

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.

payments position of the United States, perhaps some further deterioration. Preliminary reports on the balance of payments for November suggested that the deficit was about equal in size to the October and September deficits.

The Open Market Committee, in considering the appropriate course of monetary policy for the period ahead, observed that the recent tendency toward a firming of money market conditions reflected pressures generated within the market itself rather than positive action on the part of the System. The fact that market forces had resulted in increasing somewhat the Treasury bill rate level was regarded as fortunate, in view of the balance of payments problem, and it was not felt that System operations to offset the effect of the prevailing market forces would be warranted. In fact, a minority of the Committee believed that the expansionary trend and current strength of the domestic business situation would justify some lessening in the volume of reserves placed at the disposal of the banking system as a basis for further expansion of credit. However, due to the absence of stresses and strains in the economy at the present time and in light of the several remaining points of uncertainty that tended to cast some doubt on the pattern of future economic developments, the consensus favored maintaining for the immediate future approximately the same policy in respect to the supplying of reserves that the Committee had been pursuing for some time.

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

No change was indicated in positions previously expressed with respect to this authorization.

December 19, 1961

1. Authority to effect transactions in System Account.

The following current economic policy directive was issued to the Federal Reserve Bank of New York:

It is the current policy of the Committee to permit further bank credit and monetary expansion so as to promote fuller utilization of the economy's resources, together with money market conditions consistent with the needs of both an expanding domestic economy and this country's international balance of payments problem.

To implement this policy, operations for the System Open Market Account shall be conducted with a view to providing reserves for bank credit and monetary expansion (with allowance for the wide seasonal movements customary at this time of the year), but with a somewhat slower rate of increase in total reserves than during recent months. Operations shall place emphasis on continuance of the 3-month Treasury bill rate at close to the top of the range recently prevailing. No overt action shall be taken to reduce unduly the supply of reserves or to bring about a rise in interest rates.

Votes for this action: Messrs. Martin, Hayes, Balderston, Irons, Shepardson, Swan, Wayne, and Fulton. Votes against this action: Messrs. King, Mills, Mitchell, and Robertson.

(This directive was the first issued by the Committee under new procedures instituted at this meeting—explained in a subsequent entry of this date—under which the substance of the Committee's previous directive was to be divided between a "current economic policy directive" and a "continuing authority directive.")

Data for November available to the Committee at this meeting indicated continued expansion in economic activity on many fronts and a substantial rise in consumer outlays, an area with respect to which there had earlier been some uncertainty. Final figures for November industrial production indicated a rise of 1 point in the Board's index, with prospects for another 1- or 2-point increase in December. New orders for durable goods were

up moderately, and unfilled orders had risen further. The November decline in the unemployment rate on a seasonally adjusted basis, which had been suggested by preliminary figures available at the previous meeting, was confirmed in the final calculations. Preliminary estimates for gross national product in the fourth quarter indicated that despite strikes and other temporary setbacks the economy had performed up to the more optimistic of the earlier expectations.

Evidence was lacking of inflationary pressures associated with the continued upward movements in production and spending. The final price indexes for November showed no significant change on the average, with increases in some lines offset by decreases in others. Scattered figures available for December suggested that the stability was continuing. While business optimism had picked up considerably in recent weeks, figures on plant and equipment expenditure plans for the first quarter of 1962 indicated only a moderate rate of growth over the fourth quarter of 1961. Partial data on bank credit for the first half of December indicated relatively small changes in recent weeks in loans to businesses, although there had been an increase in the seasonally adjusted money supply.

The recent advance in interest rates, which was concentrated largely in the short-term area of the market, continued in the first half of December, with yields on some issues rising to new highs for the year. These advances appeared to be attributable to cyclical developments in the economy, as well as to usual seasonal factors. In contrast to the encouraging domestic picture, data on the balance of payments for November indicated an adverse basic balance as large as, if not larger than, in October, and fragmentary data for the first half of December indicated a continuation of the November trend.

