

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, February 7, 1961, at 10:00 a.m.

PRESENT: Mr. Martin, Chairman  
Mr. Hayes, Vice Chairman  
Mr. Balderston  
Mr. Bopp  
Mr. Fulton  
Mr. King  
Mr. Leedy  
Mr. Mills  
Mr. Robertson  
Mr. Shepardson  
Mr. Szymczak  
Mr. Irons, Alternate to Mr. Bryan

Messrs. Leach, Allen, and Mangels, Alternate  
Members of the Federal Open Market Committee

Messrs. Erickson, Johns, and Deming, Presidents of  
the Federal Reserve Banks of Boston, St. Louis,  
and Minneapolis, respectively

Mr. Young, Secretary  
Mr. Sherman, Assistant Secretary  
Mr. Kenyon, Assistant Secretary  
Mr. Hexter, Assistant General Counsel  
Mr. Thomas, Economist  
Messrs. Brandt, Eastburn, Hostetler, Marget,  
Noyes, and Tow, Associate Economists  
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors  
Mr. Koch, Adviser, Division of Research and  
Statistics, Board of Governors  
Mr. Knipe, Consultant to the Chairman, Board of  
Governors  
Mr. Yager, Economist, Division of Research and  
Statistics, Board of Governors  
Mr. Petersen, Special Assistant, Office of the  
Secretary, Board of Governors

Messrs. Wayne, Patterson, and Swan, First Vice  
Presidents of the Federal Reserve Banks of  
Richmond, Atlanta, and San Francisco,  
respectively

2/7/61

-2-

Messrs. Ellis, Baughman, Jones, Parsons, Clay,  
and Walker, Vice Presidents of the Federal  
Reserve Banks of Boston, Chicago, St. Louis,  
Minneapolis, Kansas City, and Dallas,  
respectively

Mr. Garvy, Adviser, Federal Reserve Bank of New York

Mr. Rudy, General Counsel, Federal Reserve Bank of  
Dallas

Mr. Stone, Manager, Securities Department, Federal  
Reserve Bank of New York

Upon motion duly made and seconded, the  
minutes of the meeting of the Federal Open  
Market Committee held on January 10, 1961,  
were approved unanimously.

Before this meeting there had been distributed to the members of  
the Committee a report of open market operations covering the period  
January 24 through February 6, 1961. A copy has been placed in the files  
of the Committee.

Supplementing the written report, Mr. Rouse commented as follows:

Experience since the last meeting indicates that the  
Committee's dual concern over the level of short-term rates  
and the availability of reserves requires an increasingly  
flexible approach to open market operations. Over much of  
the period, the money market was easy because of storm-  
induced float, and although this ease spilled over into the  
bill market at times, short-term rates tended to rise on  
balance. Last Wednesday and Thursday, on the other hand,  
there was an evident need to supply reserves at a time when  
Treasury bill rates were moving lower. The repurchase agree-  
ment provided a convenient mechanism for inserting funds.  
As to the more general effects of recent System operations,  
I think that we can take it as an encouraging sign that  
required reserves have been holding up better than could  
be expected on seasonal grounds, despite substantial  
fluctuations in free reserves.

As might be expected, there was considerable interest,  
and some skepticism, in the market over the portions of the

2/7/61

-3-

President's economic message that dealt with the relationships between short- and long-term interest rates. The immediate reaction was that prices of long-term bonds moved up in moderate trading as much as 1 point (or down about .06 per cent in yield) last Thursday and Friday, mainly on short covering by dealers and small speculative buying. Yesterday, however, prices edged down by a few 32nds, principally on small offers by holders anxious to acquire the new 18-month Treasury note offered by the Treasury. Although the message had little effect on short rates, partly because the market was already well conditioned to the official attitude toward that sector, it appears that the long-term rate has already seen some of the adjustment that the President considers desirable. The President's balance-of-payments message yesterday--suggesting that the Treasury might offer foreign official holders of dollar balances special certificates at attractive rates--had a more visible impact on short-term rates. Partly because of this, the average rates in yesterday's auction were established at 2.37 per cent and 2.57 per cent for three- and six-month bills, respectively, in each case about 7 basis points above the previous auction. Whether this trend of long and short rates will follow through remains to be seen.

The Treasury offering was considered very generously priced by the market, and the main question raised was the size of allotments to the public. Subscriptions received at the New York Bank yesterday were unusually heavy, and it appeared that some dealers were not waiting until the last minute to enter their subscriptions, as is the usual practice. There was only a modest reaction in prices of issues of comparable maturity to the new 3-1/4 per cent notes offered by the Treasury at par. Market guesses were that the new issue would start off in when-issued trading at a substantial premium; first quotations this morning of par 6 bid and par 8 offered appear to bear out that expectation. The Treasury, of course, had hoped that as a result of concentrating the refinancing in a single short-term issue--properly priced--there would be a favorable impact on both short- and long-term rates.

The System rolled over its holdings of \$3.6 billion of the maturing 4-7/8 per cent certificates into the new issue. I might add that the market has apparently not had any great difficulty in adjusting to the cash refunding method this time, even though some holders of maturing issues may not be able to roll over their maturing holdings. If cash

2/7/61

-4-

refunding should become a normal Treasury technique, there may be possibilities for the System under more normal conditions to reduce its large holdings of some individual issues by permitting some run-off of the maturing issue in future refinancings and replacement with bills.

Subscriptions already received at the New York Bank total more than \$10 billion, including the \$3.6 billion subscription entered by the System. On the basis of these subscriptions alone, allotments to the public would be around 50 per cent, and this figure will, of course, be reduced by subscriptions in other districts and by subscriptions from others entitled to 100 per cent allotments.

Mr. Robertson, referring to the change in the free reserve position that occurred between the first and second weeks of the preceding period, asked whether it was just float that caused this decline.

Mr. Rouse replied that float was responsible for the decline in the amount of free reserves between the two weeks. The bulge in float during the first part of the period was erased when the checks were collected. The Management was faced with the problem during last week of having to furnish reserves even though Treasury bill rates were moving lower. Large repurchase agreements were used on Wednesday and Thursday to meet this problem. This brought the free reserve figure up. The market turned easy and on Friday over \$150 million of those repurchase agreements were lost.

Mr. Robertson then asked if one of the reasons for letting reserves get so low and not trying to put them back was a desire to bring the bill rate back up.

Mr. Rouse replied that the bill rate was a factor.

2/7/61

-5-

Thereupon, upon motion duly made and seconded, the open market transactions during the period January 24 through February 6, 1961, were approved, ratified, and confirmed.

A staff memorandum on recent economic and financial developments had been distributed under date of February 3, 1961. With further reference to economic developments, Mr. Noyes presented the following statement:

The more optimistic sentiment in business and financial markets which has continued in recent weeks is well illustrated by the 6 per cent increase in stock prices that occurred in the month of January. This has been attributed to both the conservative and the aggressive nature of the task force reports to the new President and his own statements. Some observers seem to be appraising the future more optimistically because the Administration appears to have rejected radical proposals which they feared might be adopted, while others are pleased that prompt action is being taken to employ conventional antirecessionary weapons. The result has been a widespread further shift toward confidence in the economic outlook, despite the fact that there has been little or no improvement in the underlying facts with respect to output, trade and employment.

In January, steel mill operations were up 6 per cent from the depressed December level, an adjustment that seemed long overdue to those who have followed the relation between steel consumption and production since last spring. On the other hand, auto assemblies were down 20 per cent from the already curtailed volume. Even the earliest preliminary figure for total industrial production is still incomplete, but it now appears most likely that the index will decline one point. With auto sales down more than seasonally and department store sales off sharply in the last two weeks, total retail trade for the month is almost certain to be down, due in part, of course, to the severe weather conditions in many areas.

The 900,000 increase in unemployed resulted in a slight decline in the seasonally adjusted annual rate of unemployment, from 6.8 to 6.6 per cent, but this amount of change is not regarded by technicians familiar with the behavior of the

2/7/61

-6-

series as a significant improvement. Long-term unemployment continued to increase.

Thus, it seems clear that the more optimistic appraisals of the outlook in January were based on expectations of an early upturn, rather than on any significant improvement in general business conditions during the month. Of course, it does not follow from this fact alone that these brighter expectations will not be realized. Greater optimism itself provides some stimulus to the economy. There is also evidence that rates of decline are less severe in the case of many industries, and some have leveled out. It may be significant, for example, that on average sensitive commodity prices have not declined further in recent weeks. Furthermore, there is no doubt that the recommendations in the President's economic message a week ago, though moderate, are generally of a stimulative nature; and some, such as the accelerated G.I. insurance dividend payment and the extension of unemployment insurance benefits, will serve to bolster the demand for goods and services in the near-term future. The length of time that may be required for other parts of the program to take effect is more difficult to estimate. Previous experience with expediting Government procurement and public works programs to improve their countercyclical effects has not been altogether favorable.

One potential danger in the present situation seems to me to be that overly optimistic expectations for a strong early reversal of the downward trend will be disappointed. The easing at the end of last week and yesterday's rather abrupt decline in stock prices suggests that some reappraisal of the very bullish attitude of the preceding weeks may already be under way.

While there may be good reason to suspect that many measures of economic activity are currently at or near their cyclical low points, and will not decline much further, there is, as yet, little basis for projecting a rapid or vigorous recovery, either as a result of natural forces or measures already undertaken by Government. In this connection, it is worth remembering that the very rapid turnaround in 1958 was unusual and followed an unusually sharp decline. While there is no immutable reason that recessions and recoveries must be symmetrical, there is also no reason to suppose that one recovery will necessarily follow the pattern of its immediate predecessor. As one surveys the various elements of potential strength in the economy, none of them seems poised for a rapid upward surge. Put another way, there are very few components of total output that have

2/7/61

-7-

been depressed to such a point that substantial upward adjustment seems imminent.

Unless the Administration is provoked to much more drastic and overtly inflationary measures than have been proposed thus far, some further decline in the current quarter, followed by a more gradual--and perhaps healthier--upturn than in 1958 seems the more likely possibility.

Mr. Thomas then presented the following statement on the monetary situation:

Recent developments in the financial sectors of the economy may be reviewed in terms of the three prongs of the objectives--or aspirations--of current System policy.

