

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, October 24, 1961, at 10:00 a.m.

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

Messrs. Fulton, Johns, and Deming, Alternate Members
of the Federal Open Market Committee

Messrs. Bopp, Bryan, and Clay, Presidents of the
Federal Reserve Banks of Philadelphia, Atlanta,
and Kansas City, respectively

Mr. Sherman, Assistant Secretary
Mr. Kenyon, Assistant Secretary
Mr. Hackley, General Counsel
Mr. Thomas, Economist
Messrs. Baughman, Coldwell, Einzig, Noyes, and
Ratchford, Associate Economists
Mr. Rouse, Manager, System Open Market Account

Mr. Molony, Assistant to the Board of Governors
Messrs. Holland and Koch, Advisers, Division of
Research and Statistics, Board of Governors
Mr. Furth, Adviser, Division of International
Finance, Board of Governors
Mr. Knipe, Consultant to the Chairman, Board
of Governors
Mr. Yager, Economist, Government Finance Section,
Division of Research and Statistics, Board of
Governors

Mr. Heflin, First Vice President, Federal Reserve
Bank of Richmond

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Mr. Hickman, Senior Vice President, Federal Reserve Bank of Cleveland
Messrs. Eastburn, Lewis, Strothman, and Tow, Vice Presidents of the Federal Reserve Banks of Philadelphia, St. Louis, Minneapolis, and Kansas City, respectively
Mr. Eisenmenger, Acting Director of Research, Federal Reserve Bank of Boston
Mr. Link, Assistant Vice President, Federal Reserve Bank of New York
Mr. Holmes, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta

There had been distributed to the Committee preliminary and revised drafts of minutes of the meeting of the Committee held on October 3, 1961.

Upon inquiry by Vice Chairman Hayes as to whether there were any comments or suggestions regarding the minutes, Mr. Robertson stated that in light of a point to which his attention had been called by Mr. King, he would like to request, in connection with his comments appearing on page 13 of the revised draft, that the next-to-last* sentence be changed as follows:

He would ~~agree with Mr. King~~ SUGGEST that the Committee should not continue to guide its policy by the level of the bill rate--too much emphasis had been put on the bill rate.

No objection to Mr. Robertson's request was indicated, and it was understood that the change would be made.

Thereupon, upon motion duly made and seconded, and by unanimous vote, the minutes

* Last sentence beginning on page 13 of typed copy.

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of the meeting of the Federal Open Market Committee held on October 3, 1961, were approved.

Before this meeting there had been distributed to the members of the Committee a report of open market operations covering the period October 3 through October 18, 1961, and a supplemental report covering the period October 19 through October 23, 1961. Copies of both reports have been placed in the files of the Committee.

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

The conduct of open market operations during the period since the last meeting has been complicated by unforeseen adjustments in reserve statistics. Not only has the reserve outlook ahead been highly uncertain, but in addition there have been some large downward adjustments of free reserves for statement weeks that had already passed. The resulting lower level of free reserves, however, was not reflected in any significant firming of money market conditions. Federal funds generally traded around the 2-1/4 per cent level and rates on three-month Treasury bills continued to move in the general 2.25 - 2.35 per cent range in which they have fluctuated since late August. Although dealers held over \$1.8 billion of bills in trading accounts as of Friday night, more than half were bills due in over 90 days and on average they have been able to carry the bills at a profit. With bill rates tending to follow movements in the Federal funds rate, there would appear to be little likelihood of any increase in bill rates as long as the Committee continues to maintain the present degree of ease--particularly in view of the purchases required to meet the large-scale need for reserves over the next two weeks. However, temporary firming of the Federal funds rate to the 2-3/4 - 3 per cent level would probably help shake bills loose from dealers' portfolios and minimize the effect of our purchases on bill rates.

The Treasury plans to announce the terms of its November refinancing next week. A major question is whether the \$7 billion of maturing securities, nearly all of which are publicly owned, will be refinanced on a cash basis or whether the

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Treasury will give holders pre-emptive rights to exchange into one or more new issues. It seems likely that the Treasury will try to achieve some debt extension whichever method is employed, particularly since it appears that banks have recently tended to move out the maturity scale slightly in quest of higher earnings. Also, there has been some small buying interest in Treasury bonds on swaps out of corporates as the narrowed rate spread between Treasury and corporate issues has made the former relatively more attractive. A difficulty with the cash method is that the Treasury must specify the size of each issue it will offer, and with the market's appetite for maturities beyond the short-term area uncertain as to amount, this is not an easy problem. On the other hand, if the Treasury chooses to give "rights" to holders of the maturing issue, it will have to face the problem of attrition. If attrition should be normal, the Treasury in all likelihood would have to come to market with a special cash operation. I should mention that the System does not hold any of the maturing issue.

Thereupon, upon motion duly made and seconded, the open market transactions during the period October 3 through October 23, 1961, were approved, ratified, and confirmed.

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

A careful analysis of the whole range of economic intelligence available at this juncture seems to yield something of a dichotomy. With very few exceptions businessmen and business economists report disappointment with the behavior of the economy in the third quarter, and skepticism about the strength of the expansion ahead.

At least on the surface, there is considerable statistical evidence that seems to support this less optimistic appraisal of the situation. Even before the work stoppage at General Motors and Hurricane Carla last month, the production index was showing a curtailed rate of increase. It is difficult to estimate just how much of the weakness in industrial output in September should be attributed to

these transitory factors and the anticipation of the tie-up at Ford which materialized in October. A few components of the index continued their vigorous expansion, but most seemed to reflect a falling off in the rapid rate of increase which had characterized the advance in spring and early summer.

Unemployment was not significantly reduced--remaining just under the 7 per cent rate in September, for the tenth consecutive month.

The statistics on retail trade are perhaps the least satisfactory of all the current measures of economic activity. But even after allowing for a considerable bias on the downside, retail sales can hardly be described as buoyant. At department stores we find that, while activity has picked up a little in recent weeks, it is still at about the July level, on a seasonally adjusted basis.

The increase in personal income also moderated considerably in August and September. Actually, income declined from July to August, but after deducting the National Service Life Insurance dividend in July, the increase, at seasonally adjusted annual rates, was \$800 million in each of the last two months. This was considerably less than the month-to-month increases earlier in the year, and even less, for example, than the September to October advance a year ago.

Perhaps most important of all, wholesale prices of industrial products--that is, the prices that manufacturers receive for their products--have shown no significant upward movement during the entire recovery period and are now still more than 1/2 of 1 per cent below the March level.

If we stopped at this point, the less optimistic appraisal of the outlook which seems to have become so prevalent in the business community would seem to be justified--and one might well ask why there is any reason to question it.

There are, it seems to me, two kinds of reasons. First, if we look at the third quarter as a whole, in terms of the GNP accounts, we find that the economy was operating at levels which few believed we could achieve six months ago. The \$10 billion increase involved in the \$526 billion third quarter estimate, while less than the \$15 billion jump from the first quarter to the second, is large by any other standard. Moreover, this increase was accomplished in the face of a smaller increase in Government purchases of goods and services than was expected and a substantial cut in net exports. Thus, personal consumption expenditures actually increased more in the third quarter than the second, contrary to general expectations.

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The second set of reasons for questioning the somewhat pessimistic view which has developed is admittedly more tenuous and prospective. It stems from such facts as the scattered evidence of some improvement in the production index in October (despite the Ford strike), the rise in the seasonally adjusted rate of housing starts (despite a big drop in FHA financed activity), and the moderate, but continuing rise in manufacturers' new orders for durable goods. It is supported by the knowledge that the less than expected rise in Government spending in the third quarter probably means more for the current quarter and those ahead. It is further buttressed by the observation of those who seem best qualified to thread their way through the maze created by early model changeovers, strikes, and introduced and unIntroduced middle lines, that sales of 1962 model automobiles are going pretty well. There is also probably some truth in the oft-repeated observations that unseasonably warm weather and the unsettled situation in the auto industry have retarded soft goods sales this fall, and that cool weather and the resumption of full-time employment at auto plants will shortly give a lift to retail activity in many areas. The recent behavior of bank credit and the money supply seem to me to support a more optimistic appraisal of the outlook.

This leads to the conclusion that if we set aside the troublesome developments, of which Mr. Furth will remind us in a moment, with respect to the balance of payments, one might describe the present situation as one beset with no more uncertainty than is necessary if we are to avoid over-rapid expansion and an upward spiral of costs and prices. It does not seem to me that the signs of weakness that have appeared thus far are sufficient to suggest any easing in monetary policy, even if we were free of the constraints imposed by international factors.

On the other hand, the widespread uncertainty among businessmen with respect to the outlook, the stability of wholesale prices at reduced levels, and the hesitation in the advance in output at factories and mines all suggest that overt tightening would be ill-timed, even if a major Treasury refunding operation were not just ahead.

