countries, I am not convinced that this "inclination" would be enhanced by expanding their holdings of dollars through swaps of dollars for their currencies.

The reason for gold outflow in very recent years has been the result of foreign dollar holdings in excess of what the foreign countries desire to hold. Hence, they exchange them into gold, as they are free to do. Would those countries be any more inclined to hold their dollars and not exchange them for gold if they were provided with even more dollars by an arrangement such as is now proposed? I doubt it. Hence, I am not convinced that the proposed Federal Reserve operations in foreign currencies would solve the problem. They would merely camouflage the difficulty, which is one of dealing with the balance-of-payments problem.

As I understand the proposal, it envisages perpetual intervention in the exchange market by the Federal Reserve Bank of New York for the purpose of offsetting speculative trading in world currencies and thus endeavoring to maintain stability in the exchange value of the dollar. If this be so, it seems to me that the operation could develop some of the same disadvantages associated with operations to peg prices in the Government securities market. It can be argued that this analogy should be discounted on the grounds that the exchange value of the dollar is already pegged by the Treasury's fixed buying and selling prices for gold; it may also be said that the actual aggregate flows of funds through the foreign exchange markets are ordinarily sufficiently steady and moderate in size to be offset handily by the System without the involvement of major amounts of resources. Such comments, however, overlook some of the damaging influences upon market performance which can accompany direct interference by the central bank. If the central bank, with an arbitrary but changeable judgment backed up by practically limitless resources, were repeatedly to override private market pricing processes, the ability and willingness of private participants to make a market could well deteriorate. The market would give a distorted picture of the current balance of supplies and demands, and all interested parties, both private and governmental, would lose this up-to-the-minute indicator of the tide of trade and capital flows. Concentration of market pressures might be instigated whenever rumors arose concerning Federal Reserve interference, particularly with respect to rumors of possible changes in our buying or selling prices.

We have long eschewed operations for the purpose of pegging prices in the Government securities market, and (at least until the past year) have asserted that our operations should be for the purpose of providing or absorbing bank reserves in accordance with the needs of the economy, except where other action is necessary to correct (or possibly prevent) a disorderly market. I suspect that all of us would agree that if a disorderly Government securities market developed, the Open Market Committee should intervene for stabilization purposes, even though this might involve temporarily injecting into the banking system a more than desirable amount of reserves. Similarly, I suspect that all of us would agree that if a dangerously disorderly foreign exchange market should develop, some agency of the Government should step into the breach with adequate resources to stabilize it.

It is my understanding that this is the very purpose for which Congress provided the Stabilization Fund. If the amount of that fund is insufficient, then the Treasury should request Congress to expand the fund to an appropriate extent - the sooner the better. If the situation is as serious as is assumed by those who propose this program to the Committee, then the Treasury should have no difficulty in persuading Congress to provide the funds. The law could even be amended to provide the Treasury with some specific emergency borrowing authority from the Federal Reserve as a safeguard against such eventualities. But in the absence of a disorderly situation, I question the wisdom of continuous frequent purchases and sales of foreign currency by any agency - even by the Stabilization Fund - in an attempt to offset presumed speculation. In my judgment this would be more likely to increase speculative activities and diminish confidence in the dollar than to have the beneficial effect contemplated by the propenents of the proposed operation. In the long run, no policy of exchange manipulation is so likely to restrain unwarranted speculation against the dollar as the continuing provision or purchase of gold by our Treasury at $35 per ounce.

There are no gimmicks by which the position of the dollar can be maintained in the world. It would be unwise to resort to devices designed to hide the real problems and assuage their symptomatic effects. We should ascertain the origin of the symptoms and hasten to deal with the cause, rather than the effect. The United States must practice what it has long preached about the need for monetary and fiscal discipline. As a nation, we will not benefit from putting our head in the sand and engaging in tinkering operations designed to persuade others to think that a problem does not exist and to convince ourselves that if we can tide ourselves over the temporary pain the real difficulty will go away. This nation must face the underlying problem and deal with it in appropriate ways. We must develop and adhere to sound policies designed to eliminate unsustainable deficits in our balance of payments.

Mr. Shepardson said it seemed to him the System had enough leeway under the present statutes to justify taking such action as might be warranted. On the other hand, he thought it would be preferable to approach the matter from the standpoint of getting specific legislation. He was not sure whether such legislation should be sought by the Federal Reserve or by the Administration. The System ought to give its support, but it might be preferable if the request came from the Administration.