(1) To foster credit and monetary expansion.-- Contraction of credit and money has been somewhat smaller than is customary at this time of the year. In other words, there has been a seasonally-adjusted expansion.

(2) To avoid lowering short-term interest rates in order not to add to the outflow of gold.--Short-term interest rates have not declined in recent weeks, although some decline generally occurs in January. The gold outflow has perceptibly slackened in the past two weeks.

(3) To foster, so far as possible, further easing of long-term credit markets. This is a more indirect result of Federal Reserve operations. So far long-term rates have not declined, but their variations have shown a relationship to short-term rates that is consistent with the record of the past.

Taking up these three facets in reverse order, the situation with respect to long-term interest rates is somewhat mixed. Yields on U. S. Government bonds, which declined in December, turned up in January, as did also yields on State and local government bonds. During the last few days, however, since the President's statement regarding the desirability of lower long-term rates, prices of Treasury bonds have risen somewhat, i.e., yields have declined. Yields on both U.S. and State and local government bonds are above the low levels reached last summer. In contrast, yields on outstanding high-grade corporate bonds, which tended to rise in December, have declined in January and are at approximately the low of last August. This decline in corporate bond yields is apparently related to the reduced volume of new issues offered and in prospect since the turn of the year. New issues of State and local government securities, on the other hand, have been in somewhat larger volume than in the last quarter of 1960.

2/7/61

-8-

Stock prices have risen fairly steadily since October and the more comprehensive averages are higher than at any previous time. Trading activity has been at an exceptionally high level. Yields on stocks at recent prices and dividend returns have fallen to an average of about 3-1/8 per cent--close to the lowest levels of recent years. The margin between yields on stocks and those on highgrade corporate bonds has widened appreciably.

Some easing of the mortgage market is indicated by FNMA operations in December. Offerings and purchases continued to decline and were less than two-fifths the high volume of early 1960. Sales by FNMA, which have been negligible, increased in December to half the volume of purchases. With reduction in the maximum permissible rate on FHA mortgages from 5-3/4 per cent to 5-1/2 per cent, FNMA has set its purchase prices for the 5-1/2 per cent mortgages at a slightly smaller differential from prices for 5-3/4 per cent paper than would be indicated by the rate difference. This may provide a slight nudge toward a broader reduction in mortgage rates.

With respect to shorter-term rates, yields on 3-5 year Treasury issues rose somewhat in January, after declining in December, contrary to the usual seasonal pattern. Treasury bill rates, after declining in December, have fluctuated in January at or above the low levels previously reached. These fluctuations have shown some correspondence with variations in the reserve positions of banks. Rates on finance company paper were further reduced in January to the lowest level since 1958. The maintenance of Treasury bill rates has no doubt been aided by increases, aggregating \$500 million, in weekly bill offerings, as well as by reductions in the Federal Reserve portfolio, which has tended to reduce somewhat the availability of reserves relative to demands.

Bank credit, after allowance for seasonal variations, has expanded in recent months. Total loans and investments of banks, after increasing more than usual in December, seem to have declined less than usual in January. Loans declined substantially, after only a moderate increase in December, but banks continued to add to their holdings of Government securities, which usually are reduced in January. The reduction in business loans corresponded roughly to the usual seasonal pattern, and decreases in loans to finance companies and to brokers and dealers in securities followed rather large increases in December. Bank loans to dealers in Government securities, however, have remained rather large, while loans to other dealers in securities are relatively small.

2/7/61

-9-

The bulk of the January increase in holdings of U.S. Government securities at city banks was in Treasury bills. There were also increases in other short-term issues and in notes and bonds maturing within one to five years, with a further decline in holdings of longer-term issues. In maturity distribution of securities held, banks have substantially improved their liquidity positions during the past year. The increase in bank holdings of Treasury bills and other short-term securities may have tended to keep bill rates down, but at the same time sales of bills by the Federal Reserve and the less than seasonal decline in the money supply and in required reserves have operated in the opposite direction.

Demand deposits at banks decreased much less than usual in January, and time deposits continued to show a sizable increase. It is evident that the seasonally adjusted money supply increased by a substantial amount in January. Preliminary figures show it may have increased by \$1 billion. By the beginning of February, the money supply was probably larger than a year ago. Time deposits at commercial banks increased by about \$900 million in January. In the same month of previous years, changes have varied between increases of \$400 million and decreases of a similar amount. In the week ending February 1 there was a further sharp increase of over \$500 million in time deposits at city banks, reflecting principally a special large-scale transaction by Sears Roebuck with a number of banks whereby the banks took over customer paper, thereby increasing their consumer loans and their time deposits.

United States Government deposits, which were larger than usual at the end of December, declined substantially in January but turned up last week. Interbank balances did not decline as much as usual in January of this year. At the same time banks reduced their borrowings from other banks. These are other indications of relative improvement in bank liquidity.

Bank reserve positions continued relatively easy on the average during the past month, but showed rather wide week-to-week fluctuations and are now somewhat tighter than they have been for some time. Free reserves varied from close to \$1 billion in the weeks ending January 4 and January 25 down to around \$400 million last week. They may average even less this week; we would say about \$300 million. Required reserves, which increased by more than estimated seasonal needs in December, are now over \$200 million larger than the figure projected from the December average on the basis of the usual seasonal pattern.

2/7/61

-10-

Reserves were made available during the past 5 weeks by the seasonal return flow of currency and decline in required reserves and were absorbed by a less than seasonal decrease in float, by the gold drain of around \$400 million, and by a reduction in the System portfolio, which aggregated about \$800 million in the four weeks ending February 1. As a net result, while required reserves are now more than \$200 million above the projected level, excess reserves are below the assumed \$700 million figure by a somewhat larger amount, giving total reserves of close to the projected figure.

In projecting reserve needs for the period ahead, it seems appropriate to make some allowance for the higher level that required reserves have reached, since an aim of policy is to achieve credit expansion. The level of January 25 has been used as a base; this is more than \$100 million above the December base, but is below the level actually reached in the week of February 1 by about \$100 million. Excess reserves of \$700 million have been added to the January 25 figure for required reserves to give a total reserve base. If the gain in required reserves attained last week is maintained, the projected figure of total reserves needed will leave excess reserves of less than \$600 million and free reserves of less than \$550 million.

In the current week, some \$400 million of Federal Reserve credit would be needed to offset normal market factors draining reserves and bring total reserves to the projected figure, but \$100 million of this could be taken out next week. System operations to date, which have included substantial repurchase contracts and moderate outright purchases, will supply over \$200 million (on a daily average basis) this week and nearly \$60 million more next week, if the repurchase contracts remain until maturity, mostly February 16. On this basis, free reserves might average close to \$300 million this week and nearly \$500 million next week. In the week ending February 22, the run-off of repurchase contracts would absorb reserves supplied by market factors, and free reserves would remain close to \$500 million. In the subsequent two weeks (ending March 1 and March 8), System purchases of nearly \$500 million would be needed to maintain reserves at the levels indicated.

Most of the reserve variations during the next three months are temporary. Except for perhaps about \$100 million of additional purchases during the next few weeks, there would need to be no sustained increase in the System portfolio until early May in order to cover seasonal reserve needs and allow for an estimated gold drain of about \$40 million a week.

The Committee may wish to consider whether it wishes to provide more or less inducement to credit expansion in supplying

2/7/61

-11-

reserves. The amount of reserves supplied in recent weeks has permitted or perhaps encouraged monetary expansion, relative to the usual seasonal pattern, without actually depressing bill rates. The \$700 million of excess reserves assumed have not been available in the past two weeks largely because they have been absorbed by the higher than projected level of required reserves. Unless required reserves decline in the period ahead, the total reserve needs projected will make possible little more than \$500 million of free reserves. If credit demands should be greater than seasonal, somewhat more reserves might be needed during the next month. Decision as to when and how to supply those needs can be made by the Account Management on the basis of developments in the market.

Mr. Marget presented the following statement concerning the balance of payments and related international developments:

In January, the U. S. Treasury sold \$320 million of gold to foreign countries. This compares with a December level of \$440 million (if we leave out the special sale of \$300 million in gold to the United States by the International Monetary Fund), and a November level--the worst we have seen thus far--of over \$490 million. It is true that there has been a slackening of gold sales since January 24, but it is not possible to conclude from that fact alone, or from the mere fact that there has been some improvement as compared with the appalling figures for November and December, that the worst is now over. January 24 is still too recent a date to permit any such conclusion, and, while \$320 million is less than \$440 million and \$490 million, respectively, it is still much too high for comfort. If any comfort is to be found, it is with respect to the nature of the forces that may be working toward a reduction in the rate of gold outflow in the immediate future.

There is some comfort, to begin with, in the fact that December did not witness a repetition of the disturbing development that I reported to this Committee a month ago: namely, that November saw, for virtually the first time since our balance of payments situation became a matter of serious concern, an actual diminution in the level of foreign dollar balances, by as much as \$470 million--clear evidence, obviously, that existing foreign-owned dollar balances were being converted on a large scale into gold. In December, on the other hand, while the sum of the gold outflow and the increase in foreign dollar balances reached a record high, the level of existing dollar balances, instead of

2/7/61

-12-

showing a sharp decrease comparable to that shown in November, actually showed a significant increase. (While privately owned foreign dollar balances declined by \$82 million, official dollar balances rose by \$290 million.) We do not yet have the complete January figures on foreign-owned dollar balances, but the fact that foreign dollar holdings with the Federal Reserve Bank of New York remained virtually unchanged in January gives at least reason to hope that the mass conversion of dollar balances into gold that we feared might have started in November is, for the moment at least, in abeyance.

There is some comfort, also, in the action of a country such as Japan, which, with holdings of almost \$1.9 billion, is second only to Germany (with around \$3.5 billion) in the size of its dollar holdings convertible into gold. As I reported last time, the Japanese Finance Minister had announced on December 20 last, in reply to an interpellation in Parliament, that the Government of Japan wished to increase the ratio of gold in Japan's reserves from the present 14 per cent to 30 per cent, "following the example of other countries." On the other hand, as I also reported last time, the Minister had added that he was "in no hurry to purchase gold right now." In fact, a struggle was then going on within the Japanese Government as to whether the Japanese should or should not convert dollar balances into gold at this time. It is comforting to learn that, at least for the moment, the opponents of conversion into gold have won out. We are informed that, while Japan intends to bring its gold ratio up to 30 per cent "eventually," it does not propose to make any gold purchases for the time being.