In citing evidence of diverse trends in the economy, I hope I have not seemed uncertain or indecisive. In fact, domestic economic conditions today give a much clearer guide to policy than is often the case. The balance in favor of an actual and apparent continuation of the present posture seems to me to be overwhelming.

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

In recent weeks, it has appeared that the System was having more success than previously in its double, often conflicting, aims of fostering monetary expansion essential for economic recovery and at the same time avoiding a decline in short-term interest rates. Total bank credit expanded more in September and also in the third quarter than in corresponding periods of any previous year (at least in the last 12). The money supply showed the first substantial increase in several months, while time deposits continued to increase. These developments have been aided by substantial new cash offerings of Treasury securities, which have been acquired in large part by the banks. Federal Reserve operations have made reserves available for this credit and monetary expansion.

Treasury bill rates have been relatively firm, with yields in very short-term issues a little above the low level and those in longer bills close to the high levels of this year's relatively narrow range. Yields on medium-term Government securities have tended to decline, while those on longer-term issues have held fairly steady, despite a Treasury advance refunding exchange into that area. New issues of both corporate and municipal securities have continued in moderate volume, with the combined total close to levels of the past two years. Yields on outstanding issues have edged downward. Yields at which new corporate issues have been offered have been relatively low. The spread between yields on corporate and on U. S. bonds has narrowed, imparting strength to Treasury issues.

The record bank credit expansion in September reflected to a large extent increases in bank holdings of Government securities and in loans to dealers in Government securities. Banks and dealers have not only underwritten new Treasury issues, but have also tended to increase their portfolios. Dealers' holdings of bills have been maintained at particularly high levels. Bank holdings of other securities also increased by an unusually large amount in September. Loans to business and to sales finance companies showed the usual tax period increase by amounts comparable with or in excess of other years, despite some grumbling among banks about the disappointing loan demand. Real estate loans by banks have shown an

accelerated rise in recent months, though still quite small relative to the continued substantial mortgage lending by savings and loan associations and relative to the increase in savings deposits at banks.

Partial data for banks in leading cities as of October 18 indicate a continuation of credit expansion at a moderate rate during the three weeks since the last report date in September. Banks reduced their holdings of Treasury bills, after acquiring substantial holdings of tax bills in the last week of September, but they added to their holdings of notes, reflecting Treasury financing. Loans to dealers in Government securities increased further. Business loans increased moderately, while loans to sales finance companies declined, as seems to be customary in October.

Demand deposits and currency increased much more than seasonally in September. Further increases occurred at city banks in the first three weeks of October, though daily average figures for the first half of the month, for which final data are not yet available, may show a small seasonally adjusted decline in the money supply. That decline and some of the September increase may be due to faulty seasonal adjustments; the net result is still a substantial increase. The money supply is now about 2 per cent larger than a year ago, but is still little if any above the peak reached in the summer of 1959.

Turnover of demand deposits at banks outside financial centers has also increased nearly 2 per cent in the past year, while in financial centers, where deposit growth has been smaller, increases in the rate of turnover have been much larger. The combined increase in transactions--turnover and volume of deposits--outside financial centers corresponds closely to the growth of 4 per cent in GNP during the past year.

U. S. Government deposits at banks, which increased substantially in September, have been drawn down in October. They are still fairly large, but Treasury cash needs are also heavy. Some new cash borrowing may be needed in November, in addition to the large refunding operation.

Time deposits at commercial banks have continued to increase at a rate of about 1 per cent or more a month. The total growth in the past year has been over a sixth. This increase has occurred in savings deposits and at small banks, as well as in the much publicized negotiable time certificates of deposit. Apparently inflows of funds to nonbank savings institutions have continued at a heavy rate, though not as much as commercial bank time deposits. Savings thus continue large.

Nonbank holdings of short-term Governments have not increased in the past year, although the amount of such securities outstanding has been considerably enlarged. Banks have absorbed more than the total addition. The public has been satisfied to hold its liquid assets in deposit form.

Total liquid assets held by nonbank owners--business and consumers, and including currency, demand deposits, time deposits, savings deposits and shares, and short-term Government securities--have continued to expand. In the third quarter of the year the total of such holdings was 6 per cent larger than a year ago, compared with the GNP increase of 4 per cent. Since the first quarter of this year, however, GNP has increased 5 per cent and liquid asset holdings less than 4 per cent. The ratio of liquid assets to GNP is still somewhat lower than it was in 1958. The ratio of money supply to GNP is at the lowest level reached since the 1920's.

This situation indicates the need for continued growth in money supply and in general liquidity at a rate closely commensurate with expansion in economic activity and income. Although the rapid increase in time deposits may have largely compensated for the slower rise in the money supply, the combined increase could hardly be called any more than adequate for a period of economic recovery.

As brought out in the staff memorandum already submitted to the Committee, member bank required reserves against private deposits have increased in the past three months at an annual rate of 4 per cent, covering an expansion of time deposits at an 11 per cent rate and of demand deposits at a 2 per cent annual rate. The combined increase since February has been close to 4-1/2 per cent.

In the latest statement week, total reserves available for private deposits were adequate to provide excess reserves of over \$600 million, according to preliminary estimates. About \$140 million of these reserves, however, were obtained by member bank borrowings, which have already been reduced by about \$100 million to a minimal figure. Free reserves were below \$500 million last week, and have been for the past three weeks or so. During the current statement week, nearly \$500 million reserves are being supplied by a return flow of currency and the mid-month float rise. These additions have been partly absorbed by the reduction in member bank borrowings and in System holdings of securities. Redemptions and sales made earlier would have resulted in a reduction in

available reserves, but large purchases yesterday will wipe out some of that effect.

During the next two weeks, market factors will absorb about \$900 million of reserves, while lower required reserves, resulting from the drawing down of Treasury deposits at member banks, may release only a small amount. In this period, System purchases of securities may need to aggregate close to or over \$600 million in order to maintain an adequate volume of reserves for seasonal needs. A part of these needs will be temporary, and there could be some sales or runoffs of repurchase contracts around the middle of November, but in late November and early December further large purchases will be needed.

During the remainder of this year and into January, the net increase over present holdings, allowing roughly for this week's operations, which are not included in the staff memorandum, will range from around \$200 million in mid-November to perhaps as much as \$1,250 million for a brief period in early January. Such operations would maintain total reserves at around the amounts projected in the staff memorandum (table 3, column 3).

If credit and monetary demands continue at levels that would be consistent with economic recovery of the magnitude generally desired and expected, the maintenance of reserves at the level indicated should not have the effect of reducing short-term interest rates. At some stage in the future, as the economy approaches fuller utilization of available resources and credit demands increase, it will be appropriate to adjust the amount of reserves supplied through open market operations and make it necessary for banks to borrow some of the reserves they want. The economic expansion projected as necessary before this stage is reached is in the order of ten per cent or more and the time period is at least a year, or maybe two. A commensurate expansion in bank deposits might require close to \$2 billion additional reserves. Over the next year, at least \$1 billion of these, providing a five per cent expansion in reserves, might appropriately be supplied by open market operations. Any additional amounts needed or desired could be obtained through member bank borrowing.

Mr. Furth presented the following statement with respect to the United States balance of payments:

In the third quarter, transfers to foreigners of gold, convertible foreign currencies, and dollars amounted to \$900 million. This corresponds to a seasonally adjusted annual rate of more than \$3 billion, as compared to less than \$2 billion for the second quarter (after eliminating the influence of special debt repayments). Within the third quarter, September seems to have been the worst month, and whatever October figures are available suggest little if any improvement.

The third-quarter transfers reflected a deficit in the so-called basic balance of U. S. payments (current balance, Government expenditures, and long-term capital movements). In the second quarter, basic U. S. payments were approximately in balance.

The main reasons for this deterioration are primarily that U. S. imports increased last summer faster than expected and that the net capital outflow apparently has failed to show the expected improvement.

As to the current quarter, our export prospects are not good in Latin America, Japan, and the United Kingdom. In all these countries domestic inflationary pressures have either already led to restrictive policies or are likely to make them necessary in the near future. Prospects are only moderately good in Continental Europe, where the boom may be petering out, especially in Germany, and in Canada, where the effects of the upswing on imports are modified by those of the recent devaluation of the Canadian dollar.

It is true that exports of some categories, such as agricultural commodities and machinery, are expected to rise; but a considerable part of them will be financed by grants or long-term loans under aid and agricultural disposal programs, and will therefore be of little immediate benefit to our balance of payments.

Imports may not rise much more, as the slowing-down of our recovery in recent months may be followed by a similar behavior of imports. There is no reason to assume, however, that they will actually decline.

Similarly, there is no indication of a slowing-down of our capital outflow. Lending to Japan, which accounted for a very large part of the outflow in the first half of the year, may be further reduced or possibly even reversed. Similarly, massive capital movements to Germany and Switzerland may not be resumed. However, any improvement due to these changes could be offset if the outflow of funds to the United Kingdom were to gain momentum, as the fragmentary October data suggest.