It was the judgment of the Committee majority that improvements in the domestic economic situation coupled with the continuing balance of payments problem warranted a policy trending toward slightly less easy monetary conditions, with short-term interest rates near the high end of their recent range.

However, in view of the facts that the unemployment rate, while reduced from earlier levels, was still relatively high and that there were no symptoms of inflationary pressures, the majority felt that no substantial change from recent policies was called for. Accordingly, the Committee issued the directive quoted above.

While Mr. Robertson's analysis of the economic situation and the proper direction of policy was the same in its essentials as that of the majority, he voted against adoption of this directive on the grounds that it was undesirable to tie monetary policy to the bill rate. Mr. Mills' dissent was on the grounds that circumstances called for a greater degree of restraint than was indicated in the directive. In his opinion the Committee had been dilatory in acting firmly to combat the balance of payments problem through monetary policy, and despite a situation where an over-generous provision of reserves had continuously allowed the commercial banking system ample leeway for expanding bank loans within the total of its available resources. Messrs. King and Mitchell, on the other hand, thought the time had not yet arrived for any modification of policy in the direction of less ease.

2. Modification of form of directive to Federal Reserve Bank of New York.

As indicated in the preceding entry, the Federal Open Market Committee voted at this meeting to replace the single directive of the type it had issued to the Federal Reserve Bank of New York in the course of its meetings in the past with a "current economic policy directive" and a "continuing authority directive." In accordance with this revision of procedure the Committee adopted the following continuing authority directive:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the current economic policy directive adopted at the most recent meeting of the Committee:

- (a) To buy or sell U.S. Government securities in the open market for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account (in-

cluding forward commitments, but not including such special short-term certificates of indebtedness as may be purchased from the Treasury under paragraph 2 hereof) shall not be increased or decreased by more than \$1 billion during any period between meetings of the Committee;

(b) To buy or sell prime bankers' acceptances in the open market for the account of the Federal Reserve Bank of New York at market discount rates; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed \$75 million or 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;

(c) To buy U.S. Government securities with maturities of 24 months or less at the time of purchase, and prime bankers' acceptances, from nonbank dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or acceptances in 15 calendar days or less, at rates not less than (a) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (b) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower.

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to purchase directly 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 \$500 million.

Votes for this action: Messrs. Martin, Hayes, Balderston, Irons, King, Mitchell, Shepardson, Swan, Wayne, and Fulton.

Votes against this action: Messrs. Mills and Robertson.

(The current economic policy directive adopted at this meeting is quoted in the first policy record entry for this date.)

In the view of the majority, separation of the continuing authorizations from the current directive would permit the Committee to frame its current economic policy instructions to the Federal Reserve Bank of New York in a more effective fashion. Previously the formal economic policy instructions had been

compressed into a single clause—clause (b) of the first paragraph in directives of the former type—of a longer statement also including instruction on other matters which were subject to relatively infrequent change.

The new continuing authority directive was intended to encompass the substance of the previous single directive, except for clause (b), and of certain other authorizations and directives relating to repurchase agreements and bankers' acceptances that previously had been adopted independently of the directive. No action was taken to discontinue previous authorizations on repurchase agreements and bankers' acceptances. The language in the new continuing authority directive was rephrased from that of earlier instruments for the sake of greater clarity, but with one exception the Committee made no substantive changes in its authorizations and directions to the Account Management. The exception related to the maturity limit of securities acquired from nonbank dealers under repurchase agreements, which was 15 months under the previous authority and was set at 24 months in the new continuing directive.

Mr. Mills dissented from the action to adopt the continuing directive because, in his view, directives of the previous type that were tied to "ground rules" set out in specifically stated operating policies more clearly reflected the judgments of the Committee, and in a manner to which the interested public had become accustomed. He was concerned that in the new type of current policy directives, a tendency toward the use of amorphous statements and generalities in describing policy intentions would in the future prevent fixing responsibility for previous actions that had come under criticism.