Finally, for what it is worth, there is the evidence provided by the London gold market concerning what is described in the financial press as a "dampening of speculative enthusiasm" with respect to the price of gold. Since last Friday, the price in London has been such, after payment of brokerage and handling charges, as to yield a net price of about the United States par.

What these developments add up to, clearly, is the suggestion that we may possibly--I stress the word "possibly"--be moving into a period of a slackened rate of gold outflow, while the international financial community holds its breath to see which way things are going to move. "Things," in this context, must mean, for our purpose, the course of the United States balance of payments. For in the case of a country like the United States, with the immense reserves that it still possesses, and with the determination to use these reserves in the defense of the dollar at its present parity as freely as the President has declared it to be our determination to use them, what should matter is not such

2/7/61

-13-

expectations of speculators as rest on nothing more substantial than guesses as to how other speculators may act, but the answer to the basic question which has been facing us ever since the developments of 1958 awakened us to a realization that we, too, can have a balance of payments problem: namely, are we, or are we not, moving toward a position of reasonable equilibrium in our international accounts?

As we all know, it is the movements on capital account which have had the effect of obscuring the very real progress toward such equilibrium that we have been having in the sector which would ordinarily have been characterized as the most difficult and intractable part of our problem: namely, the trade sector. But while this may be irritating, it can hardly be ignored. Capital movements do affect the balance of payments, and therefore the international movement of dollars and gold. We do have to begin, therefore, by asking what we are likely to see, in the period immediately ahead, in the way of capital movements.

This, in turn, requires some judgment as to the nature of the forces which have been behind the very large outflow of capital that we have been witnessing. Specifically, if those commentators were right who have discussed the capital outflow of recent months as if it were solely a result of interest-rate differentials as between this country and abroad, we should not expect any relief in this quarter until there is a marked shift in the international structure of interest rates in our favor. But the evidence is quite clear that the recent capital outflow has not been solely the result of interest-rate differentials; that, on the contrary, the element of confidence in our basic domestic policies, as well as in our policy with respect to the dollar price of gold, has played a very considerable role. It is, therefore, not beyond the realm of possibility that the evidence I cited at the outset for believing that the "flight from the dollar" that had begun, particularly last November, to loom up as a most unpleasant reality, may for the moment be in abeyance, could mean that the confidence factor, which has been working against us in balance-of-payments terms, may now begin to work in our favor. But this is something that we shall be able to cheer about only when it happens. Thus far, to be sure, the statements by the President, particularly with respect to the official dollar price of gold, seem to have had a calming effect. But on occasions of this kind, one is always reminded of a remark of Voltaire's that Alfred Marshall, the great economist of the last generation, was fond of quoting. "An incantation," said Voltaire, "will kill a flock of sheep, provided that it is accompanied by a dose of arsenic." Thus far, it is principally

2/7/61

-14-

the incantation that has been so favorably received. What will be watched from now on will be the application of the arsenic, and the effects thereof.

Within the field of Federal Reserve responsibility, the arsenic involved--namely, monetary policy--is bound to have its effect on interest rates, which in turn have certainly had their effects upon capital movements, although not nearly to the extent implied by so many commentators. Here I would note only that in January there were reductions in the discount rate by both Germany and Japan. In both cases, the action was taken, not because of a significant slackening in the strength of the domestic economic situation in those two countries, but--in the words of the announcement by the German Bundesbank-- in order "to reduce the continuing inflow of foreign exchange and to facilitate the export of funds." In this respect too, then, with proper policies on our side, there is no reason to expect a further deterioration in the capital account of our balance of payments, and, over a period, we may even expect an improvement.

But, when all is said, it is our position on current account, and particularly on trade account, that is going to be really decisive. And here I recommend a perusal of the figures given on page 28 of the current Staff Report on Recent Economic and Financial Developments, with respect to what happened during the last quarter of 1960 to what is called there the "basic deficit" in our balance of payments--that is, the deficit after exclusion of recorded U. S. private short-term capital outflow and estimated unrecorded capital outflows. The latter two items amounted to a full billion in the quarter; without them, the "basic deficit" would have been \$0.4 billion, or around \$1-1/2 billion annual rate. (It should be noted that this figure of \$0.4 billion for the fourth quarter includes the Ford transaction; without that, the "basic deficit" for the quarter would have been virtually zero.) It has been recently estimated, moreover, that, taking as a basis the projection for U. S. foreign trade for the year 1961 that was made recently by the Balance of Payments Group of the National Foreign Trade Council, one arrives at the following result: that if the capital movements in response to doubts about the dollar and those in response to interest-rate differentials were to dry up this year, the over-all deficit for the year can fall to a level in the neighborhood of \$1 billion. This is still not the zero deficit that we must have in order to be able to say that we have reached that position of reasonable equilibrium in our international accounts which we have set as our goal;

2/7/61

-15-

and it is still further removed from the actual surplus in our international accounts that we must obtain in "good" years in order to balance the moderate deficits that we may expect when the cyclical constellation with respect to trade prospects may be less favorable than it is now. But it is also a picture vastly different from that of the low point in our balance-of-payments experience since 1958 (as in the second quarter of 1959) when, instead of running an export surplus at a seasonally adjusted annual rate of nearly \$6 billion, as we did in the fourth quarter of 1960, we had virtually no surplus on trade account at all. There has certainly been adjustment since that low point; and the direction and degree of adjustment have not been unrelated to the policies that were being followed during the period in question. Given time, and unremitting adherence to those policies, in all fields, which alone can assure that our products will maintain, and indeed improve, their competitive position vis-a-vis those of our principal trading partners, we can solve our balance-of-payments problem, and with it the vexing problem of apparent conflict between internal and external policy goals which is now so much with us. But those two conditions--the right policies, and enough time to let them work out to the desired result--are of the essence.

Mr. Hackley then entered the room and Mr. Hexter withdrew.

Chairman Martin said that the ad hoc Subcommittee appointed at the meeting on January 10, 1961, had had two meetings and wanted to discuss Committee operating procedures at the end of this session. Therefore, he would suggest that there be an executive session at the end of this meeting with attendance limited to the members of the Committee, the other Reserve Bank Presidents, the four incoming Presidents, and Messrs. Young, Thomas, and Rouse.

No objection to this procedure was indicated.

Mr. Hayes then presented the following statement of his views on the economic situation and credit policy:

2/7/61

-16-

It seems to me that the basic conditions which should determine our policies have not changed materially in the brief interval since our last meeting, although there has certainly been an important gain, for the time being at least, in foreign confidence in the dollar following the President's strong statements on this subject.

The domestic business picture does not seem to have brightened and may, in fact, have turned a little darker. For example, retail sales have been relatively weak, and the retail inventory-sales ratio has reached the highest level since the summer of 1958. The general inventory situation suggests that the inventory adjustment process has not yet reached completion, even though this point may not be very far in the future. Meanwhile there is always the risk that the high level of unemployment may add a further secondary push to what has been up to now an inventory recession, or at least that it makes a business turnaround more remote in the absence of special stimulating forces--this despite the high rate of personal savings over the past year, which could of course finance a revival of large-scale consumer spending. Oddly enough, the stock market has continued to ignore these more gloomy possibilities, but it is not clear to what extent the buoyant market in equities reflects business optimism as distinguished from fears of inflationary developments.

Despite the gratifying recovery in foreign confidence in the dollar, this remains a matter of great delicacy. We have made only a start toward correcting the heavy balance-of-payments deficit; and moreover, if the recession at home should deepen, and particularly if it should bring on a sizable Treasury deficit, this would put the strength of the dollar to a further test. Some deficit in the Federal Budget is to be expected, but if it should begin to approach the magnitude reached in 1958 we might face increasing skepticism abroad on the strength of our currency. And of course the same risk would arise if we were to permit a decline in short-term interest rates with a consequent stimulus to a renewed outflow of capital. Thus the balance of payments must remain a major consideration in our policy decisions.

It seems to me that the policies pursued by the System over the last month or two have been appropriate for the twin objectives posed by the domestic recession and the international status of the dollar. Banks have been supplied with a rising fund of reserves, their liquidity positions have improved, and the money supply has been increasing. The behavior of total bank credit at weekly reporting banks in January was considerably stronger than the seasonal pattern, primarily because of continued

2/7/61

-17-

acquisitions of Government securities by the banks--and this followed a record breaking expansion of bank credit in December. Time deposits moved up again strongly in early January, and I understand that the money supply will show a substantial rise in the second half of the month in contrast with the slight dip in the first half. We have also witnessed a decline in the velocity of money, a development associated with the diminished pressure on the cash balances of the public at large. Moreover, it has proved possible to hold the bill rate at around the 2-1/4 per cent level without interfering with the liquidity needs of the domestic economy.

In the light of the Treasury's recent financing announcement and our long-standing "even keel" policy, it is clear that in the next week or so we should try to maintain about the same atmosphere in the market that has prevailed during the recent past. The projections suggest that this may not be too difficult, although there is always a danger that the bill rate may slip lower while at the same time the position of bank reserves may not leave much scope for net selling of bills designed to counteract such a tendency. I would continue to place the main emphasis on the bill rate. Looking beyond this immediate situation, I think it is incumbent upon us to grapple now with the difficult implications of a continuing delicate international situation and a possibly deepening recession. At the risk of repetition, I would like again to stress the need for flexibility in our policies. We are confronted with an increased emphasis on experimentation in public policy, particularly in fiscal policy and debt management. While we should welcome these innovations to the extent that they may relieve monetary policy from carrying the whole load of countercyclical action, we should not let an inactive or an inflexible posture on our part encourage unwise actions in these other areas of public policy.

At this point I had intended to comment on the desirability of experimentation in open market operations along the lines of suggestions which have been made at the last few meetings, but I shall defer these remarks until the executive session scheduled immediately following this meeting.

I see no reason now to consider a change in the discount rate or in the directive--apart from the longer-range question as to the proper form which the directive should take. We should, I believe, have in mind the possibility that, in the event of a renewed large-scale flight of short-term capital, the System might wish to consider an increase in the discount rate in order to put upward pressure on short-term market rates--but hopefully this can be avoided, if present favorable trends continue.