This outflow presents U. S. monetary policy with somewhat of a dilemma. A gradual increase in U. S. interest rates, together with the expected gradual decline of U. K. rates, would reduce incentives for investment in U. K. short-term assets, unless offset by a reduction in the forward discount of sterling.

There is evidence, however, that a sizable part of the outflow is going into U. K. long-term securities. For this kind of investment, expectations of rising U. S. interest rates, together with expectations of a further decline in U. K. rates, might activate the outflow of funds, with some investors seeking capital gains. While these movements would come to an end once a new equilibrium level of interest rates was reached, they would in the meantime aggravate U. S. balance-of-payments problems.

In any case, we must expect the pressure on the dollar and the drain on the U. S. gold stock to continue. These pressures may be lessened later this year, as December usually shows a seasonal improvement in the U. S. balance of payments. This improvement will give us a welcome respite but should not detract attention from the basic problems.

At this point Mr. Haves related certain personal observations growing out of his recent trip to Europe, during which he attended the annual meetings of the International Monetary Fund and the International Bank for Reconstruction and Development in Vienna, Austria. In general, it seemed to him that the meetings were fruitful and resulted in a considerable net gain to cooperative international efforts, particularly because of the general agreement expressed with regard to the plan to shore up the resources of the Fund to provide standby credit arrangements to cover exceptional needs. In the press, he noted, there had been some articles interpreting certain speeches by representatives of other countries as attacks on the United States. However, no one within the United States delegation regarded them as such, and actually a harmonious feeling existed among the representatives

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of the principal nations. Rather than attacks on the United States, the speeches to which the press referred appeared to constitute attacks on loose fiscal, monetary, and economic policies in general. They seemed to be aimed at any country, whether underdeveloped or industrialized, that did not display enough self-discipline when such discipline was needed. Some countries, notably France, expressed rather specific reservations with regard to the circumstances under which they would like to see the standby credit arrangements utilized, and it was generally understood that the credits were not to be used for normal IMF purposes but only in case of major disequilibria among key currencies.

Mr. Hayes went on to say that at the meetings there appeared to be a rather high degree of confidence in the dollar, a view he had also noted in visits to London, Paris, and Frankfurt. However, these views reflected statistics for the first half of 1961, and early estimates that this year's balance-of-payments deficit would be under \$1 billion, which had led to a feeling that the United States might be on the way toward curing its balance-of-payments problem. Even so, moreover, he sensed some underlying nervousness as to whether the United States would continue to display the degree of self-discipline and determination considered necessary to meet the situation; that is, whether over a longer period the country would follow appropriate budgetary, wage, and monetary policies. The attitude with respect to the dollar could worsen rapidly if there should develop a feeling that the United States was slipping into a condition of chronic deficit in its balance of payments, and measures

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going beyond those already taken were needed on several fronts to make clear this country's determination not to let the situation drift. The country had shown a tendency toward a serious balance-of-payments problem in time of recession. The fact that the recession involved lower interest rates was one of the reasons, but the country was now in danger of showing little net improvement in its balance of payments despite the improvement in domestic economic conditions. This was a problem, then, with which he felt that everyone must be deeply concerned.

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

The most striking development since the last meeting has been the sharp deterioration in the United States balance-of-payments position in September. As a result, the third-quarter payments deficit is provisionally estimated at \$3.2 billion (seasonally adjusted annual rate) as against \$1.9 in the second quarter and \$1.4 in the first. This figure will soon become known publicly, well before the official release, and may easily be construed, both here and more particularly abroad, as a serious reversal of the encouraging tendency of the first half year, which did so much to help restore confidence in the dollar. Already there are increasing signs of nervousness abroad as to the possibility of heavier U. S. deficits over the next year or so, with a consequent growing threat to dollar stability.

Higher imports have been the major cause of the third-quarter deterioration. It is noteworthy, however, that the net short-term capital outflow has been substantial through most of 1961, and to a large extent this flow reflects a multiplicity of foreign borrowing operations in this market because interest rates here are far below those in the borrowing countries. Of course the British austerity program, including establishment of a 7 per cent Bank rate, has drawn short-term funds to London, and the recent cut to 6-1/2 per cent apparently has had relatively little effect on the strength of London's attraction for international funds.

In contrast with this critical international outlook, the domestic business situation appears calm and substantially unchanged in the past three weeks. The slower rate of expansion in September may be attributed in good part to such special factors as strikes and weather conditions; the most evidence still points to a strong, but not overly exuberant recovery. It is true that the last couple of months suggest a somewhat more cautious attitude on the part of both business and the consumer than had been expected earlier. On balance this strikes me as healthy, as the absence of speculative pressures has permitted much more stable price conditions, on the average, than might have been looked for at this stage of an upward business movement.

There is certainly nothing in the credit picture to suggest that our policies have been restrictive. On the contrary, September witnessed a very sharp rise in total bank credit and the first significant rise in the money supply in many months. Much of this may be attributed to Treasury financing; and after a brief reversal early in October, bank credit seems to have risen again in reflection of the October Treasury program. In contrast, business loans have shown no great strength and have moved about in line with seasonal expectations. The banks' liquidity position continues to look relatively easy in terms of liquid asset holdings, especially in New York. Despite loan-deposit ratios well above those prevailing during most of the post-war period, the banks have ample liquid resources to meet probable loan demands.

For the moment at least, the danger of a sharp rise in the Federal Government's deficit due to higher defense spending seems to have receded. Secretary Dillon's latest estimate of the 1962 fiscal year deficit is about in line with our own estimates of the last few weeks and substantially below some of the figures which were recently mentioned in financial circles and the press as a real possibility. It is also encouraging that he reiterated the Administration's firm intention of reaching a balance in fiscal 1963. A clearer picture of the fiscal position will develop with the release of the post-Congress budget review expected shortly. With the Treasury expected to announce the terms of the November refunding within ten days, we shall soon be confronted with the need to promote stable conditions in the money and capital markets to assist this financing operation.

As for general policy considerations, the domestic business situation would justify our adhering to the same degree of monetary ease prevailing in the last few months. On the other

hand, the balance-of-payments position is sufficiently dangerous to warrant a careful review of our policy to see whether there is anything helpful we can do in the monetary sphere without damaging the domestic economy. It seems to me that the level of short-term market interest rates--and particularly the 90-day bill rate--clearly offers the most fruitful possibilities. A higher bill rate might have some influence on capital flows and might also be of psychological value as an indication that we are not unaware of the payments problem. I would not go so far, at this time, as to suggest a rise in the discount rate, although it may well be that we shall have to come to this within the near future if the payments trend is not reversed. But for the time being I believe we should avoid the general tightening effects throughout the domestic economy that would undoubtedly accompany any such overt move.

I would think that the Manager might be instructed to seek a higher level of bill rates, say between 2-1/2 per cent and 2-3/4 per cent for the three-month Treasury bills, with a Federal funds rate of perhaps 2-1/4 per cent to 2-3/4 per cent, while still preserving a general atmosphere of ease. I am not sure this can be accomplished, but it is well worth trying. It seems to me that free reserves could be allowed to average a little lower than they have been, say around the \$400 million level, without any damage to business, especially in view of the sharp rise in bank liquidity since earlier in the year, and the sizable growth in bank credit in recent weeks. The special authorization should, in my judgment, be continued and should be used to the extent possible to help attain the twin objectives of higher short-term rates and continued monetary ease.

I should think that offerings of intermediate and long maturities should be accepted whenever available at a fair price, with little regard for reserve figures, so as to enable the Desk to make offsetting sales of short-term securities if consistent with the reserve figures. During the next few weeks, however, there may be little or no opportunity to make such offsetting sales, because of the sizable net release of reserves called for during that period; but I do think the Committee should encourage the Desk to do more swapping of this kind if and when circumstances provide a suitable occasion.

The present wording of the directive might appropriately be retained.

Mr. Ellis said that in the First District it was hard to define any pronounced trend in economic conditions. However, there seemed to be

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general satisfaction with nonmanufacturing activities; the service and trade occupations showed high and growing levels of employment. Construction activity seemed to be picking up slightly, and the banking situation was strong without exhibiting rapid growth. Therefore, the problem area was in manufacturing.

The New England production index exceeded the year-ago level by 1 per cent in August, according to the revised figures, and it was as yet too soon to have any firm indication of September trends. There was some indication that employment may have declined, while electric power consumption probably expanded. The shoe industry was disappointed in third-quarter results, for it had expected an upturn that failed to materialize. Textile producers scored some further recovery, but employment was 7 per cent behind year-ago levels.

