

FORTY-EIGHTH

Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System



COVERING OPERATIONS FOR THE YEAR

1961

ANNUAL REPORT OF BOARD OF GOVERNORS

DIGEST OF PRINCIPAL FEDERAL RESERVE POLICY
ACTIONS, 1961

Period	Action	Purpose of action
January	Limited net sales of U.S. Government securities from Federal Reserve portfolio to about \$500 million. Member bank borrowing at Reserve Banks averaged only \$50 million.	To encourage bank credit and monetary expansion by absorbing only part of seasonal inflow of reserve funds not otherwise offset by a large gold outflow.
February-August	Bought substantial amounts of U.S. Government securities with maturities over 1 year, following February 20 announcement that System open market operations would include securities outside the short-term area. These purchases were partly offset by net sales of short-term securities. Total System holdings of Governments increased about \$700 million. Member bank borrowings averaged \$75 million.	To encourage bank credit and monetary expansion while avoiding direct downward pressure on short-term interest rates, thereby moderating pressures on the U.S. balance of payments from outflow of short-term capital attracted by higher interest rates abroad.
September-December	Bought or sold at different times varying amounts of U.S. Government securities, including securities with longer maturities. Total System holdings of Government securities increased about \$1.6 billion. Member bank borrowings at Reserve Banks remained generally low.	To continue to encourage bank credit and monetary expansion while allowing for changing reserve needs due to seasonal and other factors, including a large gold outflow, and while continuing to give consideration to the balance of payments problem.
December	Raised, effective Jan. 1, 1962, maximum interest rates payable by member banks on any savings deposit from 3 to 3½ per cent, and to 4 per cent on those left in the bank for 1 year or more; also raised maximum rates on time deposits with a maturity of 6 months to 1 year from 3 to 3½ per cent, and to 4 per cent on those deposits with a maturity of a year or longer.	To enable banks to compete more effectively for savings and other time deposits, including foreign time deposits, thus moderating pressures on the U.S. balance of payments, and, over the long run, to offer additional incentive for the accumulation of savings required for financing future economic growth.

when the System did not want to absorb reserves. In such a circumstance, it might be expedient to buy longer-term securities simultaneously with the sale of shorter-term securities or to make offsetting transactions within an interval of a few days.

Mr. Robertson, in dissenting from this action, expressed the opinion: (1) that the established operating procedures and policies of the Committee were, in fact, the product of careful empirical and analytical study; (2) that they had proved in practice to be sound, both in terms of monetary policy and in terms of fair dealing with the market; (3) that in deviating from its established policies the Federal Open Market Committee was in effect asserting, without reason, that it had made a critically incorrect judgment 8 years ago and had pursued incorrect operating practices since; and (4) that critics of present methods of operating in the market were relying on the simplest theories of determination of market interest rates and making allegations on postulates having little if any basis in empirical fact. In his opinion this departure from established operating techniques would not constructively influence market rates, and he gathered from the discussion that not many (if any) at the table were confident of such a result. What he was confident of, however, was that the Committee was running serious risk (a) of undermining domestic and foreign confidence in the System's integrity and judgment and the reliability of the new Administration's assertions of an intent to maintain the stability of the dollar, (b) of impairing the market for Government securities by placing dealers and investors in the position of having to guess which area of the market the Federal Reserve was going to enter and hence affect prices, and (c) of impeding Government financing by making it extremely difficult for the Treasury to determine objectively appropriate market rates for future intermediate- and long-term financing. It was his view that these risks were too large to run.

In addition, Mr. Robertson believed it to be inadvisable for the Committee virtually to abdicate its authority and responsibility by giving practically unlimited authority to the Manager

of the Open Market Account (1) to buy and sell securities in any area of the market up to 10 years, as he saw fit, for the stated purpose of affecting rates as distinguished from providing or withdrawing reserves from the banking system, and (2) to engage in "swap" transactions—i.e., buying securities in one maturity area and selling in another—to effect changes in rates and hence marshal the System's portfolio of Government securities against market forces.

Note: On February 20, 1961, the date of initial operations in the longer-term Government securities market, the Account Manager, at the direction of the Chairman of the Open Market Committee, issued the following press statement:

The System Open Market Account is purchasing in the open market U. S. Government notes and bonds of varying maturities, some of which will exceed 5 years.