2/7/61

-18-

Mr. Erickson commented to the effect that it was necessary to give consideration to the extremely severe weather conditions that had prevailed recently in the First District when making any evaluation of business conditions. Continuing, he said that employment and production figures still showed an unfavorable trend. On the other hand, in the weeks ended January 21 and 28 there were rather substantial increases in electric power output over year-ago levels, and the January poll of New England purchasing agents was more optimistic than the December poll. Construction was down in December; for the year, residential was off 4.6 per cent, nonresidential was up 17 per cent, and public utility and heavy engineering were down 33 per cent. The over-all decline for the year was 3.4 per cent. Department store sales had been erratic due to weather conditions.

Mr. Erickson said the December survey of mutual savings banks showed a deposit gain of 5.9 per cent compared with December 1959. The comparative percentage gains had gone up gradually from the low of 4.4 per cent in May. At the end of the year, mutuals showed an increase of better than 11 per cent in mortgage loans from the previous year. The average rate on conventional mortgages was between 5-1/2 and 6 per cent, but four small banks had cut their prime mortgage rate to 5-1/4 per cent. Commercial and industrial loans of reporting member banks showed a rise in January, in contrast to a decline last year, and on January 25 were 7 per cent ahead of a year ago.

2/7/61

-19-

After expressing the opinion that the Desk had done a good job in the past two weeks, Mr. Erickson said that he would not favor a change in the discount rate or the directive at this time. He would instruct the Desk to supply reserves as needed, bearing in mind the short-term rate more than any free reserve figure.

Mr. Irons reported that on balance there had been no particularly significant changes in the Eleventh District. Construction in the past month was good; awards were very high in January. The situation in regard to petroleum stocks showed some improvement, with demand reflecting the severe weather in other parts of the country. Employment had increased, but there was also a slight increase in unemployment; in Texas, unemployment was averaging about 5.3 per cent of the labor force. It seemed doubtful that there would be any great improvement over the next few months, but neither was any particularly unfavorable trend foreseen. The industrial production index for the District was up for the most recent month. Department store sales, however, were down, with unfavorable weather a factor. Agriculture had been affected by unusually heavy rains.

Mr. Irons stated that the banking situation remained easy. Borrowings at the Reserve Bank were low and District banks were net sellers of Federal funds. However, their net sales aggregated about \$150 million less than in the preceding two-week period. Demand deposits had shown some downward movement, with most of the decline accounted for by interbank deposits. Time deposits, on the other hand, continued to rise substantially, building

2/7/61

-20-

up liquidity to a higher level than the money supply alone would indicate. While there had been some decline in loans, it was no more than seasonal, and investments were up.

Turning to policy for the next period, Mr. Irons commented that the Treasury financing suggested maintenance of the status quo. He felt the Account had done a creditable job in the past two weeks; after getting over the float problem during the earlier week, conditions were about as they should be. He would like to see about the same degree of reserve availability maintained as in the past week or so, with any deviations on the side of less aggressive ease but no overt action in that direction. As far as guides were concerned, he would favor using the short-term rate, as reflected by the bill rate, and he would like to see the bill rate around 2-1/2 per cent. Also, he would like to see the Federal funds rate in the area of 2-1/2 to 3 per cent. As far as free reserves were concerned, he would prefer the \$450-\$500 million range to the \$600-\$700 million range. He felt this would indicate a better relationship and that it would provide adequate reserve availability to the banking system. The Account should have considerable leeway in the forthcoming period, but he would urge avoiding anything that would put pressure on the Treasury bill rate. He would recommend no change in the directive or in the discount rate.

Mr. Mangels reported that developments in the Twelfth District were not significantly different from the rest of the country. The Pacific Coast had shown a slight improvement in employment and a slight

2/7/61

-21-

drop in unemployment. However, this was no cause for optimism as it reflected increased payrolls in the food processing industries due to seasonal factors. Aircraft and manufacturing employment, on the other hand, was down. The net effect of these movements kept unemployment in relation to the total labor force at a 6 per cent figure. District steel mills in the week ended January 28 were operating at 84 per cent of the 1957-59 average, which marked a leveling off after the rise during the first two weeks of January. The lumber industry remained in the doldrums, with production down and the volume of unfilled and new orders not offering any encouragement. As to agriculture, farmers were not suffering at the present time. Pacific Northwest wheat farmers in particular were doing well, since wheat prices were 17-22 cents above support prices, largely as a result of export demand. Total construction in December was up 1 per cent from 1959. Although residential construction was down 13 per cent and nonresidential was down 3 per cent, construction of public works and utilities offset those declines. In the area of retail sales, latest figures indicated that both department stores and automotive sales were down somewhat in January.

Mr. Mangels indicated that there had been a sharp decrease (\$180 million) in bank loans during the last two weeks of January, this being twice the decline during the comparable 1960 period. Demand for commercial loans was slack, and the demand for consumer and real estate loans was not encouraging. However, banks added about \$100 million to their holdings of bills and certificates. Demand deposits held about even during this period,

2/7/61

-22-

although expectations were for a more rapid decline in bank deposits in the next month or six weeks than in the past. Time deposits, on the other hand, were up somewhat despite a continuing decline in savings deposits. Only two banks, both country banks, resorted to borrowing from the Reserve Bank in January. It was reported that there had been some talk among the banking fraternity of a cut in the prime rate during the next 30 or 60 days. However, it seemed to be felt generally that if the Administration's programs were implemented and the Government needed new money for them, interest rates would be higher at the end of the year than at present.

Turning to policy, Mr. Mangels said that in view of the Treasury financing situation, he would maintain an even keel for the next week or so. He would define this as meaning free reserves somewhere around \$600-800 million, with the bill rate around 2-1/4 per cent. He would make no change in the discount rate or the directive at this time. However, by the time of the next meeting he felt that in the absence of unforeseen developments he would be inclined to move to a somewhat easier position in order to encourage recovery of the domestic situation.

Mr. Deming reported that in the Ninth District there were some optimistic appraisals of the outlook, coming mostly from the business community. However, he did not believe that this was a general feeling on the part of the public; in fact, he could paint a fairly black picture of the outlook for the District on the basis of available information. A recent newspaper poll indicated that a substantial percentage of the

2/7/61

-23-

respondents thought the outlook for the current year was not too good. Of those interviewed in January 1961, 57 per cent indicated that they thought the outlook was good compared with 79 per cent during the same month in 1960 and 71 per cent in 1959. In evaluating conditions at the present time (good, bad, or indifferent), 64 per cent thought that times were good in 1960 compared with 39 per cent in 1961. Only 15 per cent thought that times were bad in 1960, while 31 per cent felt that way in 1961. Also, the District's natural resource industries were not experiencing a great amount of activity, showing declines from preceding periods, so the outlook there was not too optimistic. The agricultural picture could be quite good, although there might be a moisture problem in the spring.

In discussing the banking situation, Mr. Deming remarked that the bank loan picture indicated a softening of activity. While loans at city banks usually fall during January, they fell faster this year, the dollar amount of decline being almost 6 times as large as the average decline over the past thirteen years. It was thought that this might reflect a shift by borrowers to other markets for funds. The banks were happy about the improvement in liquidity, but not particularly happy about the decline in loan demand.

On balance, Mr. Deming said, it appeared that the District situation was about the same as the situation in other areas. He doubted that there was a firm basis for optimism at this time on the part of business and the

2/7/61

-24-

stock market, and he could not see what underlying factors were used in arriving at this optimism.

Mr. Deming indicated that he had no disagreement with the views of Messrs. Hayes, Erickson, or Irons. In his opinion, the prescription that the Committee was following was the right one. He would not change the directive or the discount rate at this time, and he would favor using the bill rate, rather than the level of free reserves, as a guide for open market operations. He added that he felt the Desk had done a good job in the past two weeks under conditions that were somewhat less than favorable.

Mr. Allen indicated that in the short interval since the last meeting there was little new in the Seventh District. Total economic activity continued to decline in January, with the automobile industry contributing the most important depressing development. Automobile sales in January were 369,000 units, 19 per cent below last year. Some improvement was expected in February and March, with guesses that 1,250,000 cars will be sold in the first quarter, but that would be 16 per cent below the first quarter of 1960. Inventories continued relatively static, at a little over 1,000,000 units. The industry was gearing production to sales, and on that basis first quarter production would not exceed 1,300,000 units--35 per cent below last year. Automobile analysts in Detroit felt that the bottom was being scraped in terms of production and sales and that conditions would not get worse. There was much the same

2/7/61

-25-

attitude throughout the District generally, with no evidence that businessmen or consumers believed that a major slump was in the making. January saw some improvement in farm machinery and household appliances and a number of industries increased orders for steel, but the over-all production rate was held down by reductions in orders from auto producers.

Mr. Allen mentioned that there were diverse views among mortgage lenders in the Chicago market as to the probable effect of the recent reduction of the ceiling rate on FHA mortgages. The most general view was that it would merely increase the prevailing discount for such mortgages by about 2 points. However, the president of a large mortgage company believed that the reduction might be just what was needed to set in motion a downward adjustment in home mortgage rates, and an important builder considered the move beneficial as part of a package of official measures designed to bolster consumer expectations. Reports at a meeting of the nation's major lenders to agriculture, held at the Chicago Bank last week, indicated that delinquencies and foreclosures of farm real estate mortgages were at low levels, that interest rates had declined recently and were expected to decline somewhat further, that activity in farm real estate was slow, and that the supply of agricultural credit, both long-term and short-term, was adequate for 1961 and was somewhat larger relative to prospective demand than in 1960.

Mr. Allen remarked that these factors, together with movements in the long-term securities markets, seemed to indicate response, slow

2/7/61

-26-

though it might be, to monetary ease. However, the demand for bank credit continued weaker than normal for this time of year. Business loans at District reporting banks dropped \$132 million in the four weeks ended January 25, compared with \$22 million last year, but the basic deficit of Chicago central reserve city banks rose to an average of \$82 million for the period ended February 1. These banks had begun to buy bills in anticipation of the April 1 tax date and the Sears financing on January 31 generated pressure. Eight Seventh District banks purchased \$316 million of the \$1.1 billion total of Sears' customer contracts sold.