Continuing, Mr. Ellis said that the general sentiment of businessmen in the District appeared to be one of optimism regarding the outlook. This was reflected in the Reserve Bank's fall survey in which New England manufacturers were requested to review their investment plans of last spring. The respondents, employing about 20 per cent of the manufacturing employees in New England, reported that they had boosted their 1961 investment intentions by about 5 per cent since the spring survey; if present intentions were executed, outlays this year should exceed those of 1960 by about 4 per cent. Durable and nondurable goods manufacturers apparently were going to participate

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about equally in this increase, and a shift toward outlays for expansion was indicated, in contrast with the recent emphasis on modernization.

The condition of District banks had changed only moderately in the past few weeks. Business loans were down slightly, but were still up 4-1/2 per cent from the first part of the year. Other loans also went up, about twice as much as the gain nationally. Demand deposit growth matched that of the country, but other deposits lagged a little. District banks had been net sellers of Federal funds.

As to policy, Mr. Ellis said he still thought it appropriate to say that there was a vigorous lull in economic activity. He was inclined to feel that the economy was going to break out on the upside; meanwhile the economy was marking time for a move in some direction and the present degree of ease was, of course, intended to stimulate a movement in the proper direction. He would be a little reluctant to follow the suggestion of lowering the free reserve target, for he would not like to see anything done that might be interpreted as a move on the part of the System toward restriction at this stage of the business cycle. Instead, he would prefer to continue the present degree of ease and its stimulative effect. He would, however, go along with resolving doubts on the side of less ease.

Mr. Ellis indicated that he would not favor a change in either the discount rate or in the directive at this time. He would be glad

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to see the Desk seek somewhat higher levels of short-term interest rates. This inferred use of the special authorization to operate in longer-term securities, and he would favor the use of this device in providing reserves during the next few weeks.

Mr. Irons reported that conditions in the Eleventh District had not changed significantly, and that the over-all picture included some favorable and some unfavorable movements. Employment and department store sales had shown a little improvement, especially in the first half of October, and the agricultural situation was very good. Unfavorable factors included a continuation of the eight-day allowable crude oil situation, which might be expected to persist, although there had been some pickup in drilling. Construction was off a little, and production was down somewhat more in September than had been anticipated, largely due to hurricane Carla and the effect of auto strikes. On balance, District conditions were reasonably satisfactory.

Mr. Irons said that in talking with businessmen he found that the general sentiment seemed to be one of optimism, tinged with some concern as to the inevitability of inflation. Knowledgeable businessmen appeared to be more disturbed about the continuing and rising Federal deficit and the implications of the balance-of-payments deficit than about the question of economic recovery in the District or the country. In the latter respect they were not pessimistic.

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District banking conditions were reasonably liquid. Borrowing from the Reserve Bank had been running under \$1 million, with no borrowing on the part of city banks. As to bank credit, the increase in loans had been moderate and the increase in investments had been substantial, largely in reflection of Treasury financing. Demand and time deposits were both up, and on the whole the banking situation was favorable. Bankers tended to talk about loan demand being less than expected, or no better than seasonal, but they all felt in a position to meet whatever demands might appear. There had been little change in the pattern of trading in Federal funds, with Dallas banks buying and most other reporting banks selling. The totals were about two to one on the buying side.

Turning to policy, Mr. Irons said there seemed to be a three-way proposition that the Committee must try to average out. In terms of the domestic economic situation, one might say that it would seem reasonable to continue about the same degree of ease that had existed during the past three weeks. However, the international situation presented a problem possibly calling for a somewhat different conclusion. The forthcoming Treasury refunding, which was another factor to consider, suggested maintaining the status quo. Balancing these out, the Committee might do well, he thought, to give more direct attention to the matter of rates and less direct attention to the level of free reserves. He did not believe that under such an approach free

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reserves would decline enough to cause any damage from the standpoint of the domestic economy. That would enable the System to give more attention to firming short-term rates in order to provide relief on the international side without creating instability or undue restriction in the domestic market. He would envisage a Federal funds rate of 2-1/2 per cent, a bill rate in the area of 2-3/8 - 2-5/8 per cent, and little borrowing from the Reserve Banks. In that kind of pattern, free reserves might run around \$400-\$450 million, which he thought would still provide sufficient ease to avoid any restrictive or restraining influence on the economy, when consideration was given to the liquidity position of the banks. The System, of course, should provide reserves to meet seasonal requirements. He would hope, however, that any deviations from the kind of objectives the Committee had been seeking might be on the side of less ease. He would not change the discount rate or the directive at this time, and he would continue the special authorization.

Mr. Swan said that in the Twelfth District the picture was about the same as nationally. In the past month or so, however, the District perhaps had picked up a little faster. For example, nonfarm employment in the Pacific Coast States rose a little more in September than the national average. The increase, fairly general in nature, was supported by a surprising gain in aircraft employment in Southern California, which was contrary to earlier expectations of a continuing decline for several

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months. The lumber industry continued in the doldrums, with further price weakness in both lumber and plywood. Residential construction continued to be devoted increasingly to multiple-unit structures, even though vacancy rates were not particularly encouraging. District steel production fell in September but picked up again in the first two weeks of October, apparently in response to demands for construction steel.

District banks were still encountering only a moderate loan demand, with the possible exception of some continuing increase in real estate loans. In the past month or so they had been net sellers of Federal funds; however, in view of substantially increased holdings of Government securities, their net sales of Federal funds were on a much smaller scale than in the first part of September. There had been a couple of indications that some of the banks were getting a little restive about continuing to keep their maturities short in prospect of a stronger loan demand. They were worried about the income they had been foregoing and apparently were considering some lengthening of maturities.

As to policy, Mr. Swan commented that the Committee's latitude for action was considerably limited by the November refunding of the Treasury. Further, he could see nothing in the business situation that would call for any particularly significant change in policy in either direction. He had been impressed, however, by the fact that for the

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past four weeks--if one included the current statement week--free reserves had been running below \$500 million with remarkably little pressure on the bill rate, the Federal funds rate, or even, except in one week, on member bank borrowing. While he felt that the System still needed to encourage credit expansion in light of the domestic business situation and that it certainly must meet seasonal reserve needs, he thought it would add up to a satisfactory situation at the present time if the bill rate were around 2.3 to 2.5 per cent, the Federal funds rate was at 2 or 2-1/2 per cent, a low level of member bank borrowing prevailed, and free reserves could be kept around \$450 million. Although he would not argue for becoming appreciably tighter than in the past three weeks, he noted that perhaps the situation actually reflected slightly less ease than had been suggested at the October 3 meeting. He would not change the discount rate or the directive at this time, and he would continue the special authorization to operate in longer-term securities for much the same reasons that Mr. Hayes had suggested. Presumably doubts would be resolved on the side of less ease, although this would depend somewhat on the Committee's free reserve target.

Mr. Deming said that the Ninth District continued to be more atypical than typical of the nation in its economic and financial developments. In terms of total personal income, for example, its gains were greater than the nation's for the last half of 1960, less

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than for the nation in the first half of 1961, and very recently had again been running ahead. Had it not been for adverse developments in agriculture, District personal income gains would be significantly better than those for the United States--and this despite depressed conditions on the Iron Range. Measured against a year ago, net farm income in September was running 8 per cent smaller, in contrast to a U. S. gain of almost 5 per cent. District nonfarm personal income, however, was registering better than national average gains.

In banking, the District also presented a picture in sharp contrast to the nation. District member bank loans declined in September by more than in any other September, save one, since the end of World War II. For the entire third quarter the decline in loans at District member banks was very large, whereas loans usually increase significantly in this period. In fact, only in the recession year 1954 was there another third-quarter loan decline since the end of World War II, and that was only 1/15 as much as this year's drop. Furthermore, the decline was general--in both city and country banks and in all District States--and preliminary October data indicated a continuation of these movements. Deposits had continued to grow, and the improvement in bank liquidity had been marked. In September the loan-deposit ratio at country banks was 47 per cent in contrast to a high of 51 per cent in June 1961. At city banks the ratio in September was 51 per cent (it was now 49 per

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cent) as against 56 per cent in June and 61 per cent at the peak in May 1960.

Mr. Deming said that if he were reasoning solely from District experience his policy prescription probably would have to be to absorb some of the growing liquidity that could serve as the base for too much credit expansion in the future. The national picture, however, caused him to advocate no more than a continuation of about the degree of ease that had prevailed over the past three weeks, which he interpreted to be one of resolving doubts on the side of less ease. In terms of guides, he would suggest free reserves of about \$450 million, a low level of discounting (and no change in the discount rate), Federal funds around 2-1/2 per cent, and a bill rate ranging upward from 2-3/8 per cent for three-month bills. He saw no reason to change the directive and favored continuing the special authorization.

Mr. Allen said that in the Seventh District consumers appeared to be stepping up their purchases of both hard and soft goods. In August and September, producers of television, furniture, and most appliances reported large gains over the year-ago months. In the four weeks ended October 14, department store sales were 4 per cent higher than a year earlier, both in the nation and the Seventh District. If this trend continued, the question as to when consumers would begin to increase spending would have been answered.