As to the question of handling an emergency, Mr. Shepardson said it was not clear to him, absent any foreign currency holdings, just how the System could get into the operation. In the present framework of things, the acquiring of foreign currencies would seem only to create further imbalances. Also, while he thought it desirable for some agency, and perhaps the central bank, to move in in case of an emergency, he would be much concerned if attempts to counter seasonal and cyclical influences served to mask the pressure for fundamental corrections. Many examples of the fallacy of that reasoning had been seen in other Government policies.

With regard to the subcommittee concept, Mr. Shepardson said it occurred to him that the approach suggested was the reverse of the approach that should be followed in this kind of situation. In a field where many admitted to too little understanding, it seemed to him that frequent reporting to and participation by the whole Committee would help to build up the degree of understanding. Once an understanding of the problem was acquired, supervision of the operations might be delegated to a subcommittee, but it would seem wise in the beginning to provide for complete reporting to the whole Committee.

Mr. King said that, absent an urgent need, he saw no need to proceed further with this matter at this time. He did not think the Federal Reserve was the proper place for these operations if they were to be conducted. Instead, he felt that a political agency or body would be the proper place to lodge the responsibility. As he had heard it said on various occasions, if the System should get into politics at any stage it could founder. In its regular operations, the System of course touched upon domestic politics and also international affairs to some extent, but to him an operation in foreign currencies would constitute an intrusion into an area where the System should not venture. In a crisis he would throw the rule book into the desk and proceed in the best way possible, but in the absence of a crisis he saw no need for the System to go further. The Administration could make whatever recommendations it wanted to make on the subject; his own recommendation would be to put the operation in the Treasury, and he would endorse the appropriation of money for that purpose. If the Congress decided to place the responsibility with the System, the System would have to live with it. However, he had some doubt whether the organizational set-up of the System was suitable to cope with the quick decisions that would have to be made in this area.

In summary, Mr. King said, he would hope that the Administration would take whatever action it felt desirable in the way of recommendations to the Congress, and he would hope that the operation would be placed in the Treasury.

Mr. Mitchell commented that operations in foreign exchange were a very real issue and one that would become more acute with the passage of time. He was not sure to what degree reliance could be placed on private forces to equilibrate unstabilizing exchange factors. Therefore, he was not inclined to go quite as far as Mr. Robertson. On the other hand, he was not sure but that the staff proposal went too far in inferring that a stabilization operation by the System or the Treasury would be an effective way of dealing with all of the disturbances in the area concerned.

On the question of where the responsibility for exchange stabilization should be lodged, Mr. Mitchell said he was surprised to see some people who had been saying that the System should exert an influence on the international payments position through domestic monetary policy now saying that the System should refrain from operations in foreign currencies. He felt that the System must be prepared to enter into foreign exchange transactions if such operations could strengthen the dollar. The primary concern of the Federal Reserve was with good money and a sound dollar, and the Federal Reserve was the only agency having that objective as its primary concern. The Treasury was interested, of course, but it had other concerns. If a sound dollar was the primary purpose of foreign currency operations, presumably the System would want to insure that such goals as diplomatic and trade policy were definitely of secondary concern.

Mr. Mitchell stated that he had come to the conclusion, he thought, largely on the basis of what Mr. Young had said, that if foreign currency operations were going to be undertaken the Federal Reserve was the best agency to carry them out. He noted that it had been said that the proposed plan was available if an emergency arose. If this were the case, he saw an obligation to act immediately to call the matter to the attention of Congress or the Administration. The System should not wait for an emergency, but should take this step immediately. Accordingly, he would hope that the Committee would authorize and direct its Chairman to initiate negotiations with the Secretary of the Treasury, or whoever else was appropriate, in order to accomplish the drafting of legislation that would achieve the results about which the Committee was talking. Then, when the Committee again came together in a couple of weeks, he would hope that something more or less concrete along this line might be available for consideration.

Mr. Bopp said that, like others who had spoken, he was concerned about the legal basis for System operations in foreign currencies. The legal authority was not based on specific provisions of the law but rather a construction of the statutes. The System had at times operated on the basis of construction of the statutes but in a democratic process it was important, absent an emergency, to have specific authorization. Further, he thought it important to have this authorization before operations were begun. If they were begun without specific authorization, there might be some question about the need to obtain legislation.

Mr. Bopp also said, in terms of the economics of the matter, that intervention was intervention, whether in the Government securities market, the foreign exchange market, or wherever it might occur. He was somewhat surprised that it seemed to be assumed that in the foreign exchange market the System could distinguish between temporary, seasonal, and cyclical movements. It had insisted that it could not do so in the domestic market. However, he was not inclined to agree with Mr. Robertson. It was his feeling that intervention in both types of situations might be necessary. In terms of the foreign exchange market, that intervention could be on an exceptional basis, as in the case of the authorization covering operations in other than short-term Government securities.