Turning to policy, Mr. Allen stated that in his opinion the reasons so generally expressed two weeks ago for continuing the status quo continued to be valid and controlling. He would not favor a change in the discount rate, the directive, or the degree of ease.

Mr. Allen then referred to the many expressions heard to the effect that longer-term rates were too high and must be reduced. He was not at all sure that they were too high if the savings-investment process so important in our way of life was to be nourished. In any case, the word "confidence" was all-important, and by this he meant real confidence, not psychological hoop-la or "incantations," to use the word Mr. Marget had quoted from Voltaire. Bank reserves were plentiful, savings had increased substantially in the past year, and it seemed that the requisites for investment in the long-term area were present except for the one that was most necessary--confidence. It was, of course, important that the System,

2/7/61

-27-

in its limited sphere, do whatever it could to increase confidence on the part of the saver and investor, and refrain from doing anything that would impair confidence. Mr. Allen added that under present conditions, difficult as they were, he felt that the Committee could make its maximum contribution by continuing to operate until its next meeting, at least, as it had been operating for the past several weeks.

Mr. Leedy commented that it had been recommended at the end of January that the Kansas City metropolitan area be classified as a substantial labor surplus area. It was estimated that about 8 per cent of the labor force was unemployed on January 15. If the city was so classified, it would be the first metropolitan area in the District to be classified as an area of substantial labor surplus since 1959.

Regarding the banking picture in his District, Mr. Leedy said it followed much the same pattern as the neighboring Districts. There had been a substantial reduction in loans since the first of the year, demand deposits were under the year-ago levels, largely as the result of a substantial drop in interbank deposits, and there was an unusually large increase in time deposits.

Mr. Leedy recommended that the Committee continue to do what it had been attempting to do since the January 24 meeting. As he saw it, recent developments, including the attitude indicated by the President in his statements regarding the need to protect the dollar, were working in

2/7/61

-28-

the System's favor and were tending to minimize its problem. Nevertheless, the System still had a responsibility in this area that it must continue to fulfill. In his opinion, the Committee should pursue about the same policy that it had been following, being sensitive to any downward movement in the bill rate of a material nature and also keeping watch on the Federal funds rate, which he felt need be only slightly lower than the discount rate. The level of net free reserves that might eventuate from pursuing such a policy would not concern him too much.

Mr. Leach reported that business activity in the Fifth District continued to decline slowly, although a few indicators showed some slight improvement. Man-hours, seasonally adjusted, had declined in the durable goods industries, but furniture factories collectively had improved a little. In the nondurables field, activity had held up well in food and tobacco manufacturing but had declined in other groups. The small volume of forward buying continued to restrain activity in the textile industry generally, although yarn mills recently had a sizable increase in their backlog of orders. While total employment had declined, employment in the fields of trade, finance, and services remained stable or increased slightly. January department store sales slowed sharply under adverse weather conditions after a favorable early start. The position of District banks continued to ease.

Mr. Leach expressed the view that monetary policy had done its job, and a good job at that. In his opinion, any further easing at this

2/7/61

-29-

point would be a grave mistake. It was unlikely that it would stimulate employment, and on the basis of recent experience it probably would expand time deposits rather than the money supply. With loan demand relatively weak, banks presumably would channel most new funds into short-term investments, thus aggravating the balance-of-payments problem by further depressing short-term rates. However, while he was opposed to further ease, he did not think it would be advisable at the present time to adopt a positive program to mop up reserves solely to push rates higher than they now were. Although he hesitated to say anything about reserves, he believed \$700 million of excess reserves was a little high; it seemed to him that a range of \$500-600 million would be an appropriate benchmark. However, he would play down the present importance of the free reserve figure as an indicator compared with short-term interest rates, particularly the 90-day bill rate. Although the 90-day rate was recently as low as 2.13 per cent, he was pleased that it had risen to a substantially higher level. Considering existing levels of interest rates abroad, he believed the System should seriously consider offsetting action if the bill rate approached 2 per cent. This did not mean that he favored a 2 per cent peg, or any other peg, but the 2 per cent figure had acquired international psychological importance. In view of the balance-of-payments problem and the current Treasury financing, a reduction in the discount rate was entirely out of the question, and he saw no immediate need to change the directive.

2/7/61

-30-

Mr. Leach added that, inasmuch as this was probably the last Committee meeting he would attend, he would like to say that while he thought the System's policy actions since last spring had been as appropriate as any one could reasonably expect, he believed that there was much room for improvement in the manner of handling the directive to the New York Bank.

Mr. Mills said he was heartened by what he sensed to be a spreading awareness of the necessity that the Open Market Committee focus its attention on the international financial situation. To that end, it was his belief that the objective should be to develop a level of positive free reserves in the range of \$400 to \$500 million, which conceivably would be reflected in a Federal funds rate approaching 3 per cent and, he would hope, a 90-day bill rate in the range of 2-1/2 per cent. In his belief, the pursuit of that objective would not do violence to those who espoused the view that reserves should be supplied in greater abundance and who endorsed a level of positive free reserves of \$700 or \$800 million or even more. His reasoning was that in reverting back to past experience it was clear that where a level of positive free reserves in the range of \$400 to \$500 million had been maintained constantly over any considerable period, a more than ample stimulus had been given to the expansion of bank loans and investments. Again, as at the January 24 meeting, he wished to call attention to the chart of positive free reserves and negative free reserves over a period of several years. This chart

2/7/61

-31-

indicated that on the occasions when the System had permitted positive free reserves to remain for a long period at a high level it had produced conditions that were followed by a vigorous counter policy and by attendant difficulties and problems.

With regard to the international situation, Mr. Mills said it seemed to him that the Committee was fortunate in the erudite presentations that it received concerning the statistical movements of domestic and international financial affairs. However, it might also be well to turn back to the perceptiveness that comes from reading economic history. If it is true that history repeats itself, it seemed not at all improbable that the country was moving into a situation that would find its friends abroad again saying that "when America sneezes, Europe and other parts of the world have pneumonia." There were definite signs of deterioration in economic activity abroad, both in England and Western Europe, and in his opinion the economy of Japan was poised at a very narrow balance. If the movement of recessionary influences continued its downward path in the United States, history would suggest that at some point the market for foreign goods would be so impaired that the balance of trade would turn in favor of this country, possibly more violently than one would choose of his own accord. Accordingly, Mr. Mills said, his concern was more with the possibility that in the future this country would experience an inflow of gold than that it would experience a continued outflow. In the meantime, however, he thought it was of critical importance that the System

2/7/61

-32-

bring the short-term interest rate structure of the United States, to the extent of its powers, to a level that was competitive with the rate structures in Great Britain and on the Continent.

Mr. Robertson said that he would not comment on economic conditions, or debate them, except to say that there was still no upturn or any immediate indication of an upturn. The turnaround had not yet been made. It seemed to him, as he had pointed out before, that it was a grave mistake on the part of the Committee to attempt to use the bill rate as the controlling guide for monetary policy. In his opinion, this had prevented monetary policy from making the kind of contribution it was capable of making toward a reversal of the economic downturn by increasing the availability and lowering the cost of money. This failure would serve to prolong the recession.

For several months he had been urging that the Committee provide the banking system with a more ample supply of reserves in order to enable monetary policy to make whatever contribution it could toward reversing the economic trend. He still believed in the validity of that course of action, and if it resulted in driving the bill rate to 2 per cent or below, he would not be concerned. He felt that the Committee, in pressing to hold up the bill rate, had set up a "bogey," based on no good reasons that he had heard in the discussions around the table. He was not impressed with the argument that a lower bill rate would stimulate a further outflow of capital or even accentuate the outflow of gold.

2/7/61

-33-

Furthermore, he believed that any outflow of capital based on interest rates would flow back when rates here rose--as they would when the economy began to move upward. The outflow of gold would reverse itself if and when the world learned that this country meant to manage its internal affairs in a way that would revitalize the economy and at the same time maintain the stability of the dollar.

Also, he did not believe that long-term rates could be lowered significantly and effectively while the System was pegging short-term rates. Therefore, the System should have the courage to permit short-term rates to go lower. In his view, it would not require much lower short-term rates to achieve the desired effect on longer-term rates. In fact, even the policy that the System had been following was apparently beginning, belatedly, to exert some slight impact.

Mr. Robertson commented that during the past several months he had joined in voting for renewal of the policy directive. He had done so because the language of the directive was sufficiently broad to encompass his position. The statute, he noted, requires a statement of the reasons for the policy actions taken by the Committee. Although his reasons would not be in the policy record submitted to the Congress, he had voted for renewal of the directive on the basis that he had just explained, as clearly shown by the minutes of those meetings. He wanted the minute record of this meeting to make it doubly clear that, although he did agree with the economic policy specified in the language of the

2/7/61

-34-

policy directive, which called for encouraging monetary expansion, the direction of open market policy had not been fully in accord with his views.

Mr. Shepardson expressed the view that a policy of additional ease might only stimulate a sudden burst of growth that would be incompatible with the longer-run objective of sustainable economic growth. Continuing, he said that his concern about the course of monetary policy went not only to the international problem arising out of the balance of payments but also to the problem of fostering the sound growth of the domestic economy. It seemed to him there were certain fundamental adjustments that must take place, and that those adjustments were in process. After the 1957-58 recession a quick turnaround occurred, but the country shortly found itself faced with another problem, and he was not convinced that on this occasion a sudden turnaround would be desirable.

Mr. Shepardson stated that he felt the policy the Federal Reserve had been following was sound and that he would strongly urge its continuation. In his opinion attention should be given to the short-term rate not only because of its international implications but because it was important in the evolution of the domestic economy not to strive toward too sudden a change.

Mr. Shepardson then commented on his favorable reaction to the statements of the President that looked toward placing American industry

2/7/61

-35-

on a competitive basis in world markets. This, of course, was a longer-range objective that could not be accomplished immediately. Conversely, he was concerned about some of the palliatives that had been suggested which would have the effect of removing forces that hopefully would bring about basic adjustments. As he had said, those adjustments were important from the standpoint of international relations. In addition, however, they were essential to the kind of growth that was wanted in this country, based on increased productivity and increased efficiency.