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The work stoppages in the automobile and farm equipment industries, which prolonged the pause in the upward pace of business activity, now seemed to be out of the way. A strike at Chrysler remained a possibility, but unless lengthy its effect would be relatively slight because Chrysler dealers were well supplied with new model cars. Thus, fourth-quarter production of 1,800,000 automobiles was still expected, despite less than anticipated output in October. And production of approximately the same number was presently scheduled for the first quarter of 1962.

The sharp advance in automobile sales in early October was explained by the fact that virtually all companies introduced new models at about the same time and earlier than in previous years. However, there was optimism in Detroit, with many estimating around 7 million 1962 car deliveries. Inventories were in good shape and were expected to total 640,000 on October 31, of which 490,000 would be new models and 150,000 leftovers, or "dogs" to use the Detroit vernacular.

The Seventh District employment situation continued to improve, Mr. Allen said. In September three District centers--Peoria, Rockford, and Gary-Hammond--were upgraded from substantial to moderate unemployment areas. All centers still classified as having substantial unemployment were in areas influenced by the automobile industry where improvement was under way.

The substantial basic reserve deficit position of the large Chicago banks which developed within the past ten days had resulted

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chiefly from payments for three Treasury issues, which increased required reserves or absorbed reserves. Government security holdings of weekly reporting Chicago banks rose \$250 million in the three weeks ended October 18, and loans increased \$100 million during the same period. Although business demand for credit seemed to be gaining strength, it was not yet clear that the increase was anything more than seasonal.

As to monetary policy, Mr. Allen said he felt that the Committee should endeavor to continue the degree of ease that had been maintained for some time. There were indications, as he had suggested, that the upward pace of business activity was continuing, which offered reason to avoid easing the situation any further. On the other hand, he did not yet find any persuasive argument for moving to a lesser degree of ease. He would not favor continuance of the authorization which was conceived approximately nine months ago and yet was still termed, euphemistically as he saw it, the special authorization.

Mr. Clay said that while it was apparent that economic activity had leveled off, the significance of this development was not clear. Analysis and interpretation were clouded by the impact of the automobile strikes upon that industry, related industries, and the economy as a whole. Not only had the automobile strikes affected the volume of industrial output, but the resulting limited availability of new automobiles had delayed the test of consumer buying of durable

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goods--a test which was tremendously important in gauging the future pattern of economic activity. This situation had been further complicated by the unexpected leveling off in Federal Government outlays for goods and services. The nature of the hesitation in the upswing of economic activity, and the probable course of future developments, could not be accurately judged until the automobile industry hit its full stride and more information was available as to the amount and timing of Federal Government outlays.

Under these circumstances, Mr. Clay continued, the domestic economy at this time appeared to require no lessening of the effort to use monetary policy to encourage the expansion of economic activity. This view was supported not only by the nonfinancial developments in the economy. It was further underscored by the lack of increased credit demands of the type typically associated with cyclical expansion.

Accordingly, domestic considerations indicated the need for open market operations designed to encourage further credit expansion and the maintenance of a level and pattern of interest rates essentially in line with those presently existing.

Mr. Clay noted that the Committee had had evidence that short-term capital outflows again presented a problem. Under the circumstances, he suggested, the Manager of the System Open Market Account would need to conduct open market operations with a view to keeping the Treasury bill rate from going too low relative to rates abroad.

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That would appear to call for a bill rate no lower than in recent weeks, and perhaps somewhat above recent levels. Offsetting operations in longer maturities should in his opinion be undertaken to the extent necessary to maintain the Treasury bill rate at such a level, as it was important that approximately the present ease in bank reserve positions be maintained. Quite apart from other considerations, he added, the Committee would be faced with Treasury financing again for much of the period immediately ahead. Accordingly, it would want to avoid any change in policy during that period; but no change would appear to be appropriate in any case.

In Mr. Clay's view, no change was needed in either the Committee's directive or the Reserve Banks' discount rate. He felt that the special authorization with respect to operations in longer maturities should be renewed.

Mr. Heflin said that Fifth District business activity had retained the generally favorable tone reported three weeks ago. High levels of employment continued to prevail in virtually all sectors of the District economy. Insured unemployment declined more than seasonally in every month from March through August, and the latest weekly figures suggested a resumption of this favorable trend following less favorable reports early in September. Rates of insured unemployment in September were below the national rate in every State

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in the District except West Virginia. In manufacturing, uncertain markets had retarded recovery in textiles and lumber. Textile companies, however, were encouraged by the recent Internal Revenue decision allowing them to depreciate machinery for tax purposes on the basis of a 12- to 15-year useful life instead of the 25-year schedule currently in effect. This would give them substantial help in overcoming the effects of a higher support price for cotton and a higher minimum wage and should enable them to compete more effectively with imports. The furniture business, also slow to join the trend toward recovery, had improved substantially in recent weeks. Retail sales of furniture in the District were up sharply in September, and manufacturers were quite optimistic as they prepared for the fall Southern Furniture Market now in progress.

Farm income continued to improve. Through October 13, tobacco farmers in the District had sold more than one billion pounds of tobacco for about \$650 million, an income increase of about 7 per cent over the corresponding period in 1960, and average prices for the season would probably be the highest on record. Cotton production was up about 8 per cent, and prices were well above those of last year due to a higher support price. Broilers provided the only gloomy portion of the agricultural picture. Production was at an all-time high, but prices were about the lowest in history and well below costs of production.

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With respect to policy, Mr. Heflin commented that the Committee was faced with a situation that had not changed significantly for several weeks. Business activity was still rising, but the movement has lost some of its vigor. Prices continued to move sideways and there were no indications of any build-up of speculative or inflationary forces. Thus, the state of the domestic economy seemed to call clearly for continued ease. On the other hand, the delicate and uneasy international position of the dollar suggested that it would be unwise to move toward additional ease. In addition, the large Treasury refunding operation that was immediately ahead would require stable market conditions for its success. Hence, it seemed to him that the only reasonable course was to maintain the present open market policy, which would mean no change in the directive. Also, he would favor no change in the discount rate and a renewal of the special authorization.

Mr. Mills said that because he believed the Committee's policymaking was faced with critical problems that were crying for solution, his remarks today would be couched in unaccustomed bluntness. He would argue for more positive action to tighten reserves, and against dalliance with existing conditions. In his opinion it would not be possible to adopt a "troika" policy: a policy whereby interest rates would be kept low while at the same time they would be

raised, and under which a strong attitude would be taken toward the protection of the dollar. The two critical danger points that he thought deserved the Committee's attention were a perilously exposed Government securities market and the weakness of the dollar on the international exchanges. In elaboration of those points, he presented the following statement:

A similarity in the economic developments of the years 1958 and 1961 has been urged as a reason for formulating comparable Federal Reserve System monetary and credit policies. However, the most apt comparisons between these two periods have not entered into policy-making discussions and are of a financial nature:

In the early months of 1958 an ill-advised policy of forcing reserves into the commercial banking system in order to stimulate credit expansion led not only to excessive credit ease but also abetted a disastrous speculation in United States Government securities.

Now again in 1961, and flying in the face of the previous unhappy experience, a similarly undesirable policy has been embarked upon for the self-same purpose of encouraging a vast expansion of commercial bank credit. But this year a scatter gun aim has been taken at increasing the money supply regardless of the fact that in doing so damaging hits have been registered on banking, industrial, and commercial liquidity which is approaching toward an inflationary status, and on the very fabric of the money market. In this latter regard, the continuous injections of new reserves into the commercial banking system, in leaving no room for the free play of natural market factors that from time to time tighten the supply of reserves, have had the effect of drugging market participants into insensibility to the "real facts of life" by giving them an implied assurance that the Federal Reserve System has allied its policies to credit ease for an indefinitely extended period of time.

The dangerously top-heavy positions of United States Government securities dealers are a prime expression of the investment climate that Federal Reserve System policy actions have created. The dealers are now carrying positions that are beyond their

function of making markets and instead represent a growing floating and undigested supply of securities that has been mistakenly taken into account for profit motives that have been nourished by the Federal Reserve System's policies. In consequence of the market overhang of United States Government securities carried by the dealers, they are vulnerable to any shift in System policy toward restraint which would immediately be reflected in falling prices and higher interest rates. Such developments could lead to a disorderly market for United States Government securities if bank lenders felt compelled to call their loans or require additional collateral. If Federal Reserve System intervention in the market should then become necessary, an extremely confused market picture could unroll which might end in the commercial banking system holding a larger supply of reserves than that which it had been sought to diminish.

