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, December 19, 1961, at 10:00 a.m.

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

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

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

Mr. Francis, First Vice President, Federal Reserve Bank of St. Louis

Messrs. Coombs, Eastburn, Hostetler, Parsons, and Tow, Vice Presidents of the Federal Reserve Banks of New York, Philadelphia, Cleveland, Minneapolis, and Kansas City, respectively
Mr. Willis, Economic Adviser, Federal Reserve Bank of Boston
Mr. Arlt, Assistant Vice President, Federal Reserve Bank of St. Louis
Mr. Stone, Manager, Securities Department, Federal Reserve Bank of New York
Mr. Brandt, Assistant Cashier, Federal Reserve Bank of Atlanta

Upon motion duly made and seconded, and by unanimous vote, the minutes of the meetings of the Federal Open Market Committee held on November 14 and December 5, 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 December 5 through December 13, 1961, and a supplemental report covering the period December 14 through December 18, 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:

> Since the last meeting of the Committee, money market conditions have been relatively easy. Now that the concentration of pressures on the central reserve city banks has been relieved with the curtailment of dealer borrowing needs, we have had more symptoms of ease than we had earlier with the same level of free reserves. The ready availability of reserves during the first statement week of the period resulted in our selling bills in the 91-day maturity area in order to reduce the resulting downward rate pressure; in one case we partly offset our sales of bills by purchases of longer-term issues which happened to be in supply at the time. In the past few days, there have been less downward pressures

on bill rates, partly as a result of the sales we have made but also reflecting the caution which generally prevails around December 15 when considerable churning takes place in connection with tax and dividend payments. It is hard to predict the trend of bill rates for the eight remaining business days to the end of the year, but they could turn down again if the money market becomes easier. In past years money has continued in demand up to the last day or two of the year, but may not do so this year, i.e., in relation to free reserves, if free reserves remain at present levels. More likely, the problem of bill rates will be more acute after the first of the year when money conditions normally become easier and short rates tend to decline.

As to the longer-term market, psychology continues to lean toward higher rates as most developments in the news seem to point in that direction. Market prices have moved down only intermittently, however, as activity is very light and the market is so thin that prices are highly sensitive to influences of all kinds. Bank tax swapping has been unusually small as most banks have made this a profit year and are not in a position to take losses, but a sharp pickup in this kind of activity is expected by the dealers after the first of the year.

The corporate and municipal markets have been stronger in the past few days and yield spreads between corporates and Governments are quite narrow. In the corporate area the calendar of forthcoming new issues is very light and dealers have been able to dispose of a number of recent sticky offerings by lowering prices, so that their inventories are considerably reduced. The municipal market is getting a boost from the change in Regulation Q as we have reports of substantial purchases of municipal bonds by banks in order to cover the prospective greater earning needs.

Bankers' acceptances have backed up in dealer portfolios to the extent of about $104 million, mainly as a result of increases in other short-term rates and normal year-end influences. Although dealers raised the acceptance rates by 1/4 of 1 per cent in two steps, they are apparently not greatly concerned about their positions and expect the situation to straighten out after the year end; in the meantime, they are earning a good return on their holdings. They should be able to take events such as this in their stride as the bankers' acceptance market has been growing every year.

I should like also to mention that we will probably have a new name added to our dealer list in the near future. The Harris Trust and Savings Bank of Chicago has for some time been

considering establishing a dealer department and its directors last week authorized the management to take the necessary steps. This bank is one of the most active Midwestern dealers in municipal bonds, and has the experience and contacts to do a good job in Government securities.

Thereupon, upon motion duly made and seconded, the open market transactions during the period December 5 through December 18, 1961, were approved, ratified, and confirmed.

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

Most measures of economic activity showed improvement in November, as weather conditions were nearer the elusive normal, and industries directly and indirectly affected by auto strikes returned to full-scale operations. A part of the month-to-month improvement must be attributed to the fact that activity in September and October was held back by special circumstances, but even after allowing for some spill-over from this source, the November volume is impressive.

Retail sales were up 3-1/2 per cent--led by a 12 per cent gain in autos, but other sectors also showed improvement.

Industrial production was up a point in the final calculations, with the prospects for another one or two point increase in the current month.

New orders for durable goods were up moderately, despite a big drop in aircraft, and unfilled orders rose further.

One exception among the gains was a drop back to a 1,350,000 annual rate in housing starts. But this series has moved very erratically since its inception, and little significance should be attached to a single month's change, one way or the other.

As mentioned at the last meeting, there was a significant improvement in unemployment for the first time in over a year, as the rate dropped from 6.8 per cent to 6.1 per cent. It is interesting to note, however, that the underlying figures do not support as significant a month-to-month change as the overall percentage might suggest. First, it must be borne in mind that this is a period when actual unemployment normally rises, and the better showing in November reflects to some extent the

fact that seasonal layoffs were less than normal. Furthermore, the figure was unquestionably influenced by the substantial increase in the armed forces, and the fact that fewer women and teenagers appear to have entered the market for pre-Holiday jobs. Thus, we cannot assume that the months ahead will necessarily see a continuation of such rapid improvement, even if aggregate output continues to expand at relatively high rates.

In terms of gross national product, it now seems likely that the fourth quarter will equal or exceed the $540 billion rate that represented the upper limit in projections earlier in the year. In other words, despite strikes and other temporary setbacks, the economy as a whole has performed up to the most optimistic expectations. This high level of operation has, of course, affected current expectations, and business optimism with respect to the outlook for 1962 has picked up considerably in recent weeks. However, the growing optimism does not seem to be reflected in dramatic upward revisions of spending plans for next year. The results of the Commerce-S.E.C. survey of plant and equipment expenditure plans, announced shortly after the last meeting, provide an excellent example of the moderation that seems to prevail within the framework of a generally optimistic outlook. Seasonally adjusted expenditures in the first quarter of 1962 are expected to be up only $600 million from the current quarter--substantially less increase than might be associated with normal growth. Similarly, while consumer buying intentions six months ahead, as collected on a week-to-week basis by Sindlinger, are up somewhat, they are not high in relation to other recent years.

This leads me again to the observation that, while the improvement in the economy is widespread, it is proceeding at a reasonable pace and there are, as yet, none of the signs of stress and strain that are typical of an inflationary and nonsustainable boom.

For confirmation or refutation of this tentative conclusion, it seems to me that price developments provide the best evidence. Given the fact that the economy has expanded rapidly and evenly and that it shows every sign of continuing to expand at satisfactory rates, the major question which remains is whether inflationary price pressures are either present or imminent.

With this thought in mind, I have made some effort to review not only the recent behavior of the broad indexes of wholesale and retail prices--which generally cover the period up to mid-November--but also the current composites on commodity prices and the developments in specific commodity markets as well.

Relying on the more comprehensive weighted indexes through November, it seems safe to say that there was no significant

price movement one way or the other for that month. While some wholesale prices went up--notably steel scrap--others went down and most were unchanged. All the various indexes appear to yield the same conclusion--including, for example, the index of prices paid by farmers prepared by the Department of Agriculture, an index that is not often used in general analysis but which seems in retrospect to have been a pretty good indicator of the balance of inflationary and deflationary forces in the economy.

For the period since the beginning of December, one is forced to rely on less satisfactory composites of commodity prices of one kind or another. While these do not provide a comprehensive measure of general price movements and are not weighted to reflect the relative importance of the components, it is not unreasonable to assume that they would almost certainly reflect any broad shift toward inflation or away from it. The Dow-Jones commodity indexes show spot prices about steady in December, following a not inconsiderable rise in November. The futures index has generally declined since early December. The shifting relationship between spot and future in the last six or eight weeks would suggest, if anything, the reverse of a spreading inflationary psychology; that is, futures were running above spot prices in October, and they have recently been well below. The Associated Press 35 key commodity index moved downward from October to mid-November and has since inched upward a little, but it is still below the early October level.

A dogmatic conclusion as to whether there has been some subtle change in the tone of markets in the last week or so is obviously impossible. The bulk of evidence seems to me to rest heavily on the side of continued price stability. If some people are buying in anticipation of rising prices, recent market behavior suggests there are also plenty of ready and willing sellers at current levels. Of course, this situation could change, and change very quickly. The important point seems to me to be that it still exists in the face of ten months of vigorous recovery and generally optimistic expectations as to the future. To those who allege that a relatively easy monetary policy has overstayed its welcome in this recovery, a short reply might be that stable prices are awfully good company.

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

Advances in interest rates, which were pronounced in November, continued during the first half of December. To a

large extent, these advances may be attributed to customary seasonal factors and to the transitory effect of sharp reductions in the greatly extended positions of dealers in Government securities. To some extent the rises in rates have reflected expectations as to future trends, based on evidences of improved economic conditions, the anticipated effect of raising the time deposit ceiling, and greater awareness of persistent underlying forces in the balance-of-payments situation.

The actual basic demand and supply factors in credit markets and the application of official monetary policies have not been important contributors to the rise in interest rates. Credit expansion has been moderate and reserves have been available in amounts adequate to cover more monetary expansion than has occurred. Banks have had relatively large amounts of excess reserves, borrowings at the Reserve Banks have been small, and rates on Federal funds have actually declined in the past two weeks.

Yields on Treasury bills and those on the longest-term Treasury bonds have risen to the highest levels since mid-1960. Rates on bankers' acceptances and on finance company short-term paper have been raised. Yields on medium-term Government securities, however, are generally not as high as they were at times last summer. Yields on corporate bonds and on long-term State and local government issues have also remained below levels of a few months ago. However, some of the recent new issues of corporate bonds, which were offered in large amounts in November, have had to be marked down below original offering prices before they could be satisfactorily distributed by underwriting syndicates.

Dealers' positions in Government securities, which had been enlarged by about $2.5 billion, or more than doubled, from early September to mid-November, were reduced by about $2 billion in the latter part of November and the first week of December. These shifts in positions were mostly reflected in changes in dealer borrowings at commercial banks. Total holdings by dealers were brought back down close to the level of early December last year. In the past few days they have increased somewhat, and they may increase further, as is usual in December. Although dealers' positions in longer-term bills continue larger than at most times in the past year, their positions in short-term bills are moderate, and holdings of issues maturing in over a year are now smaller than they were in December 1960.

Information available as to bank credit developments in the first half of December is not adequate to provide a clear

indication of trends. On the basis of partial data for December 13, it appears that city banks showed little change in their holdings of Government securities and a further decline in loans to dealers in Government securities. Loans to other dealers in securities, however, have increased further, extending a rise that occurred in November and that reflected an increase in customer debit balances at brokers to a new high level. Banks also added further to their holdings of other securities in the first half of December. Changes in loans to businesses have been relatively small, considering the imminence of the December tax and dividend payment period.

U. S. Government deposits at banks have declined to a relatively low level, while private deposits have shown a rising tendency, with rather wide week-to-week variations. On a daily average, seasonally-adjusted basis, it is estimated that the demand-deposit component of the private money supply increased in the first half of December, approximately offsetting the decline in the second half of November. The estimated money supply, at $144.4 billion, is about 3 per cent above the level of a year ago, but only slightly above the previous peak reached in mid-1959. Time deposits have increased further. Shares at savings and loan associations have also increased substantially in recent months and the total outstanding is about 16 per cent larger than a year ago, showing about the same rate of increase as time deposits at banks.

Available information as to liquidity in general indicates that in the past year consumer holdings of liquid assets have increased substantially, both in absolute terms and relative to incomes. At the same time, consumer indebtedness has apparently not increased as much as income. Thus the financial position of consumers has improved. Liquidity of businesses, however, may actually have lessened some, although late information is not readily available. Nevertheless, with increasing profits and growing depreciation allowances, cash flows of business promise to be adequate in the months ahead to finance a large part of the moderate increase in capital expenditures now planned. With increased sales, however, these plans might be enlarged, and working capital needs might also increase.

System action can be highly influential, if not decisive, in determining the degree of liquidity available to the economy as a whole. Bank reserves have continued to be available--as has been the case for over a year and a half--to support an expansion in required reserves at an annual rate of 5 per cent.

Since more of the expansion has occurred in time deposits than in demand deposits, the annual rate of increase in total commercial bank credit has exceeded 7 per cent. Economic activity--or gross national product--has increased in the past year at about the same rate and is now at a new high level.

Consideration will need to be given to the question whether bank credit should continue to be so readily available. With prospects, as well as capacity, for continued expansion in economic activity in the months ahead at almost the same pace as in the past year, some further bank credit and monetary expansion is surely needed and desirable. Yet inducements for speculative tendencies and other excesses in the use of credit are more likely to develop, and the imposition of some degree of restraint on the rate of expansion may soon be desirable. This Committee has the specific responsibility for deciding what volume of reserves will be made available to banks for further unrestrained credit and monetary expansion.

Moderation of inducements for banks to expand credit may be exercised by slowing down the increase in reserves supplied by System open market operations. This would involve some change in the guides to operations from those presently in force. Over the past year, System actions have been guided by the two aims of fostering monetary expansion without reducing interest rates; the result has been to supply all the reserves wanted by banks as long as the Treasury bill rate was not reduced. The specific guides have appropriately been free reserves and short-term interest rates. Operations under this policy, along with the economic climate that existed, have resulted in the credit expansion that has occurred.

To impose some restraint in expansion would call for a deliberate policy of reducing the amounts of reserves supplied through open market operations in the future. If, to meet credit demands, banks should need or desire reserves in larger amounts than are supplied, they would have to increase their borrowings at the Reserve Banks. This would impose some restraint on expansion. The specific guide to operations should be total reserves--or nonborrowed reserves--rather than free reserves or interest rates, unless credit demands fall short of expectations and free reserves tend to accumulate and to bring down interest rates.

