FORTY-EIGHTH

Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System

COVERING OPERATIONS FOR THE YEAR

1961

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.

with an unfavorable external payments position. It was recognized that the resulting differential between British and U. S. short-term interest rates and credit availability, to the extent that it induced a flow of funds from this country to the United Kingdom, would be a force working to limit further decline in short-term rates domestically and perhaps exerting some upward pressure on them. Another possible effect would be some worsening of the over-all deficit in the U. S. balance of payments, particularly in view of the adverse tendencies indicated by second-quarter developments of the current year.

Balancing the considerations pertinent to the formulation of monetary policy under current conditions, the Committee concluded that although alertness to developing factors, both domestic and international, was in order, a policy of continued ease, while at the same time avoiding a decline in short-term interest rates, would be appropriate for the period immediately ahead in order to help foster domestic economic recovery at a reasonable pace. Therefore, the consensus favored continuation of approximately the same degree of ease that had been maintained recently.

Mr. Mills was of the opinion that both domestic considerations related to inflationary potentials inherent in too broad a reserve base and international considerations calling for a closer alignment between U. S. Treasury bill and foreign bill rates required a reduction in the supply of reserves, which would serve to bring some upward pressure on short-term interest rates.

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

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

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

Developments since the preceding meeting, including those focusing attention upon the relationship of U. S. short-term rates to rates in other countries, had resulted in substantial purchases of securities other than bills by the Open Market Account in order to provide needed reserves but not contribute directly to a further decline in Treasury bill rates. The renewal, with one dissent, of the authorization for operations in longer-term securities was given without restriction on the discretion of the Management of the Open Market Account to take such actions as seemed appropriate in the light of market developments and the effectuation of over-all monetary policy. However, there was some opinion within the Committee that, if feasible, a lesser volume of System purchases of securities in the longer maturity range, or even a reduction of Account holdings, would be advisable.

August 22, 1961

1. Authority to effect transactions in System Account.

Clause (b) of the directive to the Federal Reserve Bank of New York was changed to provide for open market operations with a view to encouraging credit expansion so as to promote fuller utilization of resources, while giving consideration to international factors. The previous directive, which had been in effect since June 6, 1961, provided for operations with a view to encouraging expansion of bank credit and the money supply so as to contribute to strengthening of the forces of recovery, while giving consideration to international factors.

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

Although industrial production increased to a record rate in July, it remained well below capacity levels. The consumer and wholesale price indexes remained generally steady, and sensitive industrial prices had leveled off after a rise earlier in the recovery period. Sales of durable goods, although rising, continued to lag behind manufacturers' new orders. While employment had been expanding rapidly, the level of unemployment remained near the recession high. Total retail trade was down slightly in July, reflecting principally lower automobile sales, this decline apparently being related to the earlier than usual model changeover period. While consumer spending had increased as the recovery progressed, it had shown less than a typical upsurge for this stage of the business cycle, and buying intentions, according to recent surveys, appeared to be relatively weak. Evidence suggested that consumers had been willing thus far to devote a large part of their increased incomes to saving, rather than increasing their consumption of consumer goods or accumulating physical assets.

While business improvement continued to be strong and broadly based throughout the economy, this expansion had had little counterpart in accelerated demands upon the financial system. Loan demand at banks lacked the vigor usually associated with the current stage of cyclical expansion, and bank asset expansion had reflected chiefly purchases of Federal and municipal securities. Net deposit expansion was continuing to represent largely an increase in time deposits. An upward interest rate movement appeared to reflect in the main expectations—based on the improved economic outlook, higher defense expenditures, and prospective higher levels of Treasury borrowing—rather than any change in the current need for and supply of funds. The upward rate movements were reinforced, particularly in the short-term area, by a reduced level of free reserves of the banking system in the first part of August, partly due to added required reserves against deposits created by Treasury cash financing and partly due to large market drains of unforeseen dimensions.