Mr. Bopp said he thought it was cogent to suggest a significant difference between the foreign exchange market and the Government securities market. The System had supported Government securities prices in the past and was able to do so because it had the power to create the domestic means of payment. However, in the foreign exchange market the value of the dollar could be maintained only so long as there was adequate foreign exchange and gold to support the price. If this country's basic position continued to deteriorate, it would ultimately run out of both gold and foreign exchange.

Mr. Bopp went on to say that he saw no convincing evidence of need for a subcommittee. As he read the staff documents, it occurred to him that the full Committee could issue guidelines as well as instructions to the management of the special account. Incidentally, the proposed guidelines would, without doubt, delegate a great deal of authority to the account management. Perhaps that was necessary. But if it was, there could be a direct delegation from the Committee as a whole and he did not see the need for intervention of a subcommittee.

Mr. Bryan commented that he was impressed by what Mr. Young had said in his initial statement concerning the efficiency of convertible currencies. However, if convertibility was to be maintained, it would be necessary to pursue domestic policies that did not contravene such convertibility. That was a point too often overlooked. He tended to believe that at the present time the United States dollar was headed rapidly in the direction, if it was not there already, of being a weak currency. He tended to assume, therefore, that if this country was to maintain convertibility indefinitely it would have to pursue domestic economic policies such as to permit the retention of convertibility. It would be a tragedy if the world lost any further confidence in its major reserve currency at the present time.

Mr. Bryan then raised the question whether confidence in the dollar would be increased by supplying more dollars and holding foreign currencies. He felt that the dollars supplied would sooner or later find their way into short-term obligations of the United States or would be converted into gold. Precisely the opposite course seemed to be needed; that is, a supply of less dollars to the international monetary market.

As to the legal aspect of the matter, Mr. Bryan said he was of course concerned from that standpoint. He noted that the balance-of-payments problem had not been created by monetary policy but by policies of the Administration and of the Congress. (In saying this, he was not referring specifically to the present Administration or Congress, for the problem went back a long time.) Further, he believed that the fundamental problem could be dealt with only by fiscal and legislative policies of extreme prudence. Sometimes, he observed, a great deal more harm can be done, with good intentions, by intervening to save the patient some pain than by letting him realize he is sick. In this connection he referred to the sterling crisis earlier this year and the steps that were taken by the British to deal with it. He asked whether it would have been better for the U. S. to buy sterling to ease the situation, as the European banks did under the Basle arrangements, or whether it was not better for the British to face up to the problem and take the necessary measures. The Federal Reserve System had managed to hold up the bill rate and prevent some outflow of short-term funds from this country, but he was not certain that it had really done the nation a good turn. It may have merely delayed recognition of the painful situation that exists.

Mr. Johns commented, with respect to the legal aspects of the matter, that he thought counsel had produced a lawyer-like document which presented the arguments on both sides and came to the position that System operations in foreign currencies would be defensible. However, Mr. Johns said, he was not so much concerned about the legal authority of the System to engage in this activity as some others seemed to be. When a corporation exceeded its charter powers, it was important to ask who would raise a question. In this case the question apparently could come only from one source, namely, the sovereign United States of America. The Attorney General might raise a question on behalf of the Administration, but he would assume that the System would not undertake the operation without assurance that the Administration was in agreement with it. The other source that might raise a complaint was the Congress, also representing the sovereign. However, if the Congress did not like what the System did, it could take corrective measures. They might be drastic, but the power was there to take action if the Congress so desired.

As to whether a need for these operations existed with any degree of urgency, Mr. Johns said that he would have to accept the judgment of others. If it did, he would suggest going ahead and perhaps simultaneously or later, as might be propitious, seeking legislation to clarify the System's authority. He had real doubt about the power of the Committee to delegate its responsibilities. This was an old question; the Committee had settled it years ago when it abolished the executive committee. He was not quite satisfied by the argument that a subcommittee that supervised the operations was not making policy. The executive committee was abolished because the Committee became convinced that it was not confining its activities to administration and instead was actually making policy. This is almost inevitably the result, he suggested, when delegations of authority are made to a small group.

At this point, Chairman Martin turned to Mr. Coombs and inquired whether the latter had any comments.