Altogether the present money market situation is fraught with danger. Even so realities must be faced and a start made toward implementing a moderately restraining monetary and credit policy; otherwise delay and temporizing with the present situation will only raise more difficult future problems. The sceptical attitude to Federal Reserve System policies that has been taken by domestic and foreign monetary experts, and which is a factor in the weakness of the dollar on the international exchanges and in renewed gold losses, is perhaps the strongest reason that urges a revision of policy thinking.

Mr. Mills said he would not recommend a change in the Committee's policy directive at this time. However, he would recommend moving, as he had indicated, toward a reduction in the supply of reserves. Feeling certain that there would be concern about such a policy in terms of its market consequences, he would suggest that the attitude of the Account Manager and the System to developments of that character might fall into the kind of posture outlined in the following statement:

The imperative need for, and adoption of, a mildly restrictive Federal Reserve System monetary and credit policy could foreseeably produce drastic money market effects the consequences of which must be guarded against by appropriate policy actions.

The conventional treatment for correcting a disorderly market should of course be followed.

Upward pressures on interest rates should be reflected as soon as practicable in a 3-1/2 per cent Federal Reserve Bank discount rate. The timing for an increase in the discount rate would be the juncture at which the Federal funds rate rose to and then tended to move above the present 3 per cent discount rate of the Federal Reserve Banks. In the process of these developments, it is conceivable that member banks would temporarily be in a position to finance United States Government securities dealers by borrowing at their Federal Reserve Banks at a less cost than the interest rate which they would charge on such loans, which would serve the purpose of lifting off the pressure for their reduction except only as the burden of higher carrying costs voluntarily induced dealers to reduce their credits.

Although accident rather than design has brought the level of free reserves down below \$500 million, the absence of abrupt money market tightening in response to this change in the volume of free reserves outstanding suggests that their further reduction can be accomplished and the money market conditioned for a higher Federal Reserve Bank discount rate with a minimum of market disturbance. Leaving aside the possibility of disorderly market conditions, however, a tighter money market can in any event be expected to produce higher interest yields on Treasury bills and other types of short-term United States Government securities. If this kind of development tended to draw corporate investors out of investment in commercial bank time certificates of deposits and into higher yielding U. S. Treasury bills, consideration could then be given to raising the maximum rate of interest permissible for payment under Regulation Q.

All in all, advance policy preparation to forestall any conceivably adverse effects of a shift in Federal Reserve System monetary and credit policy toward restraint is the best assurance that the change can be successfully and beneficially accomplished.

In further comments, Mr. Mills said that he would favor renewing the special authorization covering operations in longer-term Government securities. However, in the outside possibility that a disorderly market might develop, he assumed that the Account Manager would return to the Committee for instructions and that the special authorization would not

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be construed as authority to move in a disorderly market situation.

Mr. Robertson said that as of today he could not see any basis for too much concern about adhering to the degree of ease that had existed over the past several weeks. There were no inflationary tendencies apparent at the moment and the economy still needed to be stimulated. In his view, then, the Committee should continue to pursue the policy it had followed of stimulating the economy. The volume of free reserves had fallen somewhat below the level that he understood to have been contemplated at the October 3 Committee meeting, which was to a large extent justifiable because of the numerous variations in operational factors that had occurred. However, in order that monetary policy might maintain what he considered the proper posture, he would favor moving back up to a free reserve target in the neighborhood of \$500-\$525-\$550 million in the hope that this would permit the Committee to continue to carry out the spirit of its directive, which was in terms of encouraging credit expansion to promote fuller utilization of resources.

He had the definite feeling, Mr. Robertson said, that the Committee was overemphasizing the importance of the international picture; that it was permitting the foreign tail to wag the domestic dog. He was apprehensive that the Committee would let that factor deter it from doing what it could in the way of stimulating the domestic economy.

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Under no circumstances would he approve the suggestion that the swapping device be used for the purpose of stimulating the bill rate. As to the outflow of short-term capital and gold, he noted that it served as a thermometer. By tinkering with the thermometer, he felt that the System would only be fooling itself. What was needed was an effort to deal with the basic underlying difficulties, and monkeying with the thermometer only tended to put off the time for making such an effort, for the thermometer called attention to what ought to be done. As he had said on previous occasions, he felt that too much reliance was being placed on short-term rates as a guide to System policy.

Mr. Robertson also said that he would not change the directive, which he thought was appropriate as it stood, and that he would not move on the discount rate at this time because he saw no reason for a change. In his opinion, the present posture of policy was appropriate as of now, and probably would continue to be appropriate for the next one, two, or maybe even three three-week periods. Therefore, he would continue it. He would not approve renewal of the special authorization covering operations in longer-term securities.

Mr. Shepardson said that he thought the thermometer referred to by Mr. Robertson did indicate the existence of a problem. In his opinion, there was a need to get at the basic problem, and one way was to move in the direction of a tendency toward less ease. The

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international situation deserved serious consideration, both in terms of actual balance-of-payments prospects and their psychological effect. There had been a failure, it seemed to him, to get at the basic problem to which Mr. Robertson had referred. Mention had been made of the fact that prices had been relatively stable, and this was true. However, if the country was going to enjoy the desired economic growth and expansion of business, and if the basic balance-of-payments problem was going to be met, it was necessary to recognize the movement from a seller's market to a buyer's market and the need for some downward revision of prices. The buying power of consumers, measured in terms of their income, was now high, and consumers were not spending more, it seemed to him, basically because they were being more selective. Productivity gains, he noted, were now being reflected in lower prices by some industries, and their continuation would tend to offset increased costs in other sectors that were not making comparable gains. While automobile manufacturers had not raised prices on the new model cars and apparently intended to absorb the increased wage costs resulting from the recent labor contracts, there were rumors that other sectors of the economy were going to have to raise prices because of increased costs. Thus, the current step-up in spending for consumer durable goods might be due to the prospect of increased prices around the turn of the year. Certainly, the addition of more funds to validate

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price increases was not going to get at the root of the problem, and for that reason he would agree with the view that the System should trend toward a little less ease. While he would not be prepared to go quite as far as Mr. Mills at this time, nevertheless everyone should be aware of the problem that was building up and monetary policy should not be providing tinder for inflation. Rather, it should lend such support as it could to bringing about not only a leveling off but a correction of prices in those areas making real productivity gains to offset the inevitable crawl in some other areas.

Mr. Shepardson concluded by saying that he would not change the directive or the discount rate at this time. However, he would lower the free reserve target somewhat and give some attention to bringing the bill rate up to a level more in the order of 2-1/2 per cent or thereabouts.

Mr. King said that he had been satisfied with the recent operations of the Desk, which provided the type of ease that he understood the Committee to have requested at the October 3 meeting. He would have no objection if the level of free reserves fluctuated somewhat, but he was interested in maintaining the degree of ease that had prevailed and in not changing policy by talking about the resolving of doubts on the side of restraint. Further, he would suggest being careful to avoid giving those who did not understand the limitations of monetary policy the impression that it could resolve basic long-run problems; these

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must be faced up to in other ways if they were going to be solved.

If the System should try to solve, through monetary policy, problems that could not be solved in that manner, this might only tend to encourage others not to face up to those problems as promptly as they should.

After repeating that he would not alter the present degree of ease, Mr. King went on to say that at this stage he saw no need to talk about a higher discount rate because of the lack of any significant amount of borrowing by member banks from the Federal Reserve Banks. Only if the banks began to borrow more substantially would he feel that it was necessary to consider a change in the rate. In summary, he believed that a continuation of existing monetary policy would produce more satisfactory results than if the System were to start out to try to solve through monetary policy problems that must really be met in some other manner.

Mr. Mitchell suggested that there might be a tendency to forget that in a free enterprise economy there is an automatic technique for bringing the economy out of recession, namely, a reversal from inventory decumulation to inventory accumulation, which provides a substantial stimulus. At present, however, this stimulus appeared to be about exhausted; if it was not transferred to the sector of final takings, the economy would be in trouble. Turning to available evidence that might indicate whether such a transferral was taking place, he noted

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that in September retail sales amounted to \$18.2 billion on a seasonally adjusted basis, a figure that had not changed substantially for four or five months. It was below the \$18.3 billion average for the year 1960 and only slightly above the \$18.0 billion average for 1959, when there were six million less consumers, so the September figure was not reassuring. Department store sales had shown some signs of life in the past three or four weeks, but the sample was unscientific, to say the least, and difficult to interpret. Automobile sales were hopefully higher, but it was too soon to know, while consumer credit extensions were barely exceeding repayments. Data on savings inflow and outflow were not adequate for analysis on a national basis, but where good data existed, as in the Seventh District, they indicated that consumers were showing only a moderate tendency toward more liberality in their spending. Consumer psychology appeared to be adversely affected by the cold war, by continued high levels of unemployment, and by an uncertain stock market.