After indicating that he would not favor a change in the directive or in the discount rate at this time, Mr. Shepardson said it seemed to him that the degree of ease had been fully adequate. He wished to associate himself with the view that it would be preferable if the level of free reserves were on the low side of \$500 million rather than on the high side. The Federal funds rate should be somewhat below the discount rate, but it should not be in the low range that had prevailed at some times in the recent past.

Mr. King said that although there were many important problems with which the Open Market Committee could concern itself, he felt that the principal problems at present were the general state of the domestic economy and the position of the United States in international finance. Given these problems, he had been wondering how the Committee would meet its responsibility. Now, as demonstrated by the instructions to the Desk, particularly in regard to the short-term rate, the Committee had

2/7/61

-36-

indicated that it was stopping at approximately this point in the pursuit of further ease, or that it had already stopped. In his view, it had stopped at a good point. Although, as he had stated previously, he felt that the recessionary influences in this country might well continue through this year, when the upturn occurred he believed it would be more soundly based and of longer duration than the upturn that followed the recession of 1957-58, when Federal Reserve policy appeared to have involved a greater degree of ease than had prevailed during the past several months.

Mr. King went on to say that, in view of the imminent Treasury financing, it was clear to him that this was not a time for overt actions. This point of view, he noted, had already been expressed by others around the table. He would hope that the level of free reserves might be in the range of \$400-500 million rather than \$600-700 million. After indicating that he would not favor a change in the discount rate or the directive at this time, Mr. King concluded by saying that in his opinion the Committee's position with respect to maintenance of the bill rate represented one of the greatest contributions that the Committee could make in the present period.

Mr. Fulton, in reviewing developments in the Fourth District, indicated there was nothing to cause much joy. There had been a faltering rise in the production of steel. Department store sales, on the other hand, had been adversely affected by the weather and for the year to date

2/7/61

-37-

were 5 per cent below a year ago. Unemployment was still high, although on a seasonally adjusted basis there had been a slight improvement. In Youngstown, for example, the steel mills were now making inventories for themselves in anticipation of having to shut down completely at a later date for the installation of a new rolling mill, so the temporary decline in unemployment could not be classed as solid improvement. The machine tool industry was going along fairly well, receiving stimulus from foreign orders for tools. Domestic orders, however, were not coming in. New orders in the steel industry in January were about 2 per cent above December, but shipments so far in February had been the lowest for many months. A number of orders had been deferred from February to March delivery. In one of the large mills about 25 per cent of the employees had been laid off, and in other mills about 40 per cent, and the supervisors, office help, and officials had received wage reductions. Due to the falling off of automobile production and sales, that industry had been deferring and cutting back orders from steel mills and foundries. There was one gleam of hope in the fact that a number of other users of steel were coming in with rush orders, indicating a shortage in their inventory positions. If this condition was widespread, there could be some substantial buying of basic metals. However, it was understood that those who were ordering did not have more orders themselves. Their production was being maintained at low levels, but their inventories were so low they had to get more materials with which to work. Many complaints were heard

2/7/61

-38-

about the profit squeeze resulting from high operating costs and price concessions.

Turning to policy, Mr. Fulton indicated that he did not believe that the discount rate should be changed at this time. He would like to see free reserves in the neighborhood of \$500-600 million, a level that he felt would give the banking system adequate liquidity. He again suggested, as he had done at the January 24 meeting, that the language of clause (b) of the directive be changed to substitute the word "recovery" for "sustainable growth."

Mr. Bopp commented briefly on weather conditions in the Third District, noting that for 16 days the temperature had not risen above freezing. Department store sales during the week ended January 21 were 27 per cent below the previous year, and in the following week they were 16 per cent below the year-ago level. For the year to date, they were 11 per cent below 1960 figures. Unemployment was high and rising. Certainly, Mr. Bopp said, the domestic situation was not one of great hope. Unfortunately, there was the problem of the balance of payments. In terms of policy, he would not favor a change in the directive or the discount rate at this time. He felt that the present degree of ease should be maintained, and that the primary measure of that ease should be the level of short-term rates.

Mr. Patterson said that the recession in economic activity in the Sixth District appeared to have continued in January. He had prepared a report on some of the District figures. However, after hearing the other

2/7/61

-39-

reports, there appeared to be no differences of sufficient importance to warrant going into detail concerning Sixth District developments.

Mr. Johns said that although there were some in the Eighth District who claimed to discern some improvement in the business outlook, it was difficult to find facts to support such contentions. Recently, he said, the newspapers had focused attention on a report that 8.4 per cent of the labor force in the St. Louis area was now unemployed. After summarizing comments in this regard that had been made by a local employment official, Mr. Johns expressed the view that the attention directed to this matter was almost certain to affect the general feeling about the economic situation, particularly if the matter continued to receive as much attention as it had. Mr. Johns then commented on the unemployment problem that had existed for some time in Evansville, Indiana, following which he noted that although total credit at Eighth District member banks increased slightly more than \$80 million in November and December, most of the increase was in bank investment portfolios as loans rose less than seasonally. During January, total credit at weekly reporting banks declined more than seasonally, with the banks selling securities on balance.

Mr. Johns said that as he reviewed developments in the Eighth District and in the nation, he did not see much hope for an early upturn. Therefore, he continued to believe that the policy directive, which called for encouraging bank credit expansion, was appropriate. After referring to the reserve projections that had been distributed before this meeting, he said it continued to be his view that "total reserves needed"

2/7/61

-40-

should be increased modestly. In expressing this view, however, he wished to make it clear that he was not advocating more than a moderate expansion. He did not care to suggest any specific target, and instead would say merely that he would like to see "total reserves needed" increased modestly and continuously until further order.

Mr. Szymczak expressed the view that System policy had been going along in the right way. He believed it was becoming more and more clear that the thinking of the Committee was in terms of supplying enough reserves to the banking system, but, in view of the balance-of-payments problem, not going so far as to contribute to a downward movement of the short-term rate. He would subscribe to a continuation of present policy for this reason and also because the Treasury financing called for maintenance of an even keel.

Mr. Balderston commented that he assumed an even keel should be maintained during the first part of the forthcoming period because of the Treasury financing, even though the pricing of the issue offered by the Treasury might make the maintenance of an even keel less necessary than usual. Once the Treasury financing was past, however, he hoped that the views of Messrs. Hayes and Irons and others who had spoken in the same vein would be followed by the Committee. While it was not possible to tell at this juncture whether the turnaround in domestic economic conditions, when it occurred, would involve a quick recovery or a slow one, it was his view that the liquidity that had been supplied to the banking system was sufficient for the present and that the element of aggressiveness should be removed from the System's policy of ease until such time as the economy seemed to be putting the added reserves

2/7/61

-41-

to good use. As to tests, he suggested first the bill rate because of its international significance. He would also suggest the Federal funds rate, which he would like to see closer to the discount rate than it had been at some times during recent weeks. Further, he would suggest that the Committee watch the extent to which banks were buying bills. During the month of January, he noted, the banks had bought about \$500 million of Government securities, principally bills. His own concept for the period ahead was that System policy should be one of neutrality, and such a policy might mean only small additions to bank holdings of Government securities. In terms of free reserves, the effect of such a policy might be to reduce the level below \$500 million, perhaps to the \$300-400 million range. However, this was difficult to determine because of the fundamental change that had occurred in allowing member banks to count their vault cash as part of required reserves. Accordingly, he agreed with those who had suggested that for the time being it would be better to watch the bill rate than the level of free reserves.

Mr. King withdrew from the meeting at this point.

Chairman Martin indicated that he had little to add to the discussion. In his opinion the bill rate was the crucial point. A difficult problem was involved in the use of words such as "pegging" or "influencing," but under present circumstances he felt that the System should influence the short-term rate. He also felt that at this time the short-term rate provided a better benchmark of System policy than the free reserve

2/7/61

-42-

figure, which he suggested might have about outrun its usefulness as an effective measurement.

Chairman Martin said it appeared that the consensus favored no change in the discount rate and no change in the directive. It also appeared to be the consensus that the measuring benchmark of open market policy should be primarily the bill rate.

The Chairman then inquired whether anyone wished to be recorded as dissenting from the consensus, and Mr. Robertson said he agreed that the statement by the Chairman represented the consensus. He did not agree, however, with the direction of System policy.

Chairman Martin asked whether there were others who wished to comment on the consensus, and no comments were heard.

The Chairman next referred to the policy directive, and Mr. Robertson said that he agreed with the policy directive because he felt that its language encompassed his own position. The Chairman said it was his understanding that it was on the general implementation of the directive that Mr. Robertson wanted to record his dissent, and Mr. Robertson indicated that this was correct.

The Chairman then inquired whether there were others who wished to record themselves similarly, and Mr. Johns remarked that he was not at this time a member of the Committee. Chairman Martin indicated that Mr. Johns' views on open market policy, as expressed earlier during the meeting, would of course be reflected in the minutes.

2/7/61

-43-

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 monetary expansion for the purpose of fostering sustainable growth in economic activity and employment, while taking into consideration current international developments, 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.

Secretary's Note: The Chairman then called for a session at which attendance would be limited. The minutes of that session begin on the following page.

2/7/61

-44-

The meeting of the Federal Open Market Committee reconvened in the offices of the Board of Governors of the Federal Reserve System in Washington at 12:20 p.m. on February 7, 1961, with the following in attendance:

Mr. Martin, Chairman  
Mr. Hayes, Vice Chairman  
Mr. Balderston  
Mr. Bopp  
Mr. Fulton  
Mr. Leedy  
Mr. Mills  
Mr. Robertson  
Mr. Shepardson  
Mr. Szymczak  
Mr. Irons, alternate for Mr. Bryan

Messrs. Leach, Allen, and Mangels, Alternate Members of the Federal Open Market Committee

Messrs. Deming, Erickson, and Johns, Presidents of the Federal Reserve Banks of Minneapolis, Boston, and St. Louis, respectively, and Messrs. Ellis, Wayne, Clay, and Swan, Presidents-elect of the Federal Reserve Banks of Boston, Richmond, Kansas City, and San Francisco, respectively

Mr. Young, Secretary  
Mr. Thomas, Economist  
Mr. Rouse, Manager, System Open Market Account

In opening this session, Chairman Martin noted that Mr. Bryan was absent on account of illness and that, in view of the meeting of the Ad Hoc Subcommittee called for yesterday, he had requested Mr. Irons, who is the alternate for Mr. Bryan at the regular meetings, to serve for him at the Subcommittee's meeting.