Price quotations and offerings are being requested of all primary dealers in U. S. Government securities. Determination as to which offerings to purchase is being governed by the prices that appear most advantageous, i.e., the lowest prices. Net amounts of all transactions for System Account will be shown as usual in the condition statements issued every Thursday.

During recent years transactions for the System Account, except in correction of disorderly markets, have been made in short-term U. S. Government securities. Authority for transactions in securities of longer maturity has been granted by the Open Market Committee of the Federal Reserve System in the light of conditions that have developed in the domestic economy and in the U.S. balance of payments with other countries.

March 7, 1961

I. Authority to effect transactions in System Account.

The Federal Reserve Bank of New York was directed by the Committee to continue to conduct open market operations with a view toward encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments.

Votes for this action: Messrs. Martin, Hayes, Allen, Balderston, Irons, King, Mills, Robertson, Shepardson, Swan, Szymczak, and Wayne. Votes against this action: none.

A review of national and regional economic developments indicated that the recession seemed to have lost momentum. Among the more favorable economic signs was an indication that gross national product would be down only moderately in the first quarter of the year—possibly by less than 1 per cent. Industrial production had apparently leveled off in February, and it appeared unlikely that there would be a decline in March; inventory liquidation also seemed to have leveled off. According to recent surveys, plans for business capital expenditures indicated a small rise from the first half of the year to the second, and the total of planned expenditures, when compared with 1960, was down only about 3 per cent. Consumer expenditures and buying intentions also were interpreted as generally optimistic, despite some continued weakness in expressed intentions to buy houses and household durables. As against these indications of a possible turnaround in economic activity, the continuing lag in automobile sales and the persistence of a high level of unemployment and unutilized resources were of concern.

Statistics on bank credit and bank reserves were considered encouraging. Total loans and investments at weekly reporting member banks recorded a sizable gain in February, total reserves of all member banks on a seasonally adjusted basis rose substantially in February to surpass the 1960 high set in November, and required reserves, adjusted, reached a record high in February. It was anticipated that around mid-March, when large tax payments were due, there would be substantial liquidity needs, with the result that reserves of member banks would be under considerable pressure. Therefore, if the existing money market ease was to be maintained, the System might have to supply additional reserves, reabsorbing them possibly in the latter part of the month.

Preliminary statistics indicated that there had been a virtual cessation of the outward flow of short-term capital in January

and February. However, an atmosphere of uncertainty had arisen in international money markets following the German and Netherlands currency revaluations, and there was the possibility that the improved situation could reverse itself quickly.

The consensus of the Committee was that the existing monetary policy of ease should be followed until the next meeting. Considering the problem of unemployment and the continued uncertainties in the business situation, it was felt that the System should encourage credit expansion as a means of fostering economic recovery. On the other hand, since the balance of payments situation had not been fundamentally corrected, it was also felt that consideration should continue to be given to short-term interest rates in the conduct of open market operations. There were some variations in opinion within the Committee concerning whether the current degree of ease was sufficient to stimulate the economy and concerning the degree of emphasis that should be placed on the desirability of counteracting influences tending to depress short-term interest rates.

2. Authority to effect transactions in intermediate- and longer-term securities.

The Federal Reserve Bank of New York was authorized, between this date and the next meeting of the Committee, within the terms and limitations of the directive issued at this meeting, to acquire intermediate- and/or longer-term U. S. Government securities having maturities up to 10 years, 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, Shepardson, Swan, Szymczak, and Wayne. Votes against this action: Messrs. Allen and Robertson.

This special authorization, first given at the Committee meeting on February 7, 1961, was extended subject to the original understanding that all operations under it were to be consistent

with the general monetary policy expressed in the Committee's directive.

Mr. Allen voted against this action for the reasons he had given at the meeting of the Federal Open Market Committee held on February 7, 1961. (At that time Mr. Allen was not a member of the Committee, but as an alternate member he was asked to express his opinion on the proposed extension of operations. He had opposed the extension, saying that after reviewing a quantity of material on the subject—including the report of an Ad Hoc Subcommittee of the Federal Open Market Committee dated November 12, 1952, testimony by Chairman Martin before various congressional committees, and a number of treatises written by professional economists—and considering it also in the light of his own experience, he did not favor the proposed extension of operations.) Mr. Allen indicated that he was in substantial agreement with the reasons for opposing the action that were stated by Mr. Robertson at the meeting on February 7, 1961.