Mr. Robertson's dissent was on two grounds. First, he objected to the inclusion of the authority to buy Government securities from nonbank dealers under repurchase agreements at rates that could be lower, in certain circumstances, than the discount rate of the Federal Reserve Bank of New York. Second, he objected to the fact that the directive did not include certain rules within which, in his view, the Account Management should

operate on behalf of the Committee. Specifically, the document did not include any directive to the effect that open market operations were to be conducted primarily to supply or absorb bank reserves; it did not limit open market operations to short-term securities; it contained no restriction against conducting operations for the purpose of supporting any pattern of prices or yields in the Government securities market; it contained no language specifying that during periods of Treasury financing open market operations were to be conducted in such a manner as to change as little as possible prevailing money market conditions; and it contained no prohibition against "swap" transactions (i.e., offsetting purchases and sales of securities).

3. Statements of continuing operating policies and authority to effect transactions in intermediate- and longer-term securities.

The Federal Open Market Committee discontinued the three statements of operating policies that had been in effect since 1953 and were last reaffirmed by the Committee on March 22, 1960. This action was taken with the understanding that it would make unnecessary the special authorization permitting transactions in longer-term securities, adopted in February 1961 and renewed at each subsequent meeting, and this authorization was therefore not again renewed. The three discontinued operating policy statements read 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.

Votes for this action: Messrs. Martin, Hayes, Balderston, Irons, Mitchell, Shepardson, Swan, and Fulton. Votes against this action: Messrs. King, Mills, Robertson, and Wayne.

The operating policy statements had been reviewed at the meeting of March 7, 1961, in accordance with the customary practice of reviewing all continuing authorities and statements of policy at the first meeting each year following the election of new members from the Federal Reserve Banks. At that time, pursuant to the recommendation of a Subcommittee, the Committee tabled consideration of possible changes pending a more comprehensive review of the appropriate form for such statements under present circumstances, including those associated with the operations recently begun in intermediate- and longer-term securities. Subsequently, Committee members gave extended consideration to alternative possible formulations of the statements and to the advantages and disadvantages of continuing them in some form. Further deliberations at this meeting culminated in the decision to discontinue the statements.

The language of the statements had reflected the Committee's expectation that departures from various of the individual policies described would be needed from time to time, and the Committee had in fact made such departures on several occasions. The most recent was the special authorization for transactions in longer-term Government securities first made in February 1961 and renewed at each subsequent meeting until December 19, 1961. In voting to discontinue the three statements of operating policies, it was the belief of the majority of the Committee that in the future greater latitude might be needed for adapting System operating techniques to changing circumstances than had

been required over most of the period since 1953, especially in view of the change in this country's international payments position.

The decision also reflected the belief of a Committee majority that some of the advantages seen earlier in having statements of operating policies were now considerably reduced in importance. The main purpose of the statements, when they were originally adopted in 1953 and reaffirmed in subsequent years, was to clarify the role of the Federal Reserve with respect to the Government securities market. During World War II and the post-war period up to the Treasury-Federal Reserve accord of March 1951, the System maintained the prices and yields of outstanding Government securities on a relatively fixed schedule, and in the 18 months following the accord the System continued actively to support Treasury financings. A majority of the Committee had believed the statements of operating policies served a major role in defining more clearly the System's operations in the Government securities market and in facilitating the transition from a supported to an unsupported market. But the transition had long since been successfully accomplished and a majority now felt that this purpose no longer provided a compelling reason for continuing formal statements of operating policies.

Another of the original purposes of the statements was to provide guidelines for open market operations undertaken on the Committee's behalf. At the time the statements were adopted in 1953 the Federal Open Market Committee met relatively infrequently—a minimum of four times a year, with occasional additional meetings—and in the relatively long intervals between meetings responsibility for effectuating policy lay with the executive committee. Along with other types of instructions, the operating policy statements were considered to serve a useful function in providing guides for the executive committee and the Account Management. Since mid-1955, however, when the executive committee was discontinued, the full Committee had been meeting regularly at short intervals—usually every 3 weeks

—and it had been able to maintain close direction over the conduct of operations. In these circumstances the majority felt that the importance of the operating policy statements as guides for operations was also considerably reduced.