Computation of the staff projections of prospective needs for reserves to be supplied by open market operations have been altered to provide for an annual rate of increase of 4 per cent in required reserves against private deposits, instead of the

5 per cent that has characterized the past year. The 4 per cent figure would allow for an expansion in demand deposits of 3 per cent a year and in time deposits of 8 per cent, or some other combination within or around that range. Although some slowing down in the growth of time deposits from the rapid rate of the past year (around 15 per cent) seems reasonable, yet with a rise in the rates of interest paid by banks on time deposits, a fairly high rate of expansion in such deposits is likely to continue. Under the circumstances, an 8 per cent annual rate of expansion seems moderate.

If funds are drawn from other savings institutions into time deposits at banks, there would be some net reduction in total credit availability because of the reserves that banks would need to set aside. In this case, reserves should be made available to cover the additional requirements. To the extent that the funds are drawn from demand deposits at banks, reserves would be released and total potential credit expansion increased.

With continued expansion in economic activity, some moderate increase in demand deposits would presumably be needed. Allowance for reserves to be supplied through open market operations to meet a growth rate of 3 per cent in demand deposits, along with an increase of 8 per cent in time deposits, should be a reasonable minimum. Any additional needs or wants could be obtained through member bank borrowing at the Reserve Banks. Under the economic climate likely to prevail in the next year, banks would probably be willing to borrow for such purposes.

To carry out a policy of providing reserves for moderate expansion while restraining excesses, System operations would need to be conducted more directly toward regulating the total supply of reserves, with less emphasis on free reserves. Interest rates would move in accordance with the volume and strength of credit demands relative to reserves available. In view of current economic prospects, the reserve availability suggested might be expected to result in a moderate rise in short-term interest rates. If credit demands become vigorous, the rise would be more pronounced and more general.

Mr. Furth presented the following statement with respect to the international financial position of the United States:

The international financial position of the United States has not changed much for the last three weeks, and certainly

not for the better. The November deficit in the balance of payments, even if it is adjusted for transactions that do not affect the basic balance, is at least as large as, and quite possibly larger than, the October figure of $450 million, and available fragmentary data for the first half of December indicate a continuation of the November trend. The second half of the month will bring the usual seasonal respite. In fact, the year-end payments of foreign countries to the U. S. Treasury may be larger than usual if the Germans make this month their first payment under a new agreement designed to lighten the burden of our foreign military expenditures.

Neither has there been any drastic change in economic conditions abroad. Our export prospects may have improved a little in view of a continued upswing in a few major industrial countries, including Germany and Japan, in which previous reports had indicated an end of the boom.

The most promising international financial development, apart from the agreement with Germany on military expenditures, has been an agreement among the major industrial countries, scheduled to be ratified later this week by the Executive Board of the International Monetary Fund, under which the resources of the Fund will be replenished, mainly (if not exclusively) to provide for the possibility of a large U. S. drawing. U. S. participation in this agreement will require action by the Congress, as the U. S. has promised to contribute $2 billion to these resources, although at present the possibility of the IMF running out of dollars seems remote. While the agreement does nothing to correct the U. S. balance-of-payments deficit, it would help to defend the dollar against a sudden crisis. Unfortunately, the procedures needed to activate the replenishment of IMF resources will be more complicated and time-consuming than originally envisaged. The agreement, therefore, would not remove the need for a first line of defense through central bank cooperation.

In response to a question, Mr. Furth said that according to statistics compiled by the Council of Economic Advisers, it appeared that approximately three-fourths of this country's foreign aid program (recently at an annual level of about $3.6 billion) was reflected in subsidized exports. Thus, perhaps $2.7 billion out of total exports of about $20 billion could be regarded as subsidized.

Mr. Hayes presented the following statement of his views with respect to the business outlook and credit policy:

In the interest of brevity and in view of the fact that we met only two weeks ago, I shall say very little about the domestic business and credit situation. Recent data on increased production, retail sales, business spending plans, and residential construction, and reduced unemployment, all point to a good business expansion, but without any signs of over-exuberance--although there is a possibility that hedging against a steel strike may lead to an abnormally rapid build-up in steel inventories. The November statistics on total bank credit and on bank deposits were quite satisfactory, and bank liquidity is still ample despite a small decline last month.

Unfortunately the balance-of-payments situation appears even less favorable than at the last few meetings. The deficit of $550 million in November was about $100 million higher than in October--and if we exclude subscription payments to the International Development Association and the Inter-American Development Bank, the November deficit of $490 million contrasts with $340 million in October and about $300 million on the average in the third quarter. It looks as if the fourth quarter might easily show a deficit of $5 to $6 billion (annual rate), while the figure for the year as a whole, exclusive of special debt repayments, may be as high as $3 billion. The excellent export figure for October provides only very moderate comfort in the light of these statistics, for it points to a heavy outflow of capital, which is probably continuing. I was disturbed by press reports to the effect that high Administration officials expect a $2 to $2-1/2 billion deficit in 1962. I understand that the poor showing for the current quarter is causing considerable apprehension among foreign central bankers and other officials. Furthermore, as the foreign exchange markets become more fully aware of the deterioration of our position, we can expect more or less serious speculative reactions. In these circumstances, it seems to me essential that our Government have as a firm objective a very sharp cut in the over-all balance-of-payments deficit next year, perhaps to around $1 billion.

With the growing strength of the domestic economy reducing the risks of unfavorable repercussions of a move to somewhat less ease, I think we can well afford to give greater weight now to international considerations. I would like to see the

90-day bill rate maintained close to the upper level of the 2-1/2 to 2-3/4 per cent range we have been seeking; and a Federal funds rate in this neighborhood also seems desirable. In view of the psychological effects of the commercial banks' prompt reaction to the Board's move with respect to Regulation Q, and in view of the churning and seasonal pressures characteristic of the next couple of weeks, we may well be able to achieve these goals without reducing average free reserves much below $500 million; but I would be quite prepared to see them around $400 million if this should prove nesessary to keep adequate pressure on the bill rate. There might even be some positive advantage in breaking away from the $500 million figure which has unfortunately become something of a fetish in the minds of many observers. Continued use of the special authorization should prove helpful over the next few weeks.

While there is no need to change the discount rate, I should like to repeat the suggestion we made in mid-November with respect to the directive--a suggestion which now seems all the more appropriate in view of the substantially more cheerful domestic outlook and the further deterioration in the international situation. My suggestion would be that the words "to encouraging credit expansion" be replaced with the words "to providing reserves for further credit expansion," thus making clear that we no longer believe it is necessary to push so hard to enlarge the credit base. At the same time I would substitute the phrase "giving special attention to international factors" for the present phrase, "giving consideration to international factors."

In reply to a question, Mr. Furth said that recent deposits of U. S. dollar funds by U. S. companies with Canadian banks, which relend these funds through their New York agencies in the U. S. money market, had exerted an influence on the balance-of-payments figures for November, although these funds actually never left the U. S. economy. Abstracting such transactions, the November deficit might have been closer to $400 million than $550 million. However, a $400 million deficit would still be in the neighborhood of the October figure.

Mr. Hayes said it was his understanding that the amount of short-term funds going to Canada was in the neighborhood of $100-$150 million, monthly rate. In his judgment, this did not differ essentially from a short-term capital outflow to any other country.

Mr. Bryan said that all of the charts of Sixth District activity were pointing upward, with the exception of department store sales, and many of them spectacularly. Even the department store sales figures were contradicted by broader measures of retail sales. One principal series that was moving down represented improvement, namely, the decline in insured unemployment.

For some time, Mr. Bryan recalled, there had been a feeling that the Committee ought to be watching for a sharp change in the economic situation. He felt that the Committee was now alerted. Total reserves in November were well above the long-term 3 per cent trend line, about $250 million, and in his opinion total reserves were the appropriate measure at the present time. Not only had reserves been in ample supply, perhaps in excessive supply, but the banking system seemed to be reasonably liquid and capable of financing a satisfactory expansion. In the light of that circumstance, he believed that the System ought to supply reserves merely in accordance with seasonal variations and an extraordinarily modest growth factor, if any. He certainly would not put that growth factor at over a 3 per cent annual rate. The country might run into a boom that would cause the System, later on, to be

compelled to clamp down on the brakes severely, and he believed it would be better to tighten gradually at the present time. Free reserves should be allowed to fall where they would in the light of the total reserve situation, handled in the way he had suggested, and the System should be prepared to think shortly of an increase in the discount rate.

Mr. Bopp said that the Third District unfortunately was not moving up spectacularly, and not nearly as well as the country as a whole. Turning to the national economy, he commented that if the current movement continued, excess capacity could be wiped out relatively quickly, with resulting pressure on prices. At the moment, however, there appeared to be no stresses or strains. Therefore, thinking in terms of the period immediately ahead, he felt that a continuation of existing policy would be appropriate. He would not change the directive or the discount rate at this time, and he would renew the special authorization covering operations in longer-term securities.

Mr. Fulton reported that Fourth District business indicators were uniformly steady or on the plus side, now that steel was in production not only for automotive takings but inventory building. On the whole, however, the improvement in the District was occurring at a gentle pace. The rate of employment had been affected favorably by continuation of good weather conditions.

Mr. Fulton expressed the view that the present level of bill rates was satisfactory and that the System should continue to supply reserves, although not in the quantities that they had been supplied. He would favor free reserves of around $450-$500 million if that would yield about the present level of bill rates. He would not change the directive or the discount rate at present, and he would continue the special authorization.

Mr. Mitchell expressed agreement with the comments of Messrs. Bopp and Fulton, although in his opinion this might be a good time to change the directive. He indicated that he would subscribe to the changes in the directive recommended by Mr. Hayes.

Mr. King suggested bearing in mind that the country was experiencing a fairly heavy Holiday buying season, following a year in which consumers had been quite restrained in their purchasing. He did not think that the Committee should hasten to change policy merely on the basis of the Holiday buying spree. Rather, it should wait until January or February 1962 and see whether the pace of spending continued. In the absence of a change in policy, he saw no real merit in changing the words of the directive at this particular time, since that might only cause specualtion and misinterpretation when the Committee's policy record was published. If the Committee actually changed policy, that would be a different matter.

Mr. Shepardson commented that economic activity appeared to be experiencing a considerable upturn. This might reflect, as Mr. King had suggested, largely a Holiday boom, but in his opinion a general upturn was occurring. He was pleased by the staff suggestion that the growth rate of total reserves be slowed down to a 4 per cent rather than a 5 per cent target. Personally, he would be inclined to feel that the growth factor could well be reduced to 3 per cent. With a change in the target for growth, it would seem to him that the change in the directive suggested by Mr. Hayes would be appropriate. It was important that attention continue to be given to the bill rate, and he felt the objective should be to hold the bill rate in the upper part of the 2-1/2 - 2-3/4 per cent range.

Mr. Robertson said he found himself in general agreement with Mr. Bryan's comments. The Committee had been alerted, and the time had come to switch directions and start trending, ever so slowly, toward a less easy position. He would not urge any considerable shift. However, he would suggest that the Committee take its sights off of free reserves and bill rates, and merely be more restrictive in the amount of additional reserves provided. This being his view, he would doubt the wisdom of changing the directive at this time.

Mr. Mills said that he had been struck by the staff's lyrical panegyric on economic prospects and the possible development of monetary policy. His own comments would be more elegiac, but in

keeping with Mr. Bryan's reasoning, and would offer concrete proposals to accomplish definite purposes. Mr. Mills then presented the following statement:

> Any further policy actions to attempt to obstruct a groundswell strengthening in interest rates will court future difficulties arising from spreading confusion in the securities markets and a growing speculative and inflationary ferment that is gradually taking hold in the market places. As I have repeatedly stated, recognition of basic economic developments and the adoption of a suitable monetary and credit policy is long overdue. Fortunately, the difficult December tax and dividend payments period has been passed without market incident and the way is now clear to move to a monetary policy that will moderately restrain the further expansion of bank credit so as to allow only for some accommodation for bank financing of the Treasury's imminent cash financing. As far as bank loans are concerned, ample leeway is available for increasing that sector of credit by substituting loans for investments in U. S. Government securities that are presently held in bank portfolios in a total amount that carries inflationary implications. In the process of replacing U. S. Government securities with bank loans, the resulting upward pressure on interest rates will help to confirm an upward movement that has already been in evidence in the weekly Treasury bill auctions and throughout the entire list of U. S. Government securities.
>
> In view of the Treasury's approaching cash financing and subsequent refunding operations, it is vitally important that the securities markets be conditioned in advance to a somewhat higher level of interest rates. Therefore, although it would be technically preferable to wait for the new year before asserting a tighter monetary policy, the short time before the Treasury's January financing leaves no choice but to move now toward confirming Federal Reserve System approval of a higher interest rate structure. Having done so, market participants will be able to bid for the Treasury's new offering after some experience with higher rates, and with confidence that completion of the Treasury's nearby financing operations will not be followed immediately by a System policy action induced tightening of the money market and a consequent reduction in the prices of U. S. Government securities. Presumably, a further lapse of time would then be unavoidable before any additional overt policy actions for influencing higher interest rates could be undertaken.