In reply, Mr. Coombs said it was clear that many members of the Committee were concerned over the recommendation in the staff papers to the effect that System exchange operations should be employed to offset seasonal and cyclical swings in the balance of payments. This recommendation had been interpreted as implying almost continuous intervention in the exchange markets from the very outset of the program. He had personally interpreted this recommendation as a longer-range objective. At the present moment, for example, it would be extremely difficult, if not impossible, to determine with any accuracy the seasonal and cyclical patterns in this country's balance of payments, although this might well become possible at some later date. In any event, there would be no need to delegate to the manager the responsibility for deciding on intervention to offset seasonal or cyclical pressures; there would be, presumably, plenty of time for the Committee itself to discuss the pros and cons of intervention of this nature.

In Stabilization Fund operations, Mr. Coombs noted, the approach had been almost exclusively centered upon dealing with specific instances of speculative pressure against the dollar. In such instances, intervention in very moderate amount could often nip in the bud speculative movements which, if allowed to go unchallenged, might quickly develop into a major attack. Many European banks that used the New York Bank as their agent in the United States exchange market had operated over the years along these lines with extremely effective results. In our own case, the desirability of intervening to restrain speculative movements might well arise no more than fifteen or twenty times a year, with possibly lengthy intervals during which no intervention whatsoever would be required.

On the question whether the foreign exchange market was more sensitive and volatile than the Government securities market and hence allowed less time for policy decisions, Mr. Coombs stated that he was not sufficiently acquainted with the securities market to make a comparison. He did know from experience, however, that speculative pressures could boil up within a matter of minutes in the exchange market, which was at present in an extremely nervous, if not almost jittery, mood as a result of the succession of exchange crises during the past year. It would be desirable to have the resources to deal with such periodic emergencies, so that exchange operations could resist speculative trends before they had gone too far. The consequent need for making quick decisions whether or not to intervene in a given situation was complicated by the necessity of coordinating any decision on operations with the foreign central bank or banks concerned. This problem of coordination was further complicated by the five to six hour time differential between the United States and European exchange markets, which might, on occasion, compress the time available to a matter of minutes.

Mr. Hayes expressed agreement with what Mr. Coombs had said. He went on to say that he had been much interested in the comments around the table. They reflected a healthy and rather profound study of some of the basic issues involved, which were not simple, clear-cut, or easy to deal with.

The whole legislative set-up was somewhat fuzzy, Mr. Hayes noted. The New York Bank's counsel had reached the same conclusion as Mr. Hackley; namely, that the System did have sufficient legal authority. Like others, Mr. Hayes said, he would like to have that authority crystal-clear. He could see some real merit, if the System was going to be in this field to stay, in having a specific

Congressional authorization. On the other hand, he would be quite satisfied to proceed with counsel's opinion as a guide.

As to the roles of the Treasury and the Federal Reserve, some of those who commented had suggested that the Stabilization Fund was set up for this kind of purpose. Actually, however, the Fund had been used for a lot of other purposes, and probably would continue to be used for such purposes. It had been used to assist United States foreign policy in relation to various weaker countries that needed shoring up, as a kind of an arm of State Department activity. He was not sure that it would be appropriate to have the kind of operation that the Committee was discussing thrown into that kind of set-up, as opposed to keeping it in the central bank. In many foreign countries this type of operation was pretty much a central bank responsibility.

With respect to the discussion about Federal Reserve efforts to help prevent destabilizing influences on the currency, Mr. Hayes said he had been much impressed by Mr. Mitchell's comments. If the System did not have a whole-hearted concern for protecting the value of the dollar, he did not know who would. Obviously, whatever was done by the System would have to be done in close concert with the Treasury. There had been some discussion as to whether System operations might not be performed under the direction of the Treasury. He would shy away from that due to implications in respect to domestic activities, but it should be clear that the Treasury would have a veto. The System certainly was not going to be doing things in conducting foreign currency operations that would run contrary to the position of the Treasury. At the same time, the System should and could arrive at a good written agreement with the Treasury. So far as the Administration's wishes were concerned, it was his clear feeling from conversations he had had that the present Treasury attitude was highly receptive to the System getting into this activity. In fact, he had been told that the sooner the System got in, the better the Treasury would like it. This was not to say how the Congress would necessarily feel. He would suggest further exploration of that aspect.

Mr. Hayes said he sensed a little feeling, which was quite understandable, of reluctance to get the System into a new area of operations. There were some risks of loss and of criticism that might be dangerous to the System's reputation. However, one could not just say that, because the System had gotten along without these operations thus far, it could get along without them now. While he concurred in the view that this country must follow proper fundamental policies, in the present-day world the dollar was not the unique currency that it once was. This country could not just stand aside and let the waves of activity of other countries wash up against it. There might be a tendency to overlook the fact that exchange operations are a reciprocal business. If this country did not do anything, other market forces would nevertheless be operating freely. Other major central banks were operating, and operating on the dollar, in ways that affected this whole question. Instead of standing aside, therefore, he would like to see this country play a more active role on a cooperative basis.