The decision to discontinue the statements of operating policies related solely to the desirability of continuing to have such statements; it was not a decision to change the basic position of the System in relation to the Treasury or the market. The action was taken with the recognition that the bulk of open market operations would, in the nature of the case, continue to be in short-term securities; with the understanding that decisions about operations in securities of all maturities would continue to be made by the Committee in light of prevailing circumstances; and with the understanding that the Committee had no intention of pegging Government security prices, or of creating artificial market conditions at times of new security offerings by the Treasury.

Those voting against the action to discontinue the statements felt that the balance of advantages and disadvantages still favored the retention of statements in some form. It was pointed out that whether or not the Committee affirmed formal statements of operating policies, it would in effect still be acting in terms of certain rules, and there were some advantages in having these formalized even if the language admitted to a considerable degree of flexibility. The possibility that a complete elimination of the statements would have an adverse effect on the Government securities market was suggested.

Mr. Robertson's dissent was predicated on his beliefs that there should be Committee rules with respect to matters such as "swap" transactions, pegging operations, and the conduct of open market operations during periods of Treasury financing and that they should be formally set out. He also felt that the Committee should return to its previous policy of confining operations to short-term securities. In his view: (1) the operation that the Committee had launched in February 1961, including transactions in longer-term securities under the special authoriza-

tion, had not been successful in raising short-term and lowering long-term rates; (2) had the operation been pushed to the point necessary to achieve what he understood to be these twin goals, its defects would now be obvious; and (3) the deleterious effects of such operations on the market for long-term securities will become more apparent when the Treasury seeks—as it sometime must—to extend the maturity structure of the Federal debt by attempting to sell long-term securities for cash or in exchange for maturing securities. Furthermore, he believed that while it was possible for the Federal Reserve to acquire longer-term securities without impeding Treasury operations in a period such as 1961, when Treasury financing was chiefly short-term, the sale of such securities would present real problems. In his view such selling action would not only absorb long-term funds from the limited supply but would also aggravate the uncertainties which already plagued the long-term market, weakening its supporting structure and attenuating its appeal to investors. He could not foresee any time, when monetary policy called for absorbing reserves, that the Federal Reserve could sell longer-term securities from its holdings without impairing the ability of the Treasury to lengthen the debt. This, he thought, would be unfortunate, in view of the real need for the Treasury to achieve a more manageable maturity distribution of the public debt. Accordingly, he believed that operations in securities beyond the short-term area should be terminated immediately.

Mr. Mills, in dissenting, stated that it was his disposition to retain the operating policy statements in their present form, and to continue the special authorization for transactions in longer-term securities, but to modify the terms of the latter to allow continued operations in Government securities with maturities up to 2 years. It was his judgment that operations in securities in this maturity range may have had some limited success in holding up the short-term rate structure—a desirable end for balance of payment reasons—and while the apparent benefits may have been illusory to some extent, it was reasonable to attempt further experimentation. He believed that transactions in

longer-term securities had been harmful in that the market had come to regard them as patent efforts to support the market rather than as a means of influencing interest rates and that such transactions had set the stage for a full-fledged pegging operation. In his view, operations in any Government securities other than Treasury bills had the disadvantage of impairing the usefulness of the market as a sounding board for recording economic and financial movements.

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As indicated by the foregoing record, the policy directive of the Federal Open Market Committee in effect at the beginning of 1961 was aimed at encouraging monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments. During the course of the year the directive was changed four times. The first change occurred on April 18, when a directive was adopted that 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 that appeared to be developing in the economy, while giving consideration to international factors. On June 6, the qualifying words “that appear to be developing in the economy” were dropped from the directive. The next change was on August 22, when a directive was adopted that called 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. This directive was renewed at subsequent meetings until December 19, when the Open Market Committee decided to institute a procedure of issuing both a current economic policy directive and a continuing authority directive. The text of each of the two directives issued on December 19 is quoted in full in the policy record entries for that date.