Patently, time is of the essence in reorienting the existing monetary and credit policy in the direction of moderate restraint. The kind of monetary policy contemplated would also serve to fix short-term interest rates in the United States at a level that might be high enough to attract foreign investment and possibly encourage a return flow of gold. However, what I consider as having been an unpardonable delay in pursuing that objective has permitted distrust in the exchange value of the U. S. dollar to grow and will consequently vitiate counteroffensive interest rate efforts to stem the loss of gold from this country. Reliance on collective central bank and International Monetary Fund actions to protect the U. S. dollar should have been reserved for secondary emergency application and not suggested for continuing use, in that public notice of resort to these media will be regarded by cynical investors as acts of desperation and not as curatives to temporary problems of international currency imbalances.

The discount rates of the Federal Reserve Banks should be raised to 3-1/2 per cent at the time that market rates will have adjudged the appropriateness of such action. Conventional treatment should be accorded any disorderly market conditions that may develop in the U. S. Government securities market. Renewal of the special authority to operate outside of Treasury bills is in order, except that transactions should be limited exclusively to U. S. Government securities within a maturity of two years.

Mr. Wayne said that the level of short-term rates in recent weeks seemed to him fortunate and appropriate. While that level was some 25 or 30 basis points above the level prevailing six weeks ago, it still was low enough to encourage a growth of bank credit sufficient to allow business expansion to continue and at the same time was high enough not to encourage the outflow of short-term funds. This higher level of rates had been caused by several factors, perhaps the most powerful of which, since the preceding Committee meeting, had been the effects of the change in Regulation Q upon expectations. One enigma facing the Committee was the continuing effects of this change in the Regulation.

With respect to the domestic economy, Mr. Wayne said he felt, as he had for some time, that there were no clear indications of any need to lessen ease. At the same time, however, business expansion apparently had acquired enough momentum so that it could continue even with the higher rates that had prevailed recently. For the next three weeks, he would favor putting primary emphasis on the bill rate. He would not want to see that rate fall below 2-1/2 per cent and would like to see it move in the range between 2-1/2 and 2-3/4 per cent. If the effects caused by the change in Regulation Q should decline or wear off, then the large return flow of currency and the small seasonal decline in interest rates that normally begin early in January might allow the bill rate to be maintained at the desired level with somewhat smaller free reserves than in recent weeks. If that should happen, it would afford an opportunity to lower free reserves well below the $500 million level to which the market seemed to attach so much importance. The next few weeks would seem to be an appropriate time to carry out such exploratory operations if conditions should make them possible.

Mr. Wayne concluded by saying that he would not favor changing the discount rate and that he would renew the special authorization. Some revision in the directive might be desirable, and he was favorably disposed toward Mr. Hayes' recommendations.

Mr. Clay noted that economic information that had become available since the Committee meeting two weeks ago gave confirmation to the

widespread economic advance that appeared to be under way. It seemed to be essentially the type of development that had been hoped for, and one that the System should encourage to continue in order for the economy to reach a desirable level of activity. Moreover, price developments were favorable, and private demands for credit were moderate.

Accordingly, Mr. Clay felt that monetary policy should remain essentially unchanged. In fact, an indication of a change in System policy so soon after confirmation of the upward movement in activity, following the lull of early fall, and with substantial gains still to be realized, would be unfortunate. Within the framework of the same basic policy, the Committee should continue its watchfulness of the Treasury bill rate with reference to the international flow-of-funds problem. No change seemed called for in the discount rate. In whatever form the directive might be adopted at today's meeting, there would seem to be no need to alter the substance of the (b) clause of the present directive, and the authority to operate in longer maturities should be continued.

Mr. Deming commented that both the nation and the Ninth District seemed to be closing out 1961 on notes of economic exuberance. Aside from the balance of payments and a still high level of unemployment there appeared to be little but good economic news for the nation. In the District, only the continuing effects of farm drouth and depressed iron mining marred the business picture. In November, city

bank business loans showed only the usual seasonal drop, while the dollar volume of country bank loans rose more than in any previous November since World War II. Both of these developments were in sharp contrast to the record of the previous four to five months. It remained to be seen whether they represented merely a temporary reaction or more permanent strength.

Mr. Deming then referred to analyses made by the Minneapolis Bank concerning the amount of credit expansion that would be consonant with current economic developments. From them he concluded (1) that in this thrust the broadly-defined money supply had been permitted to increase significantly more in relation to the gain in gross national product than in the two previous thrusts, and (2) that bank loans could increase significantly more than they had so far without putting any great pressure on the banking system. Therefore, it seemed to him that credit policy could move into a posture of less ease without much danger of producing an aborted boom. The position of the dealers had improved significantly, so there would seem to be no great danger of producing market knots by reducing credit ease. The balance-of-payments position argued for a less easy credit policy, and he believed it was now time to move gently but more positively toward such a policy.

Specifically, he would favor a policy prescription of less ease and would implement it with a program keyed to total reserves, with allowance for a four per cent growth rate, as indicated by the staff

memorandum. He would like to abandon free reserves as a policy guide, expecting free reserves to move lower if credit demand should press harder against available reserves--either because of public or private credit demand--but not attempting deliberately to push them lower. This policy, he believed, should call for a change in the directive. He would not favor a change in the discount rate at this time, and he would renew the special authorization.

Mr. Swan said that from the comments already made, with which he was in agreement, the country seemed to be experiencing a fairly substantial business expansion while at the same time there had been no significant strains and pressures on resources and prices. Also, although this could be ascribed to market processes rather than specific policy actions, there had been some increase in the short-term rate structure. This, he thought, was a good thing. However, this situation, in the face of the still rather moderate credit demands, seemed to him to imply a need for no more than a very slight further tightening in the next three weeks, if any change at all. Already the bill rate was close to 2-3/4 per cent. While he agreed that it would be desirable to keep the bill rate in the upper part of the 2-1/2 - 2-3/4 per cent range, he did not feel that the System ought to do anything to push the rate up further until market forces moved in that direction, if they did. While free reserves might not necessarily have to be looked at as a definite guide, he thought it quite possible that they might be around $450 million,

rather than above $500 million, in the weeks ahead even with the bill rate around present levels.

In the circumstances, Mr. Swan said, he would not change the discount rate at this time. As to the directive, he liked the word "providing" rather than "encouraging" when referring to further credit expansion. In one sense, that reflected what had been gradually emerging in the past several weeks. However, he would not be inclined to substitute "special attention" for "consideration" of international factors. He would continue the special authorization.

Mr. Irons said he felt the economy had clearly moved out of the recovery stage into an expansionary stage. If one traced the movement that had taken place from the trough of recession to the present time, he would see that most major economic indicators showed rather substantial growth. It seemed to Mr. Irons a satisfactory growth. Further, the movement of the economy during the past few weeks perhaps made credit policy formulation a little easier; both the expanding domestic economy and the international situation suggested a moderate firming of policy. Although he would not advocate strong overt action, he would permit the market to firm moderately. His thinking would be in terms of a bill rate near or at the upper limit of the prevailing range, a Federal funds rate in the same area, and some increase, perhaps, in member bank borrowing according to seasonal demands. He would not provide additional reserves in substantial amount. The result might be a free reserve level of around $400 million.

What he had in mind, Mr. Irons said, might be characterized as a gradually shifting policy rather than a shifting policy. In fact, it seemed to him that over the past several weeks the Committee, without so stating, had been more or less shifting from active encouragement of credit expansion to a slightly firmer policy. He would not favor a change in the discount rate at this time, he would like to see interest rates move up a bit if the market moved them up, with no deliberate forcing action on the part of the System, and he would continue the special authorization covering operations in longer-term securities.

Mr. Irons went on to say that, while he did not know whether there would be any opportunity, in the process of absorbing reserves in the weeks ahead he would not be averse to doing a little bit of absorbing outside the bill area, if market conditions permitted, just to let it be known that the special authorization was not a one-way street under all circumstances. He had believed at the past couple of meetings that a change in the directive would be appropriate, feeling that although there may have been no perceptible shift, enough shading away from the posture of a few months ago had occurred to indicate some change in policy. He indicated that while he did not feel strongly about it, he would prefer a change in the directive and would accept the New York suggestion. At year end, he felt that the Committee must expect the Account Manager to be influenced by the tone and feel of the market.

To sum up, however, he would lean in the direction of permitting the market to firm itself a little, in light of the forces that were now in operation.

Mr. Ellis said he thought the preponderance of evidence confirmed the view that business expansion was proceeding satisfactorily. In New England, as elsewhere, sales, new orders, and inventories were up, and employment and income were rising. This expansion apparently was being stimulated by monetary policy. As he looked over the figures, he was impressed by the fact that much of the money supply increase had occurred since last summer; that in the past few months the increase had been more rapid than earlier in the year. Member banks, with a liquid asset position substantially above any fourth quarter level for at least the past eight years, apparently were in a position to meet prospective credit demands without difficulty. Given that situation, the question was whether the System should continue to support business expansion through monetary ease in the absence of evidence of an abuse of credit facilities. Speculation was not evident except perhaps in the case of steel inventories, prices were relatively stable, there was unused labor and plant capacity, and prices were not yielding to upward pressures. Nevertheless, he would favor a shading toward a lessening of monetary ease; in other words, a reduction of pressure on the accelerator. Continuation of a monetary policy developed to combat recession seemed questionable at a time when economic expansion was well under way. In

fact, the System may already have overstayed its position of ease. In his view, monetary policy should precede a change in prices rather than view them as good company.

In January and February, Mr. Ellis pointed out, the Treasury would be undertaking first a new cash offering and then a refunding, and any change in Federal Reserve policy would have to come before those operations were in process. He liked not only Mr. Thomas' analysis of the situation but also Mr. Hayes' prescription of policy, with one possible exception. There was now a short-term rate differential, on a covered basis, in favor of New York as against London. Accordingly, while the System should be vigilant, it might no longer be necessary to exercise the same degree of restraint in the bill market. In looking at participation figures, he was a little concerned that in some recent weeks the Federal Reserve's proportion of total dealer transactions in securities other than bills had been quite large. Therefore, he would suggest relying primarily on bill transactions and to a lesser extent on transactions in other securities. However, he would not be averse to accepting the suggestion of Mr. Irons. If there was a chance to sell securities other than bills without dominating that part of the market, that would be agreeable to him.

Mr. Ellis concluded by saying that if the directive should be changed in the way Mr. Hayes had suggested he would expect bill rates to be in the upper part of the 2-1/2 - 2-3/4 per cent range, Federal

funds to be close to the bill rate, and free reserves to be nearer $400 million than $500 million. He would not change the discount rate until short-term rates moved up further.

Mr. Balderston said he found the analysis presented by Mr. Thomas persuasive. The time had come, it appeared, for a shift in the direction of policy. He would hope, however, that the Committee would make the change gradually, that it would not take overt actions, and that insofar as possible it would let the market take the initiative in the tightening or restraining process. If the consensus of the meeting was as he judged it to be, it would seem proper to reflect that consensus in a change in the directive.

Mr. Baughman, who was called upon by the Chairman at this point in the absence of Mr. Allen, reported that business activity in the Seventh District was about as described at the December 5 meeting, with automobiles and steel continuing in the limelight. It was reported by steel companies in the District that orders were coming in at a rather spectacular rate, and comments were heard of plans for some kind of allocation program if the present rate of orders continued into next year. Sources in the auto industry indicated that reported sales for November were somewhat overstated, but that this was being made up in the reporting of sales for December. In other words the pickup in November was not as great as previously reported. Department store officials in the District were feeling mildly distressed because sales

in this type of retail outlet compared relatively unfavorably with sales nationally and compared with two years ago. There was no evidence from the data on bank loans of any substantial pickup in the demand for loans. However, in interviews with loan officers, several had indicated recently that some evidence of a strengthening of loan demand was beginning to appear.

Mr. Francis, who was called upon in the absence of Mr. Johns, said he would align himself with those who had expressed a desire for a 3 per cent annual rate of growth in total reserves over the next few weeks. Such a rate would be somewhat greater than the rate of growth of total reserves in the comparable periods of the 1954-55 and the 1958-59 business cycles, and this, he thought, would be appropriate.

Chairman Martin recalled that at the past several meetings he had prefaced his comments by saying that he thought System policy was evolving satisfactorily. He continued to think so. He questioned whether the situation had really come to the point where a significant change of policy was required. His thinking was a little at variance with some of the comments made today, for a couple of reasons. First, although he was not against tightening, he would like to see the market itself do the tightening. The factor of strong loan demand was not yet in the picture; the banks were still hoping and still talking about it, but it had not yet really appeared. Also, the period around the end of the year was in his opinion about as poor a time as could be selected to

make any overt change in policy or even imperceptible changes. He would hope that the System would not get itself in the position, following the increase in the maximum permissible interest rates on time and savings deposits, of being charged with causing the commercial bank prime rate to be increased at this particular juncture. If market forces produced this result, that would be a different thing, and he thought that they would. Accordingly, believing that the market would tighten on its own accord, he saw no gain in taking overt action. Seasonal pressures had moved the bill rate up recently, quite apart from System activities, but shortly after Christmas the rate would start trending downward. In the light of international conditions, he would hope that the Committee could concentrate on not letting the bill rate slide off seasonally. That might require some activity that would lead to a lower level of free reserves. Only when it was clear that the forces of the market had tightened would he be prepared to go along with an increase in the discount rate; there must be a conditioning period prior to such an increase. Despite the prospective Treasury financing, the January 9 Committee meeting would in his thinking be a much better time to determine, in light of the seasonal return flow of currency, whether to absorb more than usually would be the case, or less.