Mr. Robertson dissented from this action for the reasons that he had stated at the meeting on February 7, 1961, when the special authorization was first given.

3. Review of continuing authorities and statements of policy.

This being the first meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks for the year beginning March 1, 1961, the Committee had scheduled for review the statements of continuing operating policies that had been in effect since 1953 and were last reviewed and reaffirmed on March 22, 1960, as follows:

a. It is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).

b. Operations for the System Account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period

of Treasury financing there shall be no purchases of (1) maturing issues for which an exchange is being offered, (2) when-issued securities, or (3) outstanding issues of comparable maturities to those being offered for exchange; these policies to be followed until such time as they may be superseded or modified by further action of the Federal Open Market Committee.

c. Transactions for the System Account in the open market shall be entered into solely for the purpose of providing or absorbing reserves (except in the correction of disorderly markets), and shall not include offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System's portfolio; such policy to be followed until such time as it may be superseded or modified by further action of the Federal Open Market Committee.

At the meeting on January 10, 1961, an Ad Hoc Subcommittee of the Open Market Committee had been named for the purpose of pursuing certain studies of the Committee's operating procedures, along lines to be indicated by Chairman Martin. One subject to which that Subcommittee had devoted considerable attention was a possible revision of the statements of operating policies. However, after discussion at this meeting the Committee decided, pursuant to the recommendation of the Subcommittee, to table consideration of possible changes in the operating policy statements pending further study in the light of the authorization given at the meeting on February 7, 1961, and reaffirmed at this meeting, covering operations in intermediate- and longer-term securities.

Votes for this action: Messrs. Martin, Hayes, Allen, Balderston, Irons, King, Mills, Robertson, Shepardson, Swan, Szymczak, and Wayne. Votes against this action: none.

At this meeting the Committee also reviewed and reaffirmed all of its continuing authorities for operations, including those referred to in the two succeeding policy record entries.

4. Repurchase agreements covering U.S. Government securities.

The Committee reaffirmed the existing authorization to the Federal Reserve Bank of New York to enter into repurchase

agreements with nonbank dealers in U. S. Government securities—an authorization that had been reaffirmed by the Committee each year since it was first granted in this form on August 2, 1955. The authorization, which continued to be subject to the understanding that repurchase agreements at rates below the discount rate would be used only sparingly, specified the following conditions:

1. Such agreements
 - (a) In no event shall be at a rate below whichever is the lower of (1) the discount rate of the Federal Reserve Bank on eligible commercial paper, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills;
 - (b) Shall be for periods of not to exceed 15 calendar days;
 - (c) Shall cover only Government securities maturing within 15 months; and
 - (d) Shall be used as a means of providing the money market with sufficient Federal Reserve funds to avoid undue strain on a day-to-day basis.

2. Reports of such transactions shall be included in the weekly report of open market operations which is sent to the members of the Federal Open Market Committee.

3. In the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, the securities thus acquired by the Federal Reserve Bank of New York shall be sold in the market or transferred to the System Open Market Account.

Votes for this action: Messrs. Martin, Hayes, Allen, Balderston, Irons, King, Mills, Shepardson, Swan, Szymczak, and Wayne. Vote against this action: Mr. Robertson.

In dissenting from this action, Mr. Robertson reiterated the opinion that repurchase agreements were in fact not purchases of securities in the open market, such as the Reserve Banks were authorized by law to enter into, but instead were loans to dealers at fixed interest rates that were not related to the yield on the securities. Therefore, they should be used only as a last resort to finance dealers who were unable to obtain loans at reasonable

rates from others in order to aid them in maintaining an adequate market for Government securities. Furthermore, he was of the opinion, for reasons he had stated many times during the past 8 years, that nonbank dealers should not be given preferential treatment by being furnished loans from the Federal Reserve Bank of New York at lower rates than member banks were obliged to pay for loans from the same Reserve Bank.

The majority of the members of the Committee continued to feel that the repurchase agreement was an appropriate instrument that had proved of significant value to the Federal Reserve System in carrying out monetary policy. Therefore, they concluded that its use should not be restricted and that the authorization should not be changed to preclude the opportunity, if and when that was provided for under the authorization and appeared desirable, of using a rate lower than the discount rate.