In summary, Mr. Hayes said, he thought there was a lot to be said for undertaking this activity. Because of the fundamental interest of the System in the dollar, there was much to be said for the System engaging in the proposed operations, but in full cooperation with the Treasury.

As to just how the operations would be conducted, Mr. Hayes said he agreed with Mr. Coombs that the basic objective should be to meet speculative surges as and when they developed. These could not be predicted. He would not advocate any massive building up of holdings of major currencies at this time; rather, he would suppose that the only acquisitions of foreign exchange that the System might make in the near future would be moderate amounts of the currency of those countries with whom at the moment this country was running favorable balances. There was the prospect that in the next few months several major currencies would be running in deficit against the dollar, and those situations might provide an opportunity to build up holdings that could be used later. Further, certain comments that had been made overlooked the importance of forward operations. Mr. Hayes said these do not put any dollars in foreign hands but on the contrary may take them out of the market.

Turning to the organizational aspects of the matter, Mr. Hayes said he had no particular brief for a subcommittee as against a full Committee operation, except as a means of getting things done quickly. The more that the full Committee could understand the problems involved and get thoroughly into them, the better he would like it. He would be inclined to agree that the guidelines in large measure could be adopted by the full Committee; they would be mainly statements of long-range policy. On the other hand, if a question should arise overnight as to whether certain substantial operations should be conducted, he doubted that it would be fair to ask the manager of this activity to take the responsibility on his own, particularly when a new type of operation was involved and the System was feeling its way. Therefore, he felt there ought to be someone to whom the manager could turn for quick consultation. If it was practical to get the full Committee together on a rush basis, he would be glad to favor such an organizational arrangement, but he doubted the practicality of it. Perhaps it would be advisable to have some procedure whereby the Committee could delegate to the Chairman, or to the same people who would be on the proposed subcommittee, authorization to enter into operations within stated amounts.

Mr. Hayes said he did not want to prolong the discussion by going into too many details. Personally, he felt that the proposal under discussion would represent a constructive move and that the System should proceed along the lines suggested in the staff documents. At the same time, he would welcome the addition of concurrent Congressional authorization.

Mr. Balderston said he agreed that the proposal before the Committee provided a mechanism by which the Federal Reserve could help to meet a crisis. Although he hoped that the event would not occur, there was no way of telling whether or how soon such a crisis might develop. Since the proposed operation was so close to the function carried on by the Open Market Committee in domestic affairs, he felt it would probably be unwise not to undertake it. Looking ahead 25 or 50 years, it would probably seem like an abdication for a committee that was trying to control the volume of reserves needed by the domestic economy to have turned over to some other agency the function under discussion. Accordingly, he would propose that the Committee authorize its Chairman to work out with the Secretary of the Treasury the necessary arrangements, and to consult again with the Chairmen of the Banking and Currency Committees so that they would understand what was contemplated. This might lead to introducing legislation. Having visualized the possibility of a crisis, he was fearful that failure to act might make the System culpable. The Committee had been advised that it had a legal basis for proceeding, even though one would like a more clear-cut authorization from the Congress. Therefore, he would suggest that the Committee authorize the Chairman to proceed with necessary discussions with the Secretary of the Treasury and with the proper parties in the Congress.

Chairman Martin stated that it was clear that the Committee was not united on a good many points. However, he thought the discussion probably had covered everything that could reasonably be covered today, Therefore, he would suggest that the discussion be concluded at this point and that the sense of the meeting be that he should endeavor to explore the matter further with the Treasury and then give the Committee additional comments, including comments with respect to legislation or the division of responsibility, at the meeting on December 19.

After further discussion, it was the understanding that this was the sense of the meeting.

Chairman Martin then referred to the subject of the Committee's operating policies and directive, and to the comments that had been received following the distribution of drafts with a memorandum from the Committee Secretary dated September 6, 1961. The Chairman suggested that these matters be included on the agenda for discussion at the

December 19 meeting, with the understanding that it might be necessary for the meeting to run on into the afternoon, and agreement was expressed with this suggestion. In this connection, Mr. Wayne suggested that in view of the prospective heavy agenda, and since only a two-week interval between meetings would be involved, summaries of District economic and financial developments might be somewhat curtailed at the next meeting, and the Chairman indicated that he concurred.

As indicated by the foregoing discussion, it was understood that the next meeting of the Open Market Committee would be held on Tuesday, December 19, 1961.

The meeting then adjourned.

Ralph A. Young

Secretary