Chairman Martin noted that there had been some comments during the go-around about the special authorization covering operations in longer-term securities, and that this led into the question of the

Committee's operating procedures, which had been scheduled for discussion at this meeting. The Committee might want to arrive at a consensus on policy for the next three-week period, renew or modify the existing policy directive, and renew the special authorization, but it might prefer to discuss first the statements of operating policy and the form of the directive.

The Chairman commented, in this connection, that everyone had given much thought to the question of operating procedures, as indicated by the numerous comments and suggestions that had been received by the Secretary. In his own thinking, he said, he was more or less persuaded by the position of those who had suggested termination of the three statements of operating policy which referred to the objectives of monetary and credit policy, the confining of operations for the System Account generally to short-term securities, and the preclusion unless expressly authorized by the Committee of transactions for the purpose of altering the maturity pattern of the System's portfolio by means of offsetting purchases and sales of securities. A difficult public relations climate existed at the present time, and he was inclined to believe that a changing of words in the statements of operating policy would be subject to more misinterpretation than abandonment of those statements. A case could be made that the operating policy statements had been virtually essential in the transition from a pegged market to a free market in Government securities, and that for the first five years or so of a free

market they were almost necessary to the reconstitution of the Government securities market. Since that time, however, there may have been a real question whether the depth, breadth, and resiliency of the market was being furthered or not by the existence of these provisions. There were still some schools of thought that fed material to the press on the subject of the depth, breadth, and resiliency of the market. One or two writers tended to pick up this line, and various people in the market fostered it. Whether they were right or not, he did not know; there was some question in his mind. However, the market seemed to be getting along all right at present. Possibly, of course, the System eventually would have to take over the market in entirety, but the System had been operating in it reasonably successfully. This he did not think that any thoughtful person could properly deny.

One might have various predilections, the Chairman observed. However, he felt that it would subject the Committee to less risk of misinterpretation simply to take the position that the special authorization for operations in longer-term securities was given in February of this year, the Committee had experimented over the balance of the year, the Committee had not come to any clear conclusions, and the Committee would endeavor for a while, at least, to get along on the basis of having meetings at three-week intervals, at each of which it would establish a directive to the New York Reserve Bank and a framework within which open market operations were to be conducted.

The Chairman noted that the Committee had been giving a great deal of latitude and leeway to the Account Manager. The Committee had considered various possibilities for giving more specific instructions. In his opinion the Committee must give the Manager a certain amount of latitude, but it might be, as time went on, that a more satisfactory method of issuing instructions could be evolved. There seemed to be almost a unanimity of opinion today in wanting to give up the concept of free reserves as a guide, yet it was not easy to give up that concept because the public had gotten so attached to it. The point he was driving at was that if the Committee should terminate the statements of operating policy, it could start over again with a clean sheet of paper.

The suggestion had been made, Chairman Martin noted, that the Committee might experiment with having the Committee Secretary, the Account Manager, and the Committee Economist sit down immediately following each meeting to draft a current economic policy directive, which would be submitted within the next day or so to the Committee members for comment and would be finally approved at the following meeting of the Committee. This would place a heavy burden on the staff, and an additional burden on the Committee. However, it probably was not feasible for a large group of people to draft a directive around the table at each meeting.

Also, the Chairman said, it was necessary to face the fact that the drafting of the Committee's policy record entries was again about six months in arrears. That was not a good position for the Committee to be in, and some procedure should be worked out whereby the preparation of the policy record entries would be kept current.

The Chairman said that he thought the Committee was fairly close together today in its views on policy for the forthcoming period, although there were some questions of emphasis. There were some who would not want to make any change in the degree of ease at this particular time. He (Chairman Martin) certainly would not want any aggressive easing or aggressive tightening. He was concerned about the bill rate, and about the handling of the market in such manner as to minimize overt actions in light of the pressures that he thought were going to develop.

After commenting on certain developments in corporate finance that might have been contributing to the moderateness of loan demand at this particular juncture, the Chairman commented that he would have no objection to changing the policy directive in the manner suggested by Mr. Hayes.

Mr. Balderston made the comment at this point that although he did not want to anticipate the discussion of operating procedures, it might be, as the Chairman had intimated previously, that the Committee would like to consider making, effective with this meeting, a change

in the form of the directive. If this was so, perhaps the consideration of the revised clause (b) suggested by Mr. Hayes should be deferred.

There ensued a discussion of the procedure that it would seem advisable to follow at this meeting, during which the Chairman referred to material that had been distributed to the Committee by its Secretary. This included, under date of December 8, 1961, a collation of comments received from eleven Reserve Bank Presidents on the draft standing rules and directives of the Open Market Committee that had been circulated under date of September 6, 1961; a check list of specific issues raised in response to the September 6 drafts; and a version of the September 6 draft of standing rules that incorporated editorial and minor substantive changes suggested by Committee members and others, and considered by the Secretariat to be noncontroversial. Also, under date of December 13, 1961, there had been distributed to the Committee a revised draft of continuing authority directive to the Federal Reserve Bank of New York.

Chairman Martin then suggested that the next order of business be a go-around of comments on the basis of the material that had been distributed, and it was agreed that this procedure would be followed.

Accordingly, the Chairman first called upon Mr. Hayes, who stated that he had a great deal of sympathy with what the Chairman had said about the desirability of getting away from the formal statements

of operating policy. He was inclined to agree with the thought that perhaps the best disposition of the matter would be to abandon the operating policy statements. If that were done, he noted, there would be the question of what to do about publicizing the matter. Certainly, there ought to be a clear statement in the policy record of the Open Market Committee concerning the reasons for the action. In the thought that it might be helpful, the New York Bank had drafted some language for this purpose and would transmit it to the Secretary for consideration.

Continuing, Mr. Hayes said it seemed to him, as it apparently did to the Chairman, that at the time the Federal Reserve was getting away from pegging the prices of Government securities the statements of operating policy probably served a useful purpose. However, times and circumstances change, and the greater frequency of meetings of the Open Market Committee had altered the situation somewhat. As he had said many times, he was concerned that the existence of the operating policy statements might put the Committee in a box. The Committee ought to have a concern for a well-functioning Government securities market, but he did not think that this concern should ever be built up to a point where it took precedence over the primary responsibility for the formulation of monetary policy. There were new problems in the international field that might make flexibility even more important in the future. Whether one liked it not, there were going to be serious international problems to cope with for some time to come, and this prospect alone suggested maximum flexibility of action.

If the Open Market Committee should decide to terminate the operating policy statements, Mr. Hayes said, it might nevertheless be a good idea to state for the record that the Committee believed in certain basic principles; for example, that it had no intention of returning to a system of pegging and that, although it was a legitimate function of the central bank to have an interest in interest rates, they should reflect the decisions of market forces. Also, it should be made clear in explanatory material that there would be no change in the Committee's policy of conducting open market operations during periods of Treasury financing in such manner as to change as little as possible prevailing money market conditions. It occurred to him that it might be desirable to have explanatory material on reasons for dropping the operating rules not only in the policy record but in the Federal Reserve Bulletin. The language should be carefully worked out, and the full Open Market Committee should have a chance to review any explanatory statement before it was finalized.

Turning to the directive, Mr. Hayes expressed agreement with the proposal for a separation of the directive, as it now existed, into a continuing authority directive and a current economic policy directive. He had no changes to suggest in the draft of continuing authority directive that had been distributed most recently by the Secretary. As to one question raised by that draft, it was his opinion that the continuing directive should authorize the purchase,

under repurchase agreements with nonbank dealers, of United States Government securities having remaining maturities of 24 months or less, rather than the 15 months or less that had been specified in an earlier draft.

Mr. Hayes noted that the Open Market Committee had tried to use clause (b) of the present directive both as an instruction to the New York Bank and as the basis for its published policy record. In his opinion the form of directive that had been used was deficient in both respects. It had been necessary to develop alongside clause (b) a consensus of each meeting as a guide to the Desk. This consensus, and not the broad statement in clause (b), really provided the guide to the Management of the Open Market Account in conducting open market operations during the ensuing period. It would be his suggestion, in effect, that the consensus become the current policy directive. Further, the shortcomings of clause (b) as a vehicle for communicating to the Congress and the public had been pointed up in memoranda from Messrs. Knipe and Broida of the Board's staff and in the recent report of the staff of the Joint Economic Committee. The major cause of the deficiency was that clause (b) was so general and compressed in form that it could not reflect many subtle shifts of emphasis in the development of policy. To overcome this deficiency, he would favor experimentation along the lines that the Chairman had mentioned. Along these lines the New York Bank in its memorandum of

November 3, 1961, had suggested that provision be made for the adoption, for each meeting, of what it had referred to as a statement of general policy position. The inclusion of such a statement in the policy record, along with the current policy directive, would help to provide an adequate record showing the Congress and the public what the Committee's policy had been and how it had developed.

As to the current policy directive, Mr. Hayes said he believed it would be a mistake to try to include quantitative guides. Generally speaking, he felt that the directive should be in terms of more ease or less ease. When appropriate, reference might perhaps be made to items such as the bill rate or the feel of the market, but he would avoid making the directive a quantitative measure having any degree of strictness. That would be likely only to create new difficulties for the Committee.

As to the procedure for developing such a directive, Mr. Hayes felt that the Committee could properly request the Secretary of the Committee, the Manager of the Open Market Account, and perhaps the Committee Economist to get together after each meeting, draft a directive couched, generally speaking, in terms of more or less ease, together with a draft statement of operating rationale, and submit the draft promptly, say the following day, using leased-wire transmittal in the case of the Reserve Bank Presidents. The Secretary then could obtain comments and approval, and the approval could be ratified at

the next Committee meeting. He would favor the idea of getting approval promptly, while the matter was still fresh in the minds of the Committee.

Mr. Balderston said he had been impressed by the careful thought reflected in the letters from the Presidents. Also, although the members of the Board had not submitted letters or memoranda, they had been in touch with the Secretary and had submitted ideas to him. In view of the work and analysis that had preceded this meeting, he would personally be prepared to move ahead on the basis of the latest revised draft of continuing authority directive that had been distributed by the Secretary and on the basis of the suggestion of Chairman Martin that the statements of operating policy be terminated.

In order to provide a focus for the discussion, Mr. Balderston said he would propose that the current form of directive to the New York Bank be abandoned and that instead there be two separate directives. The first would be a continuing authority directive in the form distributed by the Committee Secretary under date of December 13, 1961. The second would be the current economic policy directive, which would be drafted after each Committee meeting by the Secretary, the Economist, and the Manager of the Open Market Account. The draft would be forwarded promptly, within the day if possible, for confirmation by the voting members of the Committee. The current directive then would be in such form as to be included in the Annual Report of the Board of Governors to the Congress.

Mr. Ellis expressed agreement with the proposal outlined by Mr. Balderston. He recalled having expressed in his written comments on operating procedures the feeling that the operating policy statements might best be left in suspense and that the Committee should operate as it had for approximately the past nine months. As to the continuing authority directive, he agreed with the draft distributed under date of December 13, 1961. Mr. Hayes had suggested that the continuing directive should authorize the purchase of Government securities, under repurchase agreement, having remaining maturities of 24 months or less. He (Mr. Ellis) had suggested in his letter 18 months or less, but this was not too important and he had no strong feeling.

Mr. Ellis said he had been impressed by the Committee's difficulty in using clause (b) both to reflect changes in the economic situation, as the Committee saw them, and to reflect shifts in the emphasis of monetary policy. He did not think that both things could be done adequately in one phrase. Therefore, he was anxious to see the Committee develop a current economic policy directive that would permit it to recognize changes in the effect of credit policy, as applied to the economy, and also to state how the Committee wished open market operations to be conducted in the ensuing period. A move in the direction he had in mind would be aided by the separation of the continuing authority directive and the current economic policy directive.

Mr. Ellis said he would like to suggest again that it might be helpful for the Committee to have before it at each meeting some suggested language for the current economic policy directive. This would provide a pattern for the discussion around the table in much the same way that Mr. Balderston's proposal had provided a background against which comments could be made during the discussion now taking place. Accordingly, he would suggest asking the staff to prepare in advance of each meeting one or two versions of a current economic policy directive. He was pleased with the suggestion that a final directive be drafted immediately following each meeting by the Committee Secretary.

In summary, Mr. Ellis said, any move that the Committee might make to separate the continuing authority directive and the current economic policy directive in such manner that the latter could fulfill the two purposes he had mentioned would in his opinion be desirable.

Mr. Irons commented that he could see the problems involved in the development of statements of operating policy that would be generally acceptable at this time, as contrasted with the conditions that prevailed when the existing statements were first adopted. At that time there was need for operating policy statements that were rather rigid and restrictive. Conditions had changed, however, and there was now a need for greater flexibility. As between a rigid statement of operating policies that would limit the Committee's

flexibility and abandonment of such rules, he would lean toward the latter course. In his written comments on an earlier draft of standing rules that had been distributed by the Secretary, he had suggested broadening them in a few places to cover what it seemed to him the Committee had actually been doing. His concern was illustrated by the statement in the draft of standing rules dated December 8, 1961, that "open market operations are conducted to supply or absorb bank reserves consistent with the credit and monetary needs of the United States, in the light of both the domestic economy and international developments." Such a statement might have been appropriate when the statements of operating policy first went into effect, but he questioned whether it was appropriate now. The Committee had engaged in operations for other purposes arising out of the international situation. As he had said, as between a rigid statement and no standing rules at all, he thought that he would favor the latter. This would, of course, throw an increased burden on the Committee at each meeting, for it would have to decide, in effect, what the rules were going to be until the next meeting.