The situation, Mr. Mitchell said, had been approximately at this same point for the past two or three meetings, and the time was getting closer when something would have to give. Either there would be a downturn in the industrial production index that could not be explained by strikes or by weather abnormalities, or activity would start moving upward. Until it was known what direction the movement

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would take, he felt that monetary policy should be as stimulative as the System could make it without betraying a concern that would serve only to add to the anxieties of consumers. If the recovery were to falter obviously, he pointed out, it would take a substantial deliberate effort on the part of Government to turn the starter over again. In such circumstances, he felt that the System must be careful to do its part to encourage the economy to move ahead. While he was concerned, of course, about the international situation, the current dilemma reflected a worsening of the balance of trade, and that was not going to be cured by the expedient of adding a few basis points to the yields on short-term Government securities. In summary, he would be inclined to "stay just about where we are" in terms of monetary policy and not to make any change that could be detected on the outside.

Mr. Fulton reported that a recent succession of happenings, including the steel strike, the early automobile model changeover, and the auto strikes, had left the economy of the Fourth District without much bounce. In the steel industry the doldrum in operations had continued, with operations down for the second week in a row. Orders were on a hand-to-mouth basis; the users of steel were not ordering for inventory purposes. Inventories were estimated at about 9.6 million tons, which was almost a minimum for working purposes, and orders for October and November delivery were no better than for September. However,

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some rebuilding of inventories, possibly in the area of three to six million tons, might take place later against the possibility of a steel strike and also against the possibility of a price increase. The industry expected production of about 107-110 million tons next year, but for this year it now appeared that production would probably be in the neighborhood of only 96-98 million tons. Industry spokesmen were saying that a price adjustment was necessary if the industry was to replace outmoded equipment. However, foreign companies had increased their capacities, prices of foreign steel were softening, and shorter delivery schedules were being offered. Also, the price decline in aluminum had put a damper on the aspirations of the steel companies.

In the rubber industry, customers seemed reluctant to increase inventories and were depending on controls to keep inventories at a minimum. They did not seem apprehensive about the possibility of price increases. Industry spokesmen expressed the opinion that automobile production for next year might be about 6.3 million units, as contrasted with the figure of 7 million projected by the automobile makers themselves. There might be some help for the heavy industries if military expenditures for conventional weapons should begin to appear, but there had been few contracts as yet.

The District unemployment situation had improved from a statistical standpoint, but analysis indicated only a slight improvement, considerably less than the statistics would suggest. The exhaustion of benefits was one factor and the shortening of the work week was another. Auto sales had shown a good seasonal increase in the Cleveland area in the past

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three weeks, but there had been a substantial decline in Pittsburgh; Cincinnati showed no trend. Department store sales had improved slightly from the poor September record; for the year to date they were still 1 per cent below last year.

Savings deposits at District banks continued to increase. Loans showed only a small increase, hardly any movement at all, and no unusual demand for bank credit was anticipated.

Mr. Fulton expressed concern about the international situation and said he would like to see the bill rate around 2-1/2 per cent. However, the domestic situation was such that a close eye should be kept on it, and he would feel that a degree of ease similar to that of the past three weeks should be maintained. He would not like to see a substantially greater degree of ease; instead, about what had prevailed recently. He would not favor a change in the discount rate or in the directive, and he would renew the special authorization.

Mr. Bopp reported that business was good in the Third District. Unemployment claims had declined to the levels of 1959, and the steady decrease in claims was now apparent in total unemployment statistics. Five major labor market areas recently had been reclassified upward. Production had been strong recently and carloadings were increasing steadily. Department store sales had improved so far in October.

This picture had been disturbed somewhat by the findings of the Reserve Bank's latest survey of capital spending. These indicated

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that manufacturers in the Philadelphia area planned to spend 10 per cent less in 1962 than in 1961. On the face of it, this was somewhat discouraging. However, since the Reserve Bank's survey was taken as of September, it might not reflect final plans, and the Bank intended to check up in January. Moreover, this survey as well as others had tended to underestimate expenditures at this phase of the cycle, and there was reason to hope that the 10 per cent figure would turn out to be erroneous.

In the banking area, no evidence was seen as yet that loan demand was picking up. In fact, loans had declined in recent weeks. Bank reserve positions had been relatively easy most of the time.

Since this was one of the few brief breathing spells in Treasury financing, it seemed important, Mr. Bopp said, to consider especially carefully whether this might be the time to move away from the Committee's position of prolonged ease. However, nothing compelling was seen in the economic picture that would dictate such a step. As long as the business expansion, and especially prices, gave no threat of getting out of hand, he believed there was every advantage in maintaining the same position of ease. The only argument to the contrary that carried much weight was the possibility that economic developments might call for less ease in the near future. This, however, was still only a possibility. If it became more than this, the Committee might have to act more drastically than if it had been

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moving away from ease gradually. But at present this seemed to him to be a risk worth taking. Therefore, he would maintain the same degree of ease and make no change in the directive or discount rate. He would continue the special authorization.

Mr. Bryan stated that as far as statistics were concerned, the Sixth District seemed to be going along without displaying any notable differences from the nation as a whole. There had been some signs of hesitation in the recent past and, although he considered it probable that the economy was going to break out on the up side, neither the nation nor the District was in the middle of an exuberant boom. There were at least substantial possibilities, in fact, that the economy might not move up, and instead would move on the down side. In the light of that uncertainty, and speaking only in terms of the very short run, he believed there should be no fundamental change in the posture of System policy. In terms of a figure, he would assume that a free reserve target in the range of \$500-\$550 million would be compatible with an expansion in total reserves appropriate to the present situation. If the country did move into an exuberant boom, the System would have to move as adroitly as possible from a posture of ease to a more restraining attitude. However, that point had not yet arrived.

Mr. Bryan went on to say that he was just as concerned as anyone about the problem in respect to the balance of payments. Aside from the unemployment situation and the military situation, he believed that perhaps this was potentially the most dangerous situation confronting the

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country. However, as he had said on previous occasions, he did not believe that the situation was going to be corrected by the change of a few basis points in the bill rate. Nothing of a fundamental nature had been done to correct the situation and to improve the attitude of other countries. Certainly there was nothing in the fiscal position that would inspire confidence in the dollar, almost nothing had been done in the area of foreign aid programs, either military or otherwise, and the country was still following a policy that encouraged wage rates to increase. In these circumstances, for the System to try to correct the balance-of-payments situation by monetary manipulation struck him as not only absurd but dangerous.

Mr. Johns said that if one looked at the internal economic situation it seemed reasonable to conclude that monetary policy should continue to be stimulative. He hastened to add, however, that he was not referring to any dramatic stimulation. Rather, he would think that an appropriate course would be to attempt to achieve the total reserves projected in column 3 of table 3 of the staff memorandum of October 20 on the outlook for member bank reserves, and he would like to see the Committee's instruction to the Desk expressed in such terms. Of course, he did not believe that one could look at the internal economic situation alone at the present time. As a matter of fact, the Committee's directive required consideration of international factors, and he assumed the Committee would give attention to such factors whether or not they were

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mentioned specifically in the directive. Certainly, he would not want to under-emphasize the importance of those factors or the dangers they involved. The dilemma of which Mr. Furth had spoken was a real and a difficult one.

It would be nice, Mr. Johns commented, if the Committee had a crystal ball that would show the future with such clarity as to insure where the economy was going. He did not disagree with the view that it could be helpful to the balance-of-payments situation, at least in the short run, if there could be such short-term rates in this country, led by the 90-day bill rate, as to reduce the incentive for so-called hot money to flee the country. If one could look and see with assurance whether the economy was going to expand and grow, with healthy and sustainable strength, then he supposed it would be reasonable to assume as a matter of course, at least based on experience, that there would be a movement of short-term rates that might be of considerable short-range benefit to the balance-of-payments situation. Conversely, if the economy should move in the other direction, an unwholesome situation could result, because lower short-term rates are generally associated with slackened economic activity. This was another way of expressing the dilemma of which others had spoken. He did not believe that monetary policy had the sole, or perhaps any major, responsibility for providing a solution to the balance-of-payments problem. Nevertheless, when he appraised the risk that monetary policy might have deleterious effects upon the

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balance of payments, at least in the short run, he came to the conclusion that the System should not gamble with tightening monetary policy that might inhibit the expansion of the economy at this particular point in time.

Mr. Balderston said he had approached the question of what open market policy would be appropriate for today by using the device of asking himself a series of questions, to most of which he found that the answers must be tentative in the absence of confirming data. His first question was whether the recovery had been in a period of hesitation recently, to which his answer was: possibly but not certainly, despite the general comment to that effect and a slight decline in the Board's index of industrial production. His second question was whether there were indications that the money supply was now responding to the introduction of reserves since February, to which the answer seemed to be in the affirmative, if one could rely upon the September increase in the active money supply of \$1.5 billion, even though the money supply seemed to have declined by a few hundred million dollars in the first half of October. His third question was whether the foregoing answer indicated that reserves needed to be supplied somewhat less rapidly to provide the same stimulus to the money supply and to the economy, to which he had answered: perhaps so, although further confirmation was needed. His fourth question was whether the transfer abroad of gold and dollars, plus the widened rate differential between New York and London, was serious enough to give concern. To this question his answer was in the

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affirmative. For this reason, he felt it would be desirable if the bill rate were to rise somewhat, even though a rise would not deter the outflow of long-term investment funds or cure the deficit in this country's basic balance of payments.