5. Purchases of bankers' acceptances, and repurchase agreements based thereon.

The Committee reaffirmed the existing authorization to the Federal Reserve Bank of New York to purchase bankers' acceptances and to enter into repurchase agreements therefor—an authorization that, with minor changes, had been reaffirmed by the Committee each year since it was first granted in 1955. The authorization read as follows:

The Federal Open Market Committee hereby authorizes the Federal Reserve Bank of New York for its own account to buy from and sell to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, at market rates of discount, prime bankers' acceptances of the kinds designated in the regulations of the Federal Open Market Committee, at such times and in such amounts as may be advisable and consistent with the general credit policies and instructions of the Federal Open Market Committee, provided that the aggregate amount of such bankers' acceptances held at any one time by the Federal Reserve Bank of New York shall not exceed \$75 million, and provided further that such holdings shall not be more than 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York.

The Federal Open Market Committee further authorizes the Federal Reserve Bank of New York to enter into repurchase agreements with nonbank dealers in bankers' acceptances covering prime bankers' acceptances of the kinds designated in the regulations of the Federal Open Market Committee, subject to the same conditions on which the Federal Reserve Bank of New York is now or may hereafter be authorized from time to time by the Federal Open Market Committee to enter into repurchase agreements covering U.S. Government securities, except that the maturities of such bankers' acceptances at the time of entering into such repurchase agreements shall not exceed 6 months, and except that in the event of the failure of the seller to repurchase, such acceptances shall continue to be held by the Federal Reserve Bank or shall be sold in the open market. Such repurchase agreements shall be at the same rate as that applicable, at the time of entering into such agreements, to repurchase agreements covering U.S. Government securities.

Votes for this action: Messrs. Martin, Hayes, Allen, Balderston, Irons, King, Mills, Shepardson, Swan, Szymczak, and Wayne. Vote against this action: Mr. Robertson.

In voting against the continuation of the authority, Mr. Robertson stated that he felt the Federal Reserve System should encourage the utmost freedom of market forces and therefore should withdraw from active participation in the acceptance market in the absence of clear indication that such participation would yield specific public interest benefits. He was not aware of evidence that such benefits had been realized since the authorization was given to the Federal Reserve Bank of New York in 1955. He opposed the use of repurchase agreements covering bankers' acceptances not only for these reasons but also for the reasons he had expressed in opposing the use of repurchase agreements covering Government securities.

In support of the majority position favoring reaffirmation of the authorization, it was stated that the Federal Reserve System had taken an active interest in promoting and assisting the acceptance market since the inception of that market, that the System had a legitimate interest in doing its part to make that market as broad and as sound as possible, and that acceptances were inherently a desirable medium for operations by a central bank.

March 28, 1961

1. Authority to effect transactions in System Account.

The Federal Open Market Committee directed the Federal Reserve Bank of New York to continue to conduct open market operations with a view to encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments.

Votes for this action: Messrs. Martin, Hayes, Allen, Balderston, Irons, King, Mills, Robertson, Shepardson, Swan, Szymczak, and Wayne. Votes against this action: none.

Additional information on economic developments in February that had become available since the previous Committee meeting tended generally to confirm the estimates presented at that time. While the prevailing tone of growing business optimism might be considered somewhat premature, nevertheless there were further indications that the economy was at least close to a bottoming out of the recession. Several key economic series that previously had been falling for some time had now either leveled off or turned upward. These included such items as new orders for durable goods, manufacturers' sales of durable goods, industrial production, and retail sales. In addition, the relatively small prospective decline from 1960 in business plant and equipment expenditures was encouraging; and housing starts, at a seasonally adjusted annual rate, had risen from the December low, although they still remained below the year-earlier level. While employment had risen in February to a level above a year earlier, the rate of unemployment increased slightly and the actual number of unemployed attained a postwar peak.

The money market had been generally easy in the past 3 weeks, a period when more tightness might ordinarily have been expected in view of the midmonth tax date. Total loans and investments at city banks declined during the first part of March. Although business loans increased about as much as usual, loans to finance companies showed a contraseasonal decline, and loans