As far as the continuing authority directive to the New York Bank was concerned, Mr. Irons said that basically he was not sure that he saw much difference in the need for such a directive and the need for standing rules. In other words, he was not sure that there was too much reason for having a continuing authority directive to the

New York Bank. There might be times that such a directive would be too rigid. If there was to be a continuing authority directive, however, he would not object to authorizing purchase of Government securities, under repurchase agreement, having remaining maturities of either 18 months or less or 24 months or less.

Turning to the current economic policy directive, Mr. Irons noted that it had been felt for public relations purposes that such a directive was a good thing to have. He did not think personally that it was necessary, with the Account Manager sitting in the meetings and hearing the full discussion. However, it was hard to make a convincing case to an outsider. This led him to favor a current policy directive that would be fairly specific; he did not think that he would favor a directive couched just in terms of more or less ease. Figures were not too good either, but it would seem better to have a few figures than for the Committee to become involved in arguments about whether there should be more or less ease. He did not know whether the Committee actually could do much better than it had done. The directive would simply represent a boiling down of all that had been said around the table. Possibly, however, there would be some public relations value in composing and approving a current policy directive for each meeting.

Mr. Irons said he would not favor the suggestion that the staff be requested to submit draft language for the directive in advance. He felt that this might have a poor public relations effect. Instead, the directive ought to be developed out of the discussion at the

meeting. In going around the table, the Committee ought to arrive at a decision as to what the current policy directive should be for the period ahead. Then, although he was not sure that the procedure would work effectively, the Committee might authorize the Secretary, the Manager of the Open Market Account, and perhaps some other staff person or persons to put down, not in one or two pages but in two or three paragraphs, some coverage of the economic situation, along with the consensus on policy for the period ahead.

Mr. Swan recalled that in his written comments he did not argue specifically for elimination of the statements of operating policy. Since that time, however, he had found himself questioning some points in the draft of standing rules that had been distributed. The draft was well drawn, but if it was a matter of choice between what had been drafted and having no operating policy statements, he would favor the latter course. He would not want to create an impression that the Committee was, so to speak, amending its constitution. As an example of the questions he would have regarding the standing rules, as drafted, he noted that the most recent draft would state that "although operations in United States Government securities are ordinarily conducted in short-term issues, the Committee may authorize transactions in all maturities when desirable because of economic or financial conditions." It would be his preference to turn the statement around and say that "operations may be conducted in all maturities, but

ordinarily are conducted in short-term issues." If that thinking were carried further, it would result in a choice between a very general set of standards and the elimination of the statements of operating policy. If they were eliminated, then as Mr. Hayes had mentioned, there were a few principles that he would like to have on record somewhere. At the same time, he would not want to have so many documents that it would be difficult to keep track of them. Therefore, if the operating policy statements were to be eliminated, he wondered if some basic principles such as he had in mind might not be incorporated in the continuing authority directive.

Mr. Swan said he would favor having a separate continuing authority directive. He would have no quarrel with the draft distributed under date of December 13, 1961, except that in it there appeared at several places the words "except as otherwise authorized," and he questioned the inclusion of such language.

Mr. Swan went on to express the view that the Committee might be running into the danger of trying to accomplish too much in the current economic policy directive, and possibly confusing this directive and the policy record. He wondered about the possibility of hindsight criticism of the current directive if it was too detailed, yet the purpose of a directive is to direct. The directive should reflect what was now expressed in the consensus, and if some quantitative measures were included, he

did not think that that would be objectionable. This would provide a more sensible directive, and one that would avoid the criticism that the Committee's directives did not mean anything. Therefore, although the directive should not be too elaborate, he would not hesitate to include some quantitative expressions and provide a true directive rather than a review of the economic situation.

On the manner of formulation of the directive, Mr. Swan indicated that he would be concerned about having one or several draft directives prepared in advance. This procedure might lead to criticism. While he doubted that the specific wording of the directive could be hammered out around the table at each meeting, he felt that the directive could be drafted after the meeting, distributed, and approved quickly enough so that it would actually be a directive for the succeeding three weeks. If the steps he had mentioned could be completed by the day following the meeting, he would consider such a schedule satisfactory.

The preparation of the directive should not be confused with the writing of the policy record entry, Mr. Swan noted. The policy record entries should be written separately. It would be desirable, of course, if the Committee could receive drafts of the policy record entries promptly, and reach agreement on them. He assumed that it would be intended that the policy record would be

published only in the Annual Report of the Board of Governors, but he felt that the release of some kind of information more frequently than once each year would be desirable. What he would have in mind would be a rather extensive discussion, and not the same thing as the policy record prepared for purposes of inclusion in the Annual Report.

Mr. Mills said that it was his disposition to be slow to change and that he would leave substantially as they stood both the present directive and the statements of operating policy. The directive was valuable, as the public and persons in academic life had become accustomed to it. Clause (b) of the directive was of special importance because changes in it reflected the judgments of the Committee and the direction of policy in a very important and desirable way. If the Committee went over to an amorphous general policy, it would be too easy for the Committee to hide behind generalities and not give a clear report to the Congress on what it had done and the reasons. As to the statements of operating policy, they might best stand in their present form, with continuation of the special authorization covering operations in intermediate- and longer-term Government securities, except that in his opinion the terms of the special authorization should be modified. In this connection, Mr. Mills presented the following statement:

From observing the results of conducting open market operations in U. S. Government securities other than Treasury bills, matured conclusions have been reached:

(a) Operations in longer-term securities, in particular long-term bonds, have been harmful rather than helpful and should be discontinued.

(b) Operations in short-term securities of maturities of two years or less have had limited success in achieving the objectives sought after and could be continued experimentally for another year.

The objections to operating in longer-term securities focus on the false market expectations and damaging consequences that have resulted from these transactions. By the end of the year it seems clear that the market has come to regard operations in bonds and other longer-term U. S. Government securities as patent efforts to support the market rather than as a means of influencing interest rates. The obvious fact that long-term securities acquired by the System Open Market Account have been very largely retained sustain the market's belief and give rise to the complaint that abstention from supporting purchases is allowing the market to drift uncontrollably. All in all, the System's longer-term securities transactions have set the stage for a full-fledged pegging operation that will ultimately burst from its chrysalis full-grown, unless discontinued promptly. Any economic benefit to the flow of funds that is inherent in longer-term operations is so obscure at best that the disadvantages of engaging in this speculative attraction far outweigh any presumed advantages.

The limited success achieved from operating in short-term securities attaches largely to the influence such transactions have had in holding up the short-term interest rate structure for balance of payments reasons. Even in this respect, the benefits obtained may have been illusory to the extent that System Open Market Account short-term transactions outside of Treasury bills have interfered with and delayed market adjustments inevitably required to reflect the changing character of economic, domestic, and international financial developments. However, further experimentation in open market operations in short-term U. S. Government securities is a reasonable attempt.

The great objection to System open market operations in both long- and short-term U. S. Government securities, other than Treasury bills, is that they have the effect of impairing the usefulness of the U. S. Government securities

market as a sounding board for recording economic and financial movements that should be recognized by appropriate monetary and credit policy treatment. Operations confined to Treasury bills previously permitted the market to reflect the economic responses that monetary and credit policy formulation must take into account.

In the light of the background outlined, the general wording of the directive to the Manager of the System Open Market Account should not be changed nor should the operating procedures be altered, other than to allow continued operations in short-term U. S. Government securities up to maturities of a two-year maximum.

Mr. Mills asked that there be recorded in the minutes his dissent from the implementation of policy according to the consensus of this meeting, as that consensus was suggested earlier by Chairman Martin. He also would dissent from the change proposed by Mr. Hayes in the wording of clause (b) of the directive, for he did not think that it reached the nub of the situation.

Mr. Mills then withdrew from the meeting.

Mr. Deming expressed the view that the Committee should abandon the statements of operating policy and that this action should be accompanied by an explanatory article setting forth the reasons. He would hope that such an article could include what might be termed a broad-gauged explanation as to how a central bank operates. As he had said in his written comments, he did not see how the Committee could rewrite its operating policy statements without the disadvantage of having to explain the changes. Therefore, he would favor elimination of the stated operating policies.

As to the current policy directive, Mr. Deming said his thinking would start with the premise that the major difficulty had resulted from lack of adequate current explanation of what the Committee was doing rather than from a lack of explanation to the Desk. In his belief, there was need for a quarterly article in the Federal Reserve Bulletin stating authoritatively what the System had been trying to do. This article would not need to be official in the sense of being signed by the Open Market Committee, but it should be authoritative. This would conform generally to the practice followed in many other countries.

As to the content of the current policy directive, Mr. Deming suggested that it be relatively simple so that the directive could be voted upon rather easily. If the directive included a lot of specifics, it might be difficult to come to any agreement. He would not have any particularly strong objection to writing a directive at this juncture in terms of total reserves, but he would not necessarily want to continue on that basis over a period of time. If there could be an improvement in public understanding about what the directive meant and how it was voted upon, then he thought it could be constructed in rather simple terms. The most feasible procedure might be to cast the directive in terms, generally speaking, of more or less ease or about the same degree of ease.

Mr. Deming said he would endorse Mr. Hayes' suggestion for a statement of general policy position, which would put a little flesh on the bones of the current policy directive. This statement need not be long; it could be as brief as the samples Mr. Hayes had submitted. If the Committee could vote on a relatively simple current policy directive, and there was also a statement of general policy position, he felt that its record would be in reasonably good shape.

Mr. Deming indicated that he was quite satisfied with the draft of continuing authority directive that had been distributed under date of December 13, 1961. He had no strong feeling on whether the continuing directive should authorize the purchase of securities, under repurchase agreement, with maturities of 15 months or less or 24 months or less. As to procedure, he suggested that the continuing directive could be adopted at each meeting of the Committee. In the alternative the continuing directive could remain outstanding until the Committee wanted to change it. In any event, he saw no need for inclusion of the phrase "except as otherwise authorized" at several places in the draft directive. If the Committee wanted to make a change in the directive, that could be done at any meeting.

With respect to the mechanics of drafting the current policy directive, Mr. Deming expressed the view that it was highly

important that the drafting be done promptly and that action by the Committee be taken as quickly as possible. He would prefer, if possible, that this action be taken on the day that the Committee met. In many cases, he thought, the drafting of the directive would not be too complicated. Where the drafting was complicated, there might be difficulties involved in attempting to obtain approval by mail or wire. In his opinion, therefore, the Committee should try to have a relatively simple current policy directive and a statement of general policy position drafted during a recess following the first part of each Committee meeting, with the thought that in most cases the Committee could reconvene after lunch and take action.

Mr. Clay noted that he had stated in his written comments that he would prefer to continue to have standing rules covering open market operations. His basic reason was that he thought the Committee must consider around the table the hard problem of broadening the scope of its standing rules. He felt definitely that the Committee should adopt a more flexible approach, not only in view of the balance-of-payments problem but also the problems of the internal economy. To face the need for a more flexible approach, he had thought that perhaps it would be a good idea for the Committee to apply itself to a broadening of the standing rules. On the other hand, the proposition of a more flexible approach

perhaps was agreed upon generally. On that assumption, he would say that the statements of operating policy were put into effect under conditions different from those now existing, that the Committee did not really need them in its continuing operations, and that he would be willing to abandon them.

Mr. Clay expressed the view that a continuing authority directive along the lines of the most recently distributed draft might well be in order. As to the separate current policy directive, he felt that this was going to require quite a bit of experimentation on the part of the Committee. Many terms were used in discussion that had different shades of meaning to each individual. In time the Committee might arrive at a better ability to communicate its instructions to the Desk, but there would no doubt be a difficult period involved. Nevertheless, he felt that the Committee ought to attempt it; the Committee ought to try to give the Desk somewhat more definitely an indication of its feelings. Perhaps, also, the Committee should experiment with a procedure such as had been suggested by Mr. Deming. This could involve some difficulties, but it might well be worth while.

Mr. Wayne said that he would favor the continuance of standing rules, for the reason that rules actually would exist whether the Committee formally adopted them or not. He recognized the difficulty of operating under such rules and would prefer in theory

to abandon them. However, the Open Market Committee was an agency of such importance that before long he felt it would be called upon by some committee of the Congress to state its principles. Thus, he felt that it would be better if the Committee had something that might be called standing rules. These could provide for alternative methods of operation to the extent feasible.

Mr. Wayne indicated that he concurred in the suggestion that it would be desirable to publish an authoritative article quarterly on the direction in which policy was moving and the reasons. He also concurred in the suggestion that the staff might be requested to prepare some possible language for a current policy directive in advance of each meeting of the Committee as the basis for discussion. Today both Mr. Noyes and Mr. Thomas had made suggestions in their statements regarding the policy that might be appropriate for the period ahead, and he saw no difficulty in asking the staff to spell this out in words that could be used as a basis for discussion.

Mr. Wayne also indicated that he would favor a separate continuing authority directive, which seemed to him essential from the standpoint of the New York Bank. As to the current economic policy directive, he felt differently from some of his colleagues. In his opinion the directive was valuable primarily from an historical standpoint and not as the basis on which the Open Market Account was managed, and it should be so written.

Mr. Robertson said he was inclined to agree generally with the view that there were going to be standing rules of some kind in any event. There could be formally-adopted standing rules, or the various rules could be dealt with at each meeting of the Committee, but there must be some rules or the Committee would be abdicating its responsibility by turning the whole job over to the Management of the Account. The "rules," of course, could be put into the continuing authority directive. In either way, i.e., using standing rules or incorporating them into a continuing authority directive, the objective of greater flexibility could be achieved.