Chairman Martin then stated that he had called this Committee meeting to receive an interim report from its Ad Hoc Subcommittee. The

2/7/61

-45-

Subcommittee, he said, had held two meetings, had had the help of documents submitted by Mr. Young and Mr. Rouse for its consideration, and had taken into account the very heavy barrage both from within and outside Government, against the System for the uncompromising position it allegedly took towards its own operating procedures and policies.

In the light of its discussions and evaluations, the several members of the Subcommittee were unanimous in the view that the System had to give some further tangible indication of open-mindedness and willingness to experiment. The whole issue of operations, they agreed, had become one of conceptual contention and, therefore, no progress could be made in resolving it by the device of papers, studies, or committee reports. There had to be evidence accumulated from actual experiment or testing to enable the System to escape from the charge of doctrinaire commitment to a laissez faire, free private market position in confining operations to short-term securities. Therefore, the sooner the System got busy at the task of obtaining empirical data the better it would be. Since that was the Subcommittee's undivided view, Mr. Rouse had been requested to propose an appropriate program of action and to set forth the requisite implemental procedures for carrying it out. Accordingly, he would ask Mr. Rouse to report on his recommendations shortly.

2/7/61

-46-

Chairman Martin next observed that, while the Subcommittee was unanimous in feeling that inauguration of a period of experiment was the only feasible course, feelings were mixed as to what the experiment would demonstrate. He himself had doubts about the outcome; at the same time, he could not prove at this time that these doubts were justified. From his discussions with dealers, he would gather that they were divided in their judgments as to whether the area of operations should remain limited as in the past eight years or should be broadened.

The Subcommittee members, the Chairman further stated, were particularly concerned about what experimental transactions outside the bill area involved with regard to System relations with the market. After all of these years of operating primarily in bills, how could the System, in experimenting with transactions outside the bill area, be fair to the market? Even if the Federal Open Market Committee had stated that its procedures could be changed or superseded at any time, was there in fact a commitment not to change without publicly-issued notice?

Chairman Martin then asked the several members of the Ad Hoc Subcommittee to offer any comment they cared to about their own views.

Mr. Mills commented to the effect that any market experiment undertaken now would have the objective of seeing whether the long rate could be moved down relative to the short rate in the present market context. While he had consistently supported the limitation of Federal

2/7/61

-47-

Open Market Committee operations to short securities, he now felt that experiment to move long relative to short rates had to be made. The Subcommittee was only divided as to its views about how the experiment should get under way--whether cautiously or boldly. Personally, he favored a bold approach.

Mr. Irons commented that Subcommittee member differences related mainly to degree of experiment. While he believed strongly in present Federal Open Market Committee procedures, he still felt that we must explore pragmatically possibilities of operations in longer sectors. Such probing should be accomplished without publicity or at least with as little publicity as possible. His counsel in undertaking experiment would be to begin in the 3-to-5 year area, then try the 5-to-8 year sector, and finally move to the 8-to-10 year maturity. Further stretching out could be pursued if desirable, but it was quite possible objectives could be reached within the intermediate range.

Mr. Balderston remarked that, as he saw it, the problem had two sides: first, experimentation with market procedure; second, public understanding of the Open Market Committee's procedures. The Ad Hoc Subcommittee has recommended experimentation with the Committee's procedures and is, therefore, reporting only with respect to the first half of the problem, and not the second. The latter should be given attention at the Committee's organization meeting in March. In conducting the experiment, he favored operations in Governments of

2/7/61

-48-

intermediate term. Avoidance of public announcement would be desirable in his opinion, and he would strongly favor leaning over backward to be fair to dealers and using the go-around for any transactions engaged in outside the short area.

Mr. Hayes reaffirmed the position he had earlier expressed to the Committee favoring flexibility in Federal Open Market Committee operations, and he stated that any experiment and demonstration undertaken in present circumstances would be altogether consistent with his views. Experiment now, he felt, was both urgent and timely. Experiment was urgent because of the System's public relations problem and timely because it might serve to lift some of the down-pressure on the short rate and put some down-pressure on the long rate, and so stimulate some long-term borrowing. He stressed that any experimental operations should be limited, be of nudging character, as regards both short and long rates, and should give no hint of pegging; pegging or establishing a pre-determined level of rates was the last thing that the Federal Open Market Committee wanted.

The problem of public announcement troubled him greatly, Mr. Hayes said, because experiment constituted important, even if temporary, departure from what was now long-established Committee operating policy. As to maturity area that might serve as a limit to experiment, he thought maybe 10 years was long enough because market impact here should certainly communicate through the rest of the maturity range. If results of

2/7/61

-49-

initial experiment should suggest a need for transactions in still longer maturities, experiment could be extended then to that area.

At this point, Chairman Martin asked Mr. Rouse to present his plan for experiment, and Mr. Rouse reported as follows:

In line with the discussion yesterday afternoon at the meeting of the Ad Hoc Subcommittee, the following program is submitted. In this outline I have endeavored to follow what seemed to me to be the trend of thinking in the Subcommittee. The program is based on the conviction that at this time the interest rate structure in relation to the balance of payments is paramount and that current short-term interest rates must be maintained and, preferably, allowed to rise somewhat. While it is conceivable that this might be accomplished by reducing somewhat the availability of reserves to the banking system, the needs of the domestic business situation may render this impracticable, thus pointing to the necessity of making purchases in areas outside of the shortest maturities. The advantage of such procedure is further pointed out by the Subcommittee's wish to make a cautious test of the feasibility of influencing longer-term rates in a downward direction in recognition of the widespread comment on the Committee's current procedures and alleged doctrinaire inflexibility.

The suggested program, which obviously must be experimental, follows:

FIRST--The Desk would be authorized to extend its operations to securities having maturities up to perhaps ten years, but initially it would be made known to the market in terms of only up to five and one-half years by means of a "go-around" in which all dealers would be asked for offerings in the range of one to five and one-half years. The amounts purchased would not need to be large. It is anticipated that the dealers thereafter will tend to keep the Desk informed of current bids and offers in that range and beyond. They will not be surprised as they are expecting something of this sort in view of the press comment of recent days.

It is not contemplated that probing operations in the five and one-half to ten year range be begun until after the market has become somewhat used to the changed frame of operations. Nevertheless it might develop that such experiments could be started prior to the next meeting of the Committee. The Desk is to keep clearly in mind that all such operations are to be modest in amount and only for the purpose and in the manner indicated.

2/7/61

-50-

SECOND--The prospective amount of additions to the System Open Market Account in the next few months is small, and most of the gross purchases or sales will need to be offset fairly promptly. Therefore if this program is to be carried out, the logic of removing temporarily at least, the prohibition against "offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System portfolio" becomes apparent, i.e., if longer securities are to be purchased, shorter securities will have to be sold or run off in order to make room. Furthermore, it may be noted that such purchases are designed primarily to affect the rate structure rather than to provide reserves.

THIRD--As an illustration--the general idea of the proposed operation is to encourage the development of a slightly higher 91-day Treasury bill rate and Federal funds rate (but still under the discount rate) and at the same time to direct purchase operations of the System Open Market Account toward somewhat longer-term securities. This does not mean that we would ever try to, or ever could, peg rates or determinedly hold them within particular ranges. Any result will be the combined product of our influence and the market's reactions.

FOURTH--As I have stated, this approach is experimental and is to be carried out in relatively modest amounts. I figure that the new authorization should include the power to purchase up to \$400 million securities maturing beyond fifteen months and up to five and one-half years, and an additional \$100 million securities maturing beyond five and one-half years and up to ten years. In suggesting these figures I assume that our next meeting will take place on March 7th. These operations are to be handled with the utmost care so as to avoid charges of unfairness to any one dealer or group of dealers and so as to avoid any charges or implication of favoritism. Detailed records are to be kept of all transactions.

I recommend that the Secretary of the Treasury and the Chairman and Vice Chairman of the Joint Economic Committee be advised promptly if this or a similar program is adopted.

Incidentally, in light of the "open mouth operation" in the press the past few days and the expectations which it has engendered in the market--that is--of System operations throughout the maturity range--I suggest that the Committee consider the issuance of a statement--for the news ticker in the first instance--such as the following:

"In the light of changes in the international and domestic situations the F.O.M.C. in recent months has been examining the implications of its operating objectives and procedures. It is suspending its

2/7/61

-51-

existing operating policies in this respect pending the conclusion of its review. In the meantime operations may be carried out in an extended range of maturities."

FIFTH--Referring again to the intermediate range of maturities (five and one-half to ten years), it is in this area that the System could be most helpful to the Treasury, having in mind the Treasury's urgent need to do successfully a sizable junior advance refunding at the earliest feasible date.

SIXTH--Finally, the execution of the proposed program will be difficult and must be delicately handled. The Desk will need all the help it can get and all the tools at the disposal of the System.

Following Mr. Rouse's report, Chairman Martin suggested a round-table discussion, with Mr. Allen volunteering to comment first. Mr. Allen stated that he was not at present a member of the Committee, and so was not entitled to vote, but he gathered that it would be in order for him to express his opinion. He assumed that, since the Chairman had stated that the Subcommittee was making only an interim report, a final report would be forthcoming at a later date and he welcomed the prospect of having time to study the recommendations which he had just heard on such an important subject.

Chairman Martin then said that no such time would be available and that a decision would have to be made at the present meeting.

Mr. Allen resumed his statement by saying that since the reactivation of the Subcommittee on January 10 he had studied the subject under discussion to the extent that time and his eyes permitted, and that he had read again the original report of the Subcommittee, a great deal of the Chairman's testimony on the subject before various Congressional committees, Mr. Riefler's paper delivered in Minneapolis on May 3, 1958, and other memoranda including that of Mr. Thomas dated November 23, 1960.

2/7/61

-52-

Mr. Allen said that in the light of what he had been able to find on the subject, as well as his own experience, he did not favor the proposed operations. He mentioned that the word "nudge" did not appeal to him, for he thought it could result either in simply annoyance or in an avalanche, neither of which would be desirable. Mr. Allen referred to the assertion that empirical evidence was lacking, and stated that Mr. Riefler had mentioned empirical evidence in supporting his argument that the Committee should not operate in long-term securities. Mr. Allen concluded by saying that if the Committee decided to follow the recommendation of the Subcommittee he shared what he understood to be the feeling of Messrs. Hayes and Rouse that a public statement regarding the change in area of Committee operations should be made.