Mr. Balderston went on to say that from these questions and such answers as he could provide to them he had come to the conclusion, on balance, that he would aim for free reserves of around \$500 million, recognizing that the coming three weeks would have less float than the past three. It was his hope that this target might be achieved with some rise in the bill rates, since this was the period of the year when such rates were under seasonal upward pressure; he would expect the Account Management to use the special authorization to protect bill rates during the next two weeks when a large decline in float would need to be offset. Even though some change in target might be considered, he was impressed by the fact that any change today should be minor in order to preserve reasonable market stability during the Treasury financing that would occur between now and the next meeting.

In summarizing the meeting, Vice Chairman Hayes commented that there had been an interesting exchange of views and that it might be somewhat more difficult than usual to express the consensus. There were several difficult problems and the manner of looking at them varied considerably around the table. A majority appeared to feel, however, that the general policy the Committee had been following was

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appropriate from the standpoint of domestic conditions. There had been comments about the continued need for stimulation of credit expansion. There had also been comments about the general stability of prices, for the moment at least, but there had been warnings on both sides of the question as to what might lie over the horizon. Some had referred to the potential danger of inflation and others had suggested that the recovery movement might not be too strongly founded. However, those were more in the nature of longer-range considerations than matters of immediate concern. As to the period immediately ahead, there was recognition that the System should meet seasonal needs for reserves and also that the System should observe the usual attitude of helpfulness toward the Treasury's refinancing program.

Turning to international factors, Mr. Hayes commented that he would like to depart for a moment from his role as Chairman and say that personally he found it hard to go along with those who had expressed the view that because things that should be done to deal with the balance-of-payments problem in fundamental ways were not being done, the System had no responsibility to do anything. He recognized, of course, the argument that the System might create an impression that it thought it could do more through monetary policy than could actually be done, and that such an impression might contribute to a letdown in other efforts. Yet, in considering the whole problem, he thought that on balance the System would lose more by standing aside

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than by doing what it could to indicate that it saw some danger on the international horizon, even though admittedly the necessary things were not being done in areas such as cost stability or even cost reduction to improve the situation fundamentally.

Reverting to his role as Chairman, Mr. Hayes said he thought that at least a goodly number of those around the table had expressed some concern about the international problem and had recognized that there was perhaps something the System could do to help, in a minor way, to show that it was aware of the problem, without doing danger to the domestic economy.

In terms of monetary policy, Mr. Hayes said it seemed to him there was a close balance around the table as between those who would favor a little tighter policy, or at least the resolving of doubts on the side of less ease, and those who would make no change in policy. It was very close. Of the members of the Committee, however, he thought perhaps a slight majority veered toward resolving doubts on the side of less ease as compared with "staying exactly where we are."

As to the level of free reserves, Mr. Hayes noted that various figures had been mentioned. In this respect, it was again very close between "staying where we are" and "very slightly fewer."

When it came to short-term interest rates, however, a clear majority had said that they would be glad to see higher rates and that they would hope the Account Manager could do something in that

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direction. The expressions as to the bill rate had included "a little higher than at present" and 2-1/2 per cent, with some even suggesting a little higher than 2-1/2 per cent. In any event, the giving of some attention to short-term rates apparently was desired by a clear majority of those present.

It was quite clear also, Mr. Hayes continued, that a majority of the Committee wished to renew the special authorization to operate in longer-term securities. A few had spoken of the value of that authorization in helping to meet the various objectives that the Committee was trying to mesh.

Further, it was clear that the Committee did not want to make any change in the policy directive to the New York Bank at this time. There had been one or two comments on the possibility of discount rate action in the future, but a large majority would feel that no action along that line seemed appropriate at the present time. This was almost a unanimous feeling.

The foregoing, Mr. Hayes said, represented his effort at stating the consensus. He then inquired whether it was felt that the consensus had been presented accurately.

In the ensuing discussion Mr. Swan commented that he had been one of those who went along with the idea of resolving doubts on the side of less ease. This, however, did not mean that he would favor a change of policy in the direction of tightening at this particular time.

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In reply to Mr. Swan, Mr. Hayes said he had not meant to infer that the consensus contemplated anything more than the resolving of doubts on the side of less ease. Turning to the matter of short-term rates, he said he thought a majority of the Committee members had expressed some interest in somewhat higher rates, and this point was confirmed by Mr. Sherman.

Mr. Hayes then inquired whether there were further comments on whether the consensus had been properly expressed.

Mr. Mills commented that the statement of the consensus was in conformity with his understanding of it, but that he would like to have recorded his dissent from the implementation of policy in the manner indicated by the consensus.

Mr. Hayes replied that he had up to this point meant to inquire only whether the consensus had been properly stated. He judged the Committee agreed that it had. Therefore, he would now ask whether anyone, in addition to Mr. Mills, wished to go on record as disagreeing that the policy implementation embodied in the consensus should be followed.

Mr. Allen said he agreed that the consensus was as stated and that it should therefore be followed. However, his own views were contained in the comments he had made earlier during the meeting.

Mr. Hayes noted that there was always an opportunity to vote on whether policy should be implemented along the lines indicated by the consensus. He inquired of Mr. Allen whether he wished to vote against

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the implementation of policy along the lines indicated by the consensus today, to which the latter responded that he was content to recognize that the consensus was as stated and to vote for its implementation. His own feelings would, of course, be recorded in the minutes.

Mr. Robertson said he felt that the consensus had been stated accurately. It was a question, in such event, whether a Committee member felt strongly enough to want to register a formal dissent against the implementation of policy along the lines indicated by the consensus. On this occasion, he did not.

Accordingly, it was understood that Committee policy would be implemented in the manner indicated by the consensus, as stated, and that Mr. Mills dissented for the reasons expressed in the statement he had made earlier during this meeting.

Mr. Hayes then stated that he understood the special authorization covering operations in longer-term securities would be renewed until the next meeting of the Committee, with Messrs. Allen and Robertson dissenting, and there were no comments to the contrary. He also understood that it was the unanimous desire of the members of the Committee to renew without change the existing policy directive to the Federal Reserve Bank of New York, and again there were no indications to the contrary.

Thereupon, upon motion duly made and seconded, it was voted unanimously to direct the Federal Reserve Bank of New York until otherwise directed by the Committee:

(1) To make such purchases, sales, or exchanges (including replacement of maturing securities, and allowing maturities to run off without replacement) for the System Open Market Account in the open market or, in the case of maturing securities, by direct exchange with the Treasury, as may be necessary in the light of current and prospective economic conditions and the general credit situation of the country, with a view (a) to relating the supply of funds in the market to the needs of commerce and business, (b) to encouraging credit expansion so as to promote fuller utilization of resources, while giving consideration to international factors, and (c) to the practical administration of the Account; provided that the aggregate amount of securities held in the System Account (including commitments for the purchase or sale of securities for the Account) at the close of this date, other than special short-term certificates of indebtedness purchased from time to time for the temporary accommodation of the Treasury, shall not be increased or decreased by more than \$1 billion;

(2) To purchase direct from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed in the aggregate \$500 million.

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

Votes for this action: Messrs. Hayes, Balderston, Irons, King, Mills, Mitchell, Shepardson, Swan, and Ellis. Votes against this action: Messrs. Allen and Robertson.

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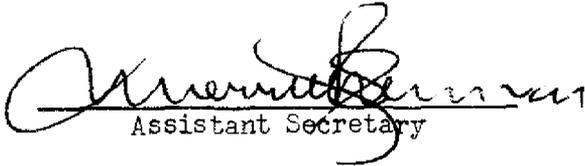
In response to an inquiry from Mr. Hayes, Mr. Rouse stated that he had no questions to raise concerning the directive to the Federal Reserve Bank of New York.

With reference to a comment made earlier during the meeting by Mr. Mills, Mr. Rouse said it was his interpretation of the special authorization covering operations in longer-term securities that in the event of a disorderly market he would, despite the existence of that authorization, come back to the Open Market Committee for instructions. He assumed that the Account Manager did not have authority under the special authorization to act in that kind of a situation.

It was agreed that the next meeting of the Federal Open Market Committee would be held on Tuesday, November 14, 1961.

There followed a brief discussion regarding the dates on which succeeding meetings might be tentatively scheduled in view of the Holiday Season. No decision was reached, however, and it was understood that the schedule would be considered further at the next meeting of the Committee.

The meeting then adjourned.


Assistant Secretary