Mr. Robertson expressed agreement with the suggestion that there be a separation of the continuing authority directive and the current policy directive. As to the latter, it seemed to him that the Account Manager should not be asked to share in the responsibility for the drafting, on the theory that it would be inappropriate for the person to whom the directive was directed to participate in formulating it. Instead, the drafting ought to be done by the Committee Secretary, with the assistance and advice of such other Committee staff as the Secretary might desire to use. The current policy directive would be a reflection of the consensus reached by the Committee at each meeting, and in his opinion it would be unwise to have the confirmation of the directive delayed

for three weeks. Consequently, he agreed that the drafting of the directive should be done promptly and that action on the directive should be part of the Committee's job before each meeting adjourned.

Mr. Robertson also expressed the view that the Committee's operating rules, whether they were contained in standing rules or in the continuing authority directive, ought to achieve as much flexibility as seemed desirable. In his opinion that flexibility had been achieved in the drafts of standing rules and continuing authority directive that had been distributed to the Committee. While there were parts of the drafts with which he would not agree, he thought they did achieve flexibility. As he saw it, there must be some rules with respect to matters such as swap transactions, pegging operations, and the conduct of open market operations during periods of Treasury financing. As drafted, the continuing authority directive would permit transactions in securities of any maturity. To that he would object simply because, as the Committee was aware, he had objected to the so-called "Operation Nudge." In this connection, Mr. Robertson presented the following statement:

> The so-called "Operation Nudge" has not been successful in achieving the twin goals of pushing up short-term rates and pushing down long-term rates. If the operation had been pursued to the extent necessary to achieve those twin goals, its defects would now be obvious. The deleterious effects of such operation upon the long-term market for Government securities will become more apparent when the

Treasury seeks--as it some time must--to extend the maturity pattern of the Federal debt by attempting to sell long-term securities for cash or in exchange for maturing securities.

Furthermore, while it is possible for the Federal Reserve to acquire long-term securities during a period such as 1961, when Treasury financing was chiefly short-term, without immediately and clearly impeding Treasury operations, the sale of such securities by the Account would present real problems. Such selling action on our part would not only absorb long-term funds from the limited supply, but would also aggravate the uncertainties which already plague the long-term market, weakening its supporting structure and attenuating its appeal to investors.

I cannot foresee any time, when monetary policy would be calling for the sale of securities to absorb reserves, that such longer-term securities could be sold from the Federal Reserve's holdings without impairing the ability of the Treasury to lengthen the maturity pattern of its publicly held securities. This would be unfortunate, in view of the real need for the Treasury to achieve a more manageable maturity distribution of the public debt.

For these reasons, I believe the special operation--"Operation Nudge"--should be terminated forthwith.

In further comments, Mr. Robertson said he felt that the Committee ought to reserve in its rules the right to change them at any meeting for any purpose. There should be a rule on swap transactions. That might be included in the continuing authority directive, with greater flexibility, but it should be there in some form. With respect to repurchase agreements, he would continue to object to making loans in the guise of repurchase agreements to nonbank dealers at lower rates than loans could be made to member banks. However, the rule could be as flexible as the Committee wanted.

Mr. Shepardson said that in general he would favor the suggestion that the Committee do away with the statements of operating policy. However, he thought that Mr. Robertson had made a point. On some matters there were guidelines, written or unwritten, that would continue to be in everyone's mind. At some future time it might be desirable to try to reformulate some general principles, for there must be some guidelines in one form or another. In his opinion, however, the difficulty involved in trying to explain changes in the statements of operating policy at this time would be greater than the difficulty involved in terminating those statements.

With regard to the continuing authority directive, Mr. Shepardson said he would agree with the suggestion that the Committee take a look at the directive at each meeting, even though it might not want to make any change. As to the current policy directive, he thought it important that the Committee try to develop more of an explanation than it had heretofore made. He would have in mind a directive that would provide some basis for explanation to people outside the System and that also would be an effective instruction to the New York Bank. A point that impressed him was that the Committee had a responsibility to give the New York Bank and the Account Manager some instruction that both the Account Manager and the Committee could check on reasonably. For that

reason he would feel that the current policy directive should be expressed more definitely than in terms of greater or lesser ease. Recognizing the difficulty of using target figures, it seemed to him that the Committee would have to develop something tangible enough so that the Committee, the Account Manager, and the general public could appreciate what was being done. As had been suggested today the kinds of figures used in the directive could be changed from time to time depending on the prevailing circumstances, but he was inclined to feel that some figures should be included. Further, he would like to have the directive incorporate a summary statement of basic economic conditions. The directive should be prepared promptly, and he would be inclined to favor a procedure under which the Committee would recess and reconvene after lunch to adopt the current policy directive.

Mr. King said that the arguments for and against discarding the operating policy statements seemed to him very nearly in balance. He could convince himself either way without difficulty. In his opinion, however, there would be an adverse psychological effect from dropping the statements of operating policy entirely at this time. Accordingly, with emphasis on the psychological effect that he foresaw, he would prefer to retain the standing rules and broaden them as necessary. Although he was not entirely happy with that conclusion, it was the conclusion to which he felt that he must come.

Mr. King indicated that he would favor the adoption of a continuing authority directive. As to the current policy directive, he said that he had always been dissatisfied with the (b) clause in the present form of directive. He would hope that the Committee could use some quantitative guides, with variations from time to time. As to procedure, he concurred in the suggestion that the whole process of drafting and adopting the current policy directive should be completed before each Committee meeting adjourned.

Mr. Mitchell said he had been impressed by the comment that if the Committee did not have formal statements of operating policy, it would nevertheless have some kind of rules, possibly by inadvertence. If an article was published in the *Federal Reserve Bulletin*, perhaps that would be the new dogma. Personally, he would want to have a set of standing rules.

As to the continuing authority directive, Mr. Mitchell indicated that he would have no objection to any of the suggestions that had been made on that score. As he saw it, the current economic policy directive was the crux of the problem. The views of the Committee members might be stated in all kinds of ways, but the Manager had to leave each meeting with an impression of what the Committee wanted. The Chairman tried to lighten that burden by stating a consensus, yet the Account Manager could not help but be influenced by what had been said around the table. For example, for the past several meetings he

(Mr. Mitchell) had said that he would not rock the boat, that he would avoid creating any impression of a change in monetary policy. In his opinion that was enough of a directive under existing conditions. When it came to figures, every man sitting around the table would tend to use whatever figures he liked, and there might be some question as to the importance of these quantitative suggestions. It was important, he thought, to have the interpretation of the consensus put down in black and white promptly, and the Committee should remain in session until the job of adopting a current policy directive had been completed.

On the matter of attempting to state the reasons why the directive had been adopted, Mr. Mitchell commented to the effect that he would consider this an extremely difficult job, particularly if it was expected to be completed within a short period of time. Time was needed to think the matter over and look at the record of the meeting. On the other hand, the instruction to the Account Management had to be determined immediately. In his opinion, the Account Manager should participate in the preparation of the directive because it was his understanding of what the Committee had been saying that really counted. The problem of the directive was an important matter from the standpoint of public relations and also from the standpoint of the Committee's dealings with the Manager of the Account.

Mr. Fulton said that he would favor abandoning the statements of operating policy on the premise that they were conceived at a time when the System had stopped pegging the price of Government securities and at a time when the Open Market Committee was utilizing an executive committee. He noted that the opening paragraph of the proposed continuing authority directive would authorize and direct the Federal Reserve Bank of New York, to the extent necessary to carry out the current economic policy directive, to do certain things. If any unusual circumstances developed, they could be brought to the attention of the Committee by the Account Manager, and the Committee could write a prescription every three weeks, if it wished, to change the methods followed up to that time. Therefore, he would approve the continuing authority directive in the form of the draft distributed under date of December 13 and abandon the statements of operating policy.

Mr. Fulton indicated that he would favor a form of current economic policy directive that would include a brief reference to the economic atmosphere and then an instruction to the Management of the Open Market Account. In his opinion the staff presentations made to the Committee at the beginning of each meeting could be translated into brief form for presentation to the Committee at the time of each meeting. Then the Chairman could draw a conclusion regarding policy from the comments made around the table. With that background, he did not feel that it should be too great a burden for the Secretary to

develop language that the Committee could agree upon before the meeting adjourned as an instruction to the Account Management.

Mr. Bopp said that he would favor elimination of the statements of operating policy. He was impressed by the suggestion that an explanation be given concerning the reasons why the statements were initially adopted, why they were being eliminated, and what should not be inferred from their elimination. Such an explanation could also refer to certain basic principles under which the Committee operated, including the maintenance of an even keel during periods of Treasury financing.

With regard to the draft of continuing authority directive, Mr. Bopp indicated that he would favor elimination of the phrase "except as otherwise authorized" on the theory that the Committee could make such changes from time to time as it desired. With regard to the current economic policy directive, he envisaged that it might begin with a brief discussion of the economic environment, with the thought that growing out of that discussion would come the instruction to the Account Management. He would hope that different words might be used in the directive at almost every meeting; in his opinion the Committee had tended to keep clause (b) of the present directive unchanged for too long a time. He was somewhat concerned, however, that the Committee might get itself into a box if it emphasized in the directive any specific quantitative targets. The directive should be stated in terms

of goals that the Account Manager could reasonably be expected to achieve. On occasions the Committee might want to refer to some quantitative target or to indicate that the Manager should pay more attention than usual to some factor such as the bill rate. Generally speaking, however, while it was nice to be precise, he had some concern about the results of using quantitative targets. As to timing, he noted that the directive would not actually be a directive until it had been voted on by the Committee. Therefore, this should be done as part of the Committee's job at each meeting despite any inconvenience involved.

Mr. Bryan said that the two statements most nearly reflecting his own general philosophy were those of Messrs. Mills and Robertson. In regard to the statements of operating policy, he noted that the comment had been made several times that they had been evolved as a response to a special situation peculiar to the Federal Reserve System. In some ways that was a true statement; one could argue, therefore, that they were no longer necessary. The statements of operating policy, however, referred to a number of matters, some important and some relatively unimportant. In his opinion they should be considered not merely as a response to a particular situation in the Federal Reserve System, but in some sense as a sort of self-admonition, including an admonition to bear in mind one of the classical canons of central banking that nearly everyone had violated from time to time, to the

injury of self and country. The canon to which he referred was that a central bank should deal only in paper of short term and of unquestioned goodness. Accordingly, in the operating policy statements, the Committee indicated that it would deal in the securities that were most nearly the equivalent of cash. This rule need not always be adhered to rigidly, but it must be adhered to generally. The Bank of England had violated this canon from time to time, to the injury of itself and its country, and so had the Bank of France. During the 1920's the Federal Reserve System had gotten itself into trouble, and its country also, because the Reserve Bank discount windows were making capital loans under the guise of discounting eligible paper. Thus, the statements of operating policy were something more than an ad hoc response to a particular situation.

With regard to the current policy directive, Mr. Bryan said he agreed with the view that the directive should not be a command, only a target. Moreover, the directive, even as a target, would be meaningless if applied to so short a period as a week. From time to time various quantitative guides in the field of reserves might have considerable importance, and at other times they might have less importance. Essentially, however, it would be unfair to the Account Management and to the Agent Bank to issue a directive in terms of means that were not at their command.

The meeting then recessed and reconvened at 2:30 p.m. with the same attendance as at the conclusion of the morning session except that Mr. Mills was present and Mr. Bryan was not present.

Chairman Martin raised for consideration the question of procedure from this point. After some discussion, Mr. Balderston said that, as he had indicated earlier, he would be willing to put in the form of a motion a proposal that the Committee terminate the three statements of operating policy that had existed since 1953, discontinue the use of the existing form of policy directive, adopt a continuing authority directive in the form of the draft distributed by the Committee Secretary under date of December 13, 1961, and agree to the use of a current economic policy directive, which would be prepared and acted upon in connection with each meeting of the Committee.

Question was raised whether this should be understood to mean that the Committee would not have any formalized standing rules, and Mr. Balderston replied that this was correct. Chairman Martin commented that, as he understood it, the continuing authority directive would be essentially the statement of standing rules. Mr. Hayes noted, however, that although the draft of continuing authority directive dated December 13, 1961, would refer to certain mechanical details relating to operations for the Open Market Account, it would not embrace the subjects now covered in the statements of operating policy. If he understood correctly the effect of Mr. Balderston's proposal, the

material embraced in the statements of operating policy, or at least most of it, would be eliminated. Chairman Martin replied that this was correct. However, the continuing authority directive could be amended at any time by the Committee to include any of the matters now covered in the statements of operating policy, or other matters, if the Committee so desired. In effect, the Committee would be starting over again with a new base.

There followed further references to the content of the draft of continuing authority directive dated December 13, 1961, and the effect of having to vote for or against so inclusive a motion as had been outlined by Mr. Balderston. Certain members of the Committee indicated that they would favor parts of the proposal, but not others, and that they would prefer to have an opportunity to vote on a different basis.

Mr. Shepardson then moved that the three statements of operating policy, reaffirmed most recently at the meeting on March 22, 1960, be terminated, and this motion was seconded by Mr. Balderston. These statements of operating policy read as follows:

> a. It is not now the policy of the Committee to support any pattern of prices and yields in the Government securities market, and intervention in the Government securities market is solely to effectuate the objectives of monetary and credit policy (including correction of disorderly markets).
>
> b. Operations for the System Account in the open market, other than repurchase agreements, shall be confined to short-term securities (except in the correction of disorderly markets), and during a period of Treasury financing there shall

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

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

In discussion of the motion, Mr. Irons raised the question whether it was the sense of the motion to terminate the statements of operating policy, as such, or to say that the Committee would not have any standing rules.