Mr. Erickson stated that he would favor the experiment but thought that a public announcement was quite unnecessary for a temporary deviation from established practice.

Chairman Martin observed that he really leaned against a public announcement himself, but thought that everyone should express his view before any voting was done on it.

Mr. Szymczak stated that he thought market experiment in the present environment was wise but that any public statement about it would be injudicious because the Federal Open Market Committee wanted the market to be affected by operations and not by any statement.

2/7/61

-53-

Mr. Johns expressed himself as being sympathetic to experiment though doubtful as to its efficacy. If the Committee did engage in experiment, he definitely thought that it had a responsibility for making some statement to inform the market and the public.

Chairman Martin noted that there was really not much that a Federal Open Market Committee statement could add to the publicity that had already been given to the possibility of System experiment to influence interest rate patterns through recent Administration statements and press commentary.

But Mr. Hayes doubted whether this disposed of the question of System statement or announcement because once the press knew that transactions in the intermediate or longer area had actually transpired, there would be questions put to the Board and Reserve Banks that would have to be answered.

To this, Chairman Martin replied that the risk in a statement was that it might be interpreted as making a commitment to continue indefinitely the operations in the long terms and as a commitment to support the whole market.

Mr. Deming commented that, while favorable to experiment, he did hope that our instruction to the Manager of the Account would be in terms of amount of operations and not in terms of effect on market interest rates. From the discussion that he had heard and despite protestations to the contrary, he thought the Federal Open Market Committee was treading awfully close to a peg of market interest rates. In

2/7/61

-54-

view of all the risks of mininterpretation and misunderstanding, it would be most unwise in his view to issue any statement. Who does the Committee want to inform? he asked. Foreign financial observers? The System condition statement would do this. Market dealers? The Desk's go-arounds would do this. The public? In his opinion, the System had better have "no comment" for the public.

Mr. Leach observed briefly that, in his judgment, the time was ripe for experiment, but that no statement should be issued since, as Mr. Szymczak had noted, we didn't know what to say.

Mr. Bopp, while favoring experiment, was of the opinion that a public statement would be essential. Questions will be numerous, he said, and we can't afford not to respond to them. Furthermore, he stressed that the initial reaction to a given operation that reflected a change of procedure might differ significantly from the reaction to the same operation that was part of a standard procedure. Consequently, he did not feel that significant conclusions could be drawn in a matter of weeks. He felt also that no relevant conclusions could be drawn from a program that was launched with an announcement that it was experimental. The announcement that he had in mind would state that the new procedure was undertaken to stimulate the domestic economy without aggravating problems concerning our balance of payments.

Chairman Martin again expressed reservations against a statement, saying that the Committee was on record in its continuing operating

2/7/61

-55-

procedures and policies, reaffirmed each year, as being prepared to change policies at any time. He also noted that the language of the Committee's directive adopted at each meeting was flexible enough to embrace transactions outside the short area.

But Mr. Hayes interposed that it was not a question of a very elaborate statement; in fact, the less formal and elaborate it was the more satisfied he would be with it.

At this juncture, Mr. Robertson stated that he would like to present his views. In his opinion, he said, there would be justification for experiment (a) if the Committee in its own view had doubts about the substance and reason of its existing position, or (b) if the Committee was threatened with dire political consequences if it were unable to bring forward empirical evidence favorable to its view. Neither of these bases of experiment is present, he contended. The real danger to the Committee, he felt, was retrogression. There is no reason why the Committee should feel that the burden of proof was on it rather than on its critics.

As regards the matter of public announcement, Mr. Robertson expressed himself as strongly favoring some statement to press, saying that an experiment was under way to deal in all areas of market. What really disturbed him, he said, was that no one at the table thought that much could be accomplished by the experiment, but they were still willing to engage in it.

2/7/61

-56-

Mr. Leedy observed that the System confronts an unprecedented operating problem stemming out of balance-of-payments developments. Since the System has done all that it can to provide adequate reserves to the banking system to foster economic recovery, the fact that it has to make some adjustments now to deal with the balance-of-payments problem should meet with sympathetic reception. The System would be in a defensible position, as he saw it, and the System should not hesitate to defend itself.

Mr. Shepardson stated that he felt the present policy had been a correct one. He recognized, however, the difficulty of proving its validity and that some experimentation might be necessary to demonstrate the effect, if any, of a different approach. Mention had been made of a cautious as compared with a bold approach. It seemed doubtful to him that a cautious approach would produce any measurable results and that if we were to experiment it should be done on the more extensive basis. Furthermore, it seemed to him that some statement was necessary if we were to avoid serious misunderstanding.

At this point, Mr. Mills emphasized the great difficulties in compromising in a public statement the different points of view and shadings of opinion that had been expressed.

Chairman Martin next asked Mr. Rouse how he thought sophisticated investors would respond to knowledge that the System was operating outside the short area, whether they would respond by testing System

2/7/61

-57-

position, and whether there was any hazard of such tests reaching avalanche volume.

Mr. Rouse responded by saying that, in his opinion, there would be testing but that it would be cautious and not avalanche in character.

Mr. Allen stated that he continued to have a worry about the press relations angle of the matter. Either the Presidents should have a common line in writing from which to answer press queries or there should be a spokesman for the Federal Open Market Committee to whom the queries should be referred. From his standpoint, the only answer he could now give to any queries would be: "I am not the spokesman for the Federal Open Market Committee."

Mr. Szymczak observed that it was only necessary to admit that transactions in intermediate- or longer-term securities were a departure from established practice and to point to the country's balance of payments as justifying it.

At this stage, Chairman Martin stated that he thought the discussion had proceeded far enough and if there was no further comment that members considered to be important, he would like to put the issue to a vote.

There followed some roundtable discussion about the scope of the directive that might be given to the Federal Reserve Bank of New York for operations in the Account. The discussion consensus was that the directive should provide adequate latitude for an effective testing.

2/7/61

-58-

This was resolved to be an authority for change, between this date and the next meeting of the Committee to be held on March 7, 1961, in the Account's holdings of intermediate- and longer-term securities not to exceed \$500 million and an authority to acquire securities of this category up to a maturity of 10 years.

Question was raised of Mr. Rouse whether his plan would be first to probe in the shorter intermediate range and then later to probe longer, to which his answer was in the affirmative.

Both Chairman Martin and Mr. Hayes individually emphasized that the authority was not intended to change monetary policy and that any transactions carried out need to be consistent with the general monetary policy expressed in the Committee's directive approved at the regular meeting just held. In the absence of the need for net additions to the System portfolio, the operations would involve, it was explained, either concurrent sales at the short end to offset purchases in the longer area or offsetting operations after an interval probably not longer than a few days.

Thereupon, Chairman Martin polled the members of the Committee, the alternate members present, and the other Presidents present concerning their views of the Ad Hoc Subcommittee's recommendation and the program of action proposed by Mr. Rouse.

Votes favoring the recommendation: Members Martin, Hayes, Balderston, Bopp, Fulton, Leedy, Mills, Shepardson, and Szymczak;

2/7/61

-59-

Alternate Members Irons, Leach, and Mangels; and nonmember Presidents Deming, Erickson, and Johns. Votes against the recommendation: Member Robertson and Alternate Member Allen.

In voting against the recommendation, Mr. Robertson argued along the following lines, which he later submitted in written form:

It was his 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 asserting, without reason or conviction, that it made a critically incorrect judgment eight 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.

Mr. Robertson further stated that he, for one, believed that 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

2/7/61

-60-

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.

He also felt that the reversal of such a fundamental position as this should not be taken without a public announcement of the nature of the Open Market Committee's future operating procedures and the reasons therefor, for otherwise there would be grave doubt concerning the purpose and extent of the System's operations in other than the short-term area of the Government securities market with a consequent adverse effect on general public confidence, the diminution of which can be ill afforded at this time.

In addition, he 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

2/7/61

-61-

system, and (2) to engage in "swap" transactions--i.e., buying securities in one maturity area and selling in another--to effectuate changes in rates and hence marshal the System's portfolio of Government securities against market forces.

Chairman Martin then put the question as to whether a statement should be issued explaining the departure from established operating procedures of the Federal Open Market Committee. From the roundtable discussion that had preceded and which then further took place, the majority sentiment, the Chairman thought, was clearly against such a statement and, without objection, he so ruled. In this concluding discussion, it was brought out and strongly emphasized that there was a real risk that this test might be frustrated if word got around the market that System purchases of longer terms were just an experiment. For the test to provide useful empirical evidence, the market needed to look upon the transactions as a change in Federal Open Market Committee practice.

In concluding the discussion, Chairman Martin stated that the documentation that the Subcommittee had had before it would be distributed to all of the members and nonmember Presidents for their information.

The meeting then adjourned.

Secretary's Note: The Manager of the Open Market Account commenced open market operations in longer-term Government securities on the afternoon of February 20, 1961. At that time he issued the following statement:

2/7/61

-62-

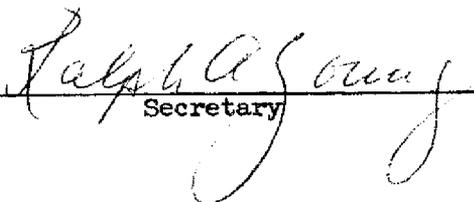
At the direction of the Chairman of the Open Market Committee of the Federal Reserve System, the following announcement was made today by the Manager of the System Open Market Account for the information of the public and all participants in the market for Government securities:

"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."

The decision to issue a statement, which reversed the understanding reached at the February 7 meeting, was made in the light of subsequent discussions between Chairman Martin, Vice Chairman Hayes, Mr. Rouse, Manager of the System Open Market Account, and Mr. Roosa, Under Secretary of the Treasury. The consideration weighing most heavily in the decision was the desirability that all market participants be informed at the same time that the Trading Desk was engaging in transactions outside the usual short-term sector and that no market group gain any trading advantage in the operations by virtue of information not known by the whole market.

  
Secretary