As to the balance of payments, preliminary data on gold and dollar transfers to foreigners for July suggested a July payments deficit about twice the monthly rate of deficit for the second

quarter of the year. While the July situation reflected in part temporary and seasonal influences, over-all payments tendencies suggested deterioration of the deficit position, particularly in terms of the trade balance.

There was general agreement within the Committee that economic and financial developments, both domestic and international, should continue to be watched closely. However, for the ensuing 3-week period the consensus favored continuing about the same degree of ease that had prevailed, except during the period in early August when a confluence of market factors contrived to produce more firmness than had otherwise been the case. The change in the language of the directive therefore did not signify an intent to effect any immediate change in System policy. Instead, it reflected the view of the Committee that the amended wording was more appropriate at a time when the domestic economy was progressing from the stage of recovery into an expansionary phase.

Although concurring in general with the consensus, Mr. Mills was of the opinion that natural demand forces should be relied upon to foster an expansion of bank loans, and that forcing reserves on the commercial banking system could only lead to future inflationary and speculative problems as well as cause foreign observers to question the suitability of monetary policy in the United States as related to balance of payments and inflationary considerations.

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

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

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

The Committee renewed the authorization, with two dissents, on a basis that continued to vest in the Management of the Open Market Account discretion, within the scope of current Committee policy objectives, for determining the extent to which the authority should be utilized in the light of market developments. One member of the Committee, Mr. King, favored continuing the authorization in effect, but disengaging from operations under it for the time being, while another member, Mr. Mills, voted for continuation of the authority with the recommendation that it be used, when practicable, for reduction of the Open Market Account's portfolio of securities other than Treasury bills. Mr. Robertson, one of the two members who dissented from renewal of the authorization, cited the shrinkage in private retail buying interest in the long-term Government securities market which had accompanied the continuation of official purchases of such securities, and the lack of any apparent major benefits from such purchases. Although he believed that cessation of operations in longer-term securities would be the wisest course, he suggested that the Committee begin by returning to the initial standard, set on February 7, 1961, of barring operations in securities maturing beyond 10 years. This, he felt, would lay the foundation for progressively further limitations later as, in the Committee's view, conditions might make such action appropriate.

September 12, 1961

1. Authority to effect transactions in System Account.

The Committee renewed without change the directive to the Federal Reserve Bank of New York calling for open market operations with a view to encouraging credit expansion so as to promote fuller utilization of resources, while giving consideration to international factors.

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

Available economic data, mostly relating to the month of August, indicated the continuation of a recovery movement in

which almost all economic indicators had risen above their earlier peaks, but without evidence, however, of an attitude of excessive exuberance on the part of the business community. Some stimulation from additional defense expenditures appeared to be about offset by a lower level of consumer spending than might ordinarily be expected at the current stage of the business cycle. Consumer credit outstanding, which declined in July, appeared to have declined further in August. While the recovery movement appeared to be dependent to a considerable extent on the stimulus provided by the public sector of the economy, there was no suggestion that the stimulus from that sector would be withdrawn. On the other hand, while the vastly increased liquidity of the economy, especially in the hands of consumers, constituted a reservoir of potential spending, there was no present evidence of a significant increase in consumer spending.

Commercial bank loans and investments declined somewhat in August following the large increase in July, which had been due mainly to Treasury financing operations. Business borrowing from banks had thus far shown a rise of no more than usual seasonal proportions. The money supply, narrowly defined to include only currency and demand deposits, changed little in August for the fifth successive month, while the rise in time and savings deposits at commercial banks slackened slightly after having maintained a sharp rate of increase, seasonally adjusted, earlier in the summer.

As to the balance of payments, it appeared that the large transfer of gold and dollars from the United States to foreigners in July could be accounted for mainly by temporary factors, including a large outward capital movement, a reduced trade surplus reflecting a contraseasonal rise in imports, and a seasonal increase in tourist expenditures. Preliminary indications suggested that the deficit may have been reduced in August. Nevertheless, even if the July deficit reflected temporary factors, the gravity of any tendency toward deterioration of the U. S. international payments position was apparent, particularly when viewed