Chairman Martin replied that adoption of the motion would mean the termination of the statements of operating policy as such. However, the proposed continuing authority directive could in his opinion properly be called a rule. What it might be called later would depend on its possible growth.

Mr. Shepardson said he had assumed, in making his motion, that an appropriate explanatory article would be developed for publication concerning the discontinuance of the operating policy statements. This would be in accord with the suggestion that had been made earlier during this meeting.

Chairman Martin then indicated that the voting on the motion would be with the understanding that if the operating policy statements

were terminated, such an article would be prepared for publication.

There being no further questions, the Chairman called for a vote and the motion was carried.

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

Messrs. Bopp, Clay, Deming, and Ellis indicated that if they had been members of the Committee at the present time they would have voted for the motion.

The Committee then turned to the draft of continuing authority directive to the Federal Reserve Bank of New York that had been distributed under date of December 13, 1961, and agreement was reached on certain changes in the draft. The first change was to specify that the Federal Reserve Bank of New York was authorized to buy United States Government securities with maturities of 24 months or less at time of purchase from nonbank dealers for the account of the Reserve Bank under agreements for repurchase of such securities in 15 calendar days or less. (The number of months had not been inserted in the December 13 draft.) The second change was to eliminate, at all places where they appeared in the draft of continuing authority directive, the words "except as otherwise authorized." The third change was to eliminate the word "best" from the portion of the draft directive which stated that the Federal Reserve Bank of New York was

authorized to buy or sell United States Government securities in the open market for the System Open Market Account at best market prices.

A motion then was made by Mr. Hayes, and seconded by Mr. Balderston, that the following continuing authority directive to the Federal Reserve Bank of New York be adopted, effective immediately:

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

(a) To buy or sell United States Government securities in the open market for the System Open Market Account at market prices and, for such Account, to exchange maturing United States Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account (including forward commitments, but not including such special short-term certificates of indebtedness as may be purchased from the Treasury under paragraph 2 hereof) shall not be increased or decreased by more than $1 billion during any period between meetings of the Committee;

(b) To buy or sell prime bankers' acceptances in the open market for the account of the Federal Reserve Bank of New York at market discount rates; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed $75 million or 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York;

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

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to purchase directly from the Treasury for the account of the Federal Reserve Bank of

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

No further discussion being requested, the Chairman called for a vote and the continuing authority directive was adopted.

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

Messrs. Bopp, Clay, Deming, and Ellis indicated that if they had been members of the Committee at this time they would have voted for adoption of the continuing authority directive.

Mr. Robertson stated that he had voted against the adoption of the continuing authority directive for several reasons. First, he objected to the inclusion of the authority to buy United States Government securities from nonbank dealers under repurchase agreements at rates that could be lower, in certain circumstances, than the discount rate of the New York Reserve Bank. Second, he objected on the ground that the continuing authority directive did not include certain rules within which the Management of the Open Market Account must operate on behalf of the Open Market Committee. Specifically, the document did not include any directive to the effect that open market operations were to be conducted primarily to supply or absorb bank

reserves; it did not limit open market operations to short-term securities and instead permitted operations in Government securities of any maturity; and it contained no restriction against conducting operations for the purpose of supporting any pattern of prices or yields in the Government securities market. Also, the continuing authority directive contained no language specifying that during periods of Treasury financing open market operations were to be conducted in such manner as to change as little as possible prevailing money market conditions. Finally, the continuing authority directive contained no prohibition against swap transactions (offsetting purchases and sales of securities for the purpose of altering the maturity pattern of the System's portfolio).

> Secretary's Note: Later in the meeting, Mr. Robertson requested that the statement he had presented during the morning session on operations in intermediate- and longer-term securities also be regarded as a part of the explanation of his dissenting vote.

The Chairman inquired of Mr. Mills whether he wished to include any comments in the record concerning his vote on the motion, and Mr. Mills replied that comments in explanation of his position had been presented by him at this morning's session.

There followed a brief discussion, in light of a question raised by Mr. Thomas, which brought out that certain special authorities most recently reaffirmed by the Committee at its meeting on March 7, 1961,

such as the authorities in respect to repurchase agreements and bankers' acceptances, continued in existence and were not terminated by the action of the Committee terminating the three operating policy statements. Mr. Hayes noted in this connection that at some subsequent meeting, if it were found that some of the special authorities needlessly duplicated what was in the continuing authority directive, the Committee could terminate those authorities if it so desired.

The discussion then turned to the content of the current economic policy directive and the procedure envisaged for its preparation and adoption.

Mr. Hayes suggested that the consensus as to policy, in whatever form it might be stated by the Chairman and accepted by the Committee, constitute the basis of the current policy directive. He also suggested initiating a procedure whereby the Secretary of the Committee, the Account Manager, and the Economist of the Committee would formulate a general statement of policy position giving the rationale underlying the consensus and that this statement, in draft form, be distributed to the members of the Committee for vote by wire or mail. The consensus, however, should be voted upon before the adjournment of the meeting.

Chairman Martin stated that the consensus today was not as clear as it had been on a number of occasions. However, he thought the consensus was clearly not to become easier and instead, perhaps, to trend in the direction of slightly tighter monetary conditions,

although without any overt change in policy, with emphasis placed on maintaining the Treasury three-month bill rate in the range of 2-1/2 - 2-3/4 per cent.

Mr. Hayes inquired whether the consensus did not favor keeping nearer the upper part of the 2-1/2 - 2-3/4 per cent range, to which Chairman Martin replied that he would say there was some inclination to keep nearer the upper portion of the range.

The Chairman then inquired whether the members of the Committee agreed that the consensus was as he had stated it.

Mr. Shepardson referred to the suggestion that had been made by several persons during the meeting that the target for further growth of total reserves be reduced fron an annual rate of 5 per cent to 4 per cent, or even as low as 3 per cent. He inquired whether that would be considered a tightening. Chairman Martin commented that he would prefer to say a "trending," and after some discussion Mr. Shepardson said that he would not interpret the suggested reduction of the growth target for total reserves as a tightening. Mr. Hayes suggested that this might be regarded as a trend toward a bit tighter situation, and Chairman Martin suggested that it might be referred to as a trend toward a less easy situation.

Mr. Thomas commented that this discussion illustrated the problem involved in using the word "tightening." Much would depend on what credit demands developed. In his statement this morning he had

been suggesting that the Committee indicate that it would supply through open market operations the amount of reserves that would be adequate for a certain amount of growth in total reserves and let the market decide whether or not there would be a tightening. The 4 per cent growth rate that he had mentioned was after allowance for seasonal variations. Whether interest rates would rise or the money market would tighten would depend on whether credit demands pressed against the available supply of reserves.

Chairman Martin then said it seemed to him that it would be wiser for the Committee to use some reference to the bill rate than to specify quantities of reserves for growth or to specify something in terms of the money supply. He did not believe that it would be feasible to try to pin down such factors.

Following additional discussion, Chairman Martin restated his conception of the consensus of this meeting. As he saw it, the consensus was along the lines of concentrating on a bill rate in the upper part of the range of 2-1/2 - 2-3/4 per cent and trending toward a slightly less easy monetary condition, without overt action.

Chairman Martin inquired whether there was disagreement on the part of members of the Committee with his statement of the consensus, and no comments to such effect were heard.

The Chairman then called for a vote on the implementation of policy according to the stated consensus.

Of the members of the Committee, Messrs. Martin, Hayes, Balderston, Irons, Shepardson, Swan, Wayne, and Fulton voted for the implementation of policy along such lines, while Messrs. King, Mills, Mitchell, and Robertson voted in the negative.

Messrs. Bopp, Deming, and Ellis indicated that if they had been members of the Committee at this time they would have voted for the implementation of policy according to the consensus, while Mr. Clay indicated that he would have voted in the negative.

Mr. Robertson stated that he opposed the implementation of policy according to the consensus on the basis that he did not believe in tying monetary policy to the bill rate.

Mr. Mills stated that he had dissented because the policy would not be as strongly restraining as he believed conditions required. He added that at every juncture where there had been some tendency toward even a modest tightening, that tightening had not occurred; at the first shadow of any market disturbance, the Committee had turned and moved in the other direction.

Mr. King said that his dissent was largely on the basis that he thought this was the wrong time for any trend in the direction of less ease. In his opinion it would be wiser to wait until after the Holiday shopping period was out of the way. He felt, however, that a month or a month and a half from now he would be likely to come to the same conclusion as the majority of the Committee.

Mr. Mitchell said that his dissent was on the ground that he did not think this was the right time to start tightening.

Mr. Clay said he did not believe that this was the time to start even a slight movement toward tightening.

In further comments on the policy reflected in the consensus, Chairman Martin said that he did not view it as representing a tightening. Mr. Swan said he would regard it as reflecting essentially a continuation of what had been going on, and Mr. Hayes suggested that it reflected a slight change of emphasis. Mr. Balderston referred to a "deceleration of acceleration."

The Chairman then commented that the next matter for consideration would appear to be the question of writing a current economic policy directive to the New York Bank. The question was whether to request the Secretary, the Account Manager, and the Economist to draft a directive that would reflect the consensus.

Mr. Robertson made the suggestion that such a procedure might be instituted at the next meeting, when the staff would be better prepared.

Mr. Hayes said he would interpret this suggestion as contemplating, in effect, that the Committee would reinstate clause (b) temporarily. He went on to bring out that his earlier suggestion on procedure had been that the Committee adopt the consensus as the current policy directive, and that it cause to be prepared following the meeting a statement of general policy position. Unless the Committee had those two things

together, he felt that it would not have proper evidence to report to the Congress what it had done.

Mr. Robertson then clarified that his suggestion would be, for the purpose of this one meeting, to take out clause (b) of the old directive and insert language that would fit in with the statement of the consensus.

Mr. Shepardson noted that today's meeting presumably would be the last meeting of the Committee during the current calendar year. At this morning's session there had been interjected, prior to the determination of policy for the forthcoming period, a discussion of operating procedures. In his opinion it might be better to conclude the action on policy today according to the procedure that had been in existence at the beginning of the meeting. For this meeting, in other words, the Committee would issue a directive the same way that it had in the past. The new procedures could then become effective with the first meeting of the Committee in the new year.

Mr. Balderston said he had been concerned about the impression that the Committee's published policy record had made on the academic fraternity and other sophisticated groups. He had been hopeful that this year the Committee could adopt a new set of directives that would be more intelligible to those who had enough interest in the Federal Reserve System to read the Annual Report of the Board. He would like the report this year to put the Committee's best foot forward.

Mr. Hayes noted that the consensus of this meeting had been agreed upon by the Committee. It would be his suggestion that the Committee now ask the Secretary to transmit a statement of policy position to the members of the Committee, with the thought that this could then be approved and embodied in the directive.

Chairman Martin commented that such a procedure would seem to raise the question of taking another vote, and Mr. Hayes responded that the purpose of the so-called statement of policy position would be to present the reasons why the Committee had come to the consensus that had been agreed upon. Those who did not favor the policy expressed in the consensus presumably would not agree with the statement of policy position.

Chairman Martin then inquired whether such a procedure would be generally agreeable to the majority of the Committee, and there were no comments to the contrary. Accordingly, Chairman Martin stated that it would be understood that the procedure would be along such lines. The Secretary would have to do the best that he could by way of experimentation and the Committee would have to consider the problem in detail at its next meeting.

Mr. Sherman commented that it would appear that the vote on implementation of the consensus, as stated by the Chairman, was the policy action of the Committee at this meeting. That vote was what would go into the policy record.

No difference of opinion with this comment was indicated.

Mr. Shepardson then moved that, beginning with its next meeting, the Committee follow a procedure whereby promptly after the morning session of each meeting the Secretary, the Manager of the System Open Market Account, and the Economist would prepare, bearing in mind the suggestions as to content expressed during today's discussion, a draft of current economic policy directive on which the Committee would act before the meeting adjourned. This motion was seconded by Mr. Balderston.

In discussion of the motion, Mr. Swan said he understood that the statement to be drafted would be more limited in scope than the entry that would subsequently be prepared for inclusion in the Committee's policy record.

In reply, Mr. Hayes called attention to the draft statements of general policy position that had been submitted with the New York Bank's letter of November 3, 1961. In substance, the statement he envisaged would be a brief resume indicating why the Committee reached the conclusions that were embodied in the consensus. Such a statement would indicate the factors to which the Committee had given weight, and what it was trying to stress.

Mr. Swan said he would not object to the contemplated procedure. He had simply been wondering how much substance it was envisaged would be incorporated in the proposed statement.

Chairman Martin replied that he would have in mind getting as much substance into the statement as feasible. He went on to say that those who dissented from the consensus would have their votes recorded in the minutes of the particular meeting. The statement of the majority position on policy would then be drafted by a group consisting of the Secretary, the Account Manager, and the Economist.

Mr. Robertson suggested that there might be a situation where the Secretary, Economist, and Account Manager would not agree among themselves. The Account Manager, he said, certainly should understand exactly what was involved and should be fully consulted. The Economist also should be fully consulted. However, the responsibility for the drafting should be placed with the Secretary. There should never be an occasion where no draft was submitted simply because the group could not reach agreement.

Mr. Mitchell noted that the principals would be at hand, and Chairman Martin said it would be expected that the staff group would bring in some draft. He agreed, however, that the responsibility for placing a draft before the Committee should be centered in the Secretary, even though other staff members would be involved in the drafting process.

There being no further discussion, the Chairman called for a vote on the motion as to procedure made by Mr. Shepardson, and the motion was carried, Messrs. Martin, Hayes, Balderston, Irons, King, Mitchell, Robertson, Shepardson, Swan, Wayne, and Fulton voting in favor of the motion, and Mr. Mills voting against it.

Messrs. Bopp, Clay, Deming, and Ellis indicated that if they had been members of the Committee at this time they would have voted in favor of the motion.

Mr. Mills stated that a favorable vote on his part would not have been consistent with his position, expressed earlier during this meeting, favoring retention of the form of policy directive that had been used up to this time.

Chairman Martin turned to Mr. Rouse at this point and inquired whether there were any prospective developments in the period ahead on which he would like to comment, and Mr. Rouse indicated that he had no comment.

> Secretary's Note: Pursuant to the procedure that had been agreed upon for this meeting during the foregoing discussion, the Secretary, the Account Manager, and the Economist subsequently drafted a current economic policy directive to the Federal Reserve Bank of New York which the Secretary transmitted to the members of the Committee, who were asked to indicate their approval or disapproval of the wording, including an indication as to which of two alternates they would prefer for the last clause of the first sentence in the second paragraph (see directive below). On the basis of the replies received, certain minor changes were made in the draft. On December 21, 1961, the Secretary advised the President of the Federal Reserve Bank of New York by telegram that at the meeting of the Federal Open Market Committee on December 19, 1961, the Federal Reserve Bank of New York had been authorized and directed, until otherwise directed by the Committee, to execute transactions for the System Open Market Account in accordance with the following current economic policy directive:

It is the current policy of the Committee to permit further bank credit and monetary expansion so as to promote fuller

utilization of the economy's resources together with money market conditions consistent with the needs of both an expanding domestic economy and this country's international balance-of-payments problem.

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

The votes recorded on the foregoing directive were the same as those recorded during the meeting concerning the implementation of policy according to the consensus, as stated by Chairman Martin. However, Mr. Hayes and Mr. Swan, while voting for the above current economic policy directive, indicated they would have preferred, as the language of the last clause of the first sentence in the second paragraph, "but with a slight shift in emphasis in the direction of less ease."

At this point Mr. Hexter, Assistant General Counsel, joined the meeting.

With reference to the question of Federal Reserve operations in foreign currencies, Chairman Martin noted that there had been distributed to the members of the Committee copies of a letter addressed to him under date of December 18, 1961, by the Secretary of the Treasury. This letter had been obtained as the result of discussions with the Secretary that he had undertaken in accordance with the authorization given to him at the Committee meeting on December 5, 1961. The text of the letter referred to by the Chairman was as follows:

As you know, I have been much interested in the work of the Open Market Committee and its staff in exploring the possibility of Federal Reserve operations in and holdings of selected convertible foreign currencies. The proposal which has been developed seems to be highly constructive.

The Treasury, relying upon the Federal Reserve Bank of New York as fiscal agent, has experimented with foreign currency operations and holdings over the past nine months, with very useful effects on the functioning of the foreign exchange markets and desirable effects in safeguarding the international value of the dollar. During this short period, our recently attained convertible international payments system has been going through its first real test. From time to time, we have had to deal with unusual payments flows of quite some size, occasioned in part by uncertainty about the relationship of currency values.

I share the view of many European financial leaders that we must not allow these volatile flows of funds to undermine the international financial mechanism we have all struggled so hard to rebuild during postwar years. As you are aware from last week's press announcement regarding the IMF, we have just negotiated an important supplement to the Fund's resources to help us deal with any developing disequilibrium in balance of payments relationships among the larger industrial countries that threatens an impairment of the monetary system.

While the IMF special resources arrangement will be a major reinforcement of the world's payments system, we must not overlook other means of keeping that system convertible, efficient and sustainable. Operations along lines in which the Treasury's Stabilization Fund has experimented are one of these means.

In view of its limited resources, the Fund's foreign currency operations have necessarily been on a pilot basis. In my opinion, these pilot activities justify the belief that operations carried out on a broader and more adequate scale will be beneficial to the functioning of exchange markets and to the pivotal role which the dollar plays in them.

At the same time, it is important to recognize that such operations can best be conducted by the central bank because only the central bank can make the prompt smooth adjustments that are called for domestically. In view of the established responsibility that central banks have for sound and stable monetary conditions, the world's financial community is naturally looking to them to play an active role in maintaining a sound payments system. It is surely a proper central banking

function to engage in temporary operations that will help to buffer and moderate tendencies towards volatile flows of funds. Over the longer period, the very existence of a central banking capability for coping promptly and effectively with volatile flows can give confidence to international traders and investors, and further the orderly evolution of international market processes.

If the Federal Reserve decides to undertake foreign currency operations, the Treasury and the Federal Reserve will both need to recognize in advance, of course, that they will have to feel their way; that effective methods of operations and effective working relationships between them can only be worked out gradually; and that they need to learn together the best ways of carrying our mutual responsibilities for a sound dollar internationally. In such an effort, the Treasury on its part would naturally want to avoid impinging on the independence of the Federal Reserve System within the Government.

If the Open Market Committee decides to consider its current proposal further, we will need to consult together on the details of any division of responsibilities between the Treasury and the Federal Reserve.

I realize that the Committee might be hesitant to embark on operations in which it has not engaged since the establishment of the Stabilization Fund under the Gold Reserve Act of 1934. If the Committee should be interested in the opinion of the Treasury's General Counsel regarding the statutory provisions governing foreign exchange operations by Government agencies, or if the Committee desires to obtain some statutory clarification of these provisions, the Treasury's legal staff will be ready to cooperate with yours.

It would be helpful if questions about the Committee's plans in the foreign currency field could be resolved before our legislative program for the next session of the Congress has to be submitted. Before final activation, of course, any specific proposal will need to be reviewed and discussed with the National Advisory Council in accordance with the provisions of the Bretton Woods Agreements Act.

In view of the current sensitivity being shown by the foreign exchange markets to the balance of payments problem of the United States, it is desirable to make progress in this matter as rapidly as is feasible.

In closing, I might add that, according to my information, foreign currency operations by the Federal Reserve on a broader basis than those pioneered by the Stabilization Fund would be welcomed by other central banks.

Chairman Martin commented that, the letter having been received, it now appeared to be up to the Committee to decide whether it wanted to go forward with the matter at this juncture, whether it wished to delay further, or whether it wanted to turn down the proposal. That was where the matter stood at the moment. The Chairman called attention particularly to the portion of the letter in which the Secretary of the Treasury said he realized that the Open Market Committee might be hesitant to embark on operations in which it had not engaged since the establishment of the Stabilization Fund under the Gold Reserve Act of 1934 and that if the Committee should be interested in the opinion of the Treasury's General Counsel regarding the statutory provisions governing foreign exchange operations by Government agencies, or if the Committee desired to obtain some statutory clarification of these provisions, the Treasury's legal staff would be ready to cooperate with the legal staff of the Federal Reserve.

If the Committee wished to go forward with this matter, the Chairman said, it would seem to him that it ought to authorize the legal staff of the Committee to work with the legal staff of the Treasury on something that would bring to the attention of the House and Senate Banking and Currency Committees the problem with respect to statutory clarification of the Federal Reserve's authority to deal in foreign currencies in the manner proposed. That would seem to be the logical and orderly procedure. First, however, the Open Market Committee

ought to decide whether it wanted to go forward with this matter at all.

His own thinking, the Chairman said, was that in view of world conditions at the present time the Federal Reserve should be prepared to deal in foreign exchange. The rationale for such operations had been set forth quite clearly in a memorandum from Mr. Thomas dated December 14, 1961, copies of which had been distributed to the Committee. A good case, Chairman Martin thought, could be made that the central bank was the proper agency to handle such operations. If an attempt was going to be made to deal with volatile flows of funds, the System must be prepared to operate somewhat like the Open Market Committee in the Government securities market. In his opinion, it would be helpful to all concerned if the Committee could move forward on this matter today because it would take time to work out some of the necessary relationships. In his opinion, the Committee should go forward. However, he would now throw the matter open for discussion.

Chairman Martin then turned to Mr. Hayes, who said that he would not take a great deal of time today because he had spoken on the subject at previous Committee meetings. In brief, he would like to express concurrence in the memorandum from Mr. Thomas, which provided a general rationale for the kind of activity under consideration. It was a fact, Mr. Hayes noted, that this type of operation fell, generally speaking, within what were considered central banking

operations in most of the major countries of the world. Therefore, it was quite logical to feel in principle that this was an area of operations on which the Federal Reserve System should embark.

Mr. Hayes said he was satisfied that the Federal Reserve did have legal authority to conduct such operations. Personally, he would be ready to move forward on the basis of Mr. Hackley's opinion. At the same time, he could see distinct benefits in obtaining statutory clarification from the Congress. From where he sat, it was rather hard for him to judge what length of time would be involved in getting such clarification. The question, therefore, was whether to proceed while getting such authorization from the Congress or to wait until it had been obtained. He would agree that it would be appropriate to enter into discussions with the Treasury's legal staff and to take up with appropriate parties the question of how statutory clarification might best be secured. Nevertheless, he had some feeling that the sooner the System embarked on this activity the better it would be from a purely practical point of view, in that the resources of the Stabilization Fund were quite limited. Recognizing the need, he thought that the System would be derelict if it failed to move reasonably promptly. However, he was willing to leave to the Chairman the decision on how promptly that ought to be done in relation to the new legislation that would be sought.

Mr. Ellis said that the memorandum from Mr. Thomas had provided an underlying rationale more appealing to him than the earlier discussions,

which were based to a substantial extent on methodology and legal relationships. He noted that the proposal had not been presented to the Committee as a matter of great urgency. If the matter was not one of great urgency, he felt that in the longer run the System would be on sounder footing if it proceeded carefully and undertook to obtain some statutory clarification, as suggested in the letter from the Secretary of the Treasury. The appropriate procedure, it seemed to him, would be to follow the course indicated by the portion of the letter to which particular reference had been made by Chairman Martin. This suggested that the Committee should authorize Counsel to enter into discussions with the legal staff of the Treasury, with the objective of obtaining a statutory definition of responsibility, so that System operations could get off on the right foot.

Mr. Irons said that with the receipt of the Secretary of the Treasury's letter, his earlier questions had been partly answered. He would favor proceeding with the proposal on the basis of the procedure suggested in the Secretary's letter, namely, that the legal staffs of the Federal Reserve and the Treasury get together and work out the details of statutory clarification.

Mr. Swan indicated that he agreed with the views expressed by Messrs. Ellis and Irons. Looking further ahead, he would think in terms of following the plan set forth in the revised draft papers from the staff that had been distributed to the Committee under date of December 12,

1961. This set of documents met the objections that he had previously expressed. [1/]

Mr. Deming said that he would regard operations in foreign currencies as a proper activity for the central bank if statutory clarification could be obtained. He had several relatively minor points regarding the technicalities of the staff documents, and if agreeable he would set those forth in a letter.

Chairman Martin indicated that it would be appropriate to submit those comments by letter.

Mr. Clay said that he would favor moving forward to obtain statutory clarification.

1/ The revised draft papers embodied several suggestions made at the Committee meeting on December 5, 1961. The proposed instructions of the Open Market Committee regarding open market transactions in foreign currencies (Paper No. 2) contained an amended enumeration of purposes of such transactions, and a sentence had been added stating expressly that the operations should not be used to obscure basic changes in the U. S. balance of payments. The proposal to establish a subcommittee of the Open Market Committee had been eliminated; instead the Chairman and Vice Chairman of the Committee and the Vice Chairman of the Board would be authorized, within guidelines issued by the Committee, to set maximum amounts for individual currency holdings and exchange rate limits, to review and approve understandings between the New York Bank and foreign central banks, and to take action in emergencies when the decision of the Committee could not be sought in time. It was made clear that the Committee would be continuously provided with full information on transactions. The guidelines for open market operations in foreign currencies (Paper No. 4) would now be issued by the Committee itself; and the pertinent section had been amended to eliminate reference to seasonal and cyclical swings and thus make it clear that System transactions should aim only at moderating or cushioning the effects of unusual payments swings. The proposed explanatory paper on the aims and scope of System foreign exchange operations had been amended to conform to the changes in the two aforementioned papers. In addition, Mr. Hackley had submitted a new paper (Paper No. 7) embodying suggestions for possible statutory clarification of the System's authority to engage in foreign exchange operations.

Mr. Wayne likewise expressed the view that the legal staff of the Federal Reserve should be authorized to work with Counsel for the Treasury to obtain statutory clarification. In view, however, of the phraseology of the Secretary of the Treasury's letter and the opinion of the Committee's General Counsel that the Federal Reserve had statutory authority to engage in foreign exchange operations, he would be willing, if time was of the essence, to proceed with such operations while seeking statutory clarification.

Mr. Mills said that he would proceed with the proposal. However, as he had brought out at the December 5 meeting, the mechanism was experimental and he had serious misgivings as to whether the operations in foreign currencies would work out to the benefit of the Federal Reserve System. Those misgivings went back very importantly to the System's experience in operating outside the bill market in Government securities. This operation was to have been experimental, but it had now developed into a permanent procedure, one that in his opinion had not worked out to the general good.

Mr. Robertson expressed the view that the subject was of such importance as to warrant thorough analysis by the Congress to determine what it would want the Federal Reserve to do. Consequently, he would favor exploration of the matter, as contemplated in the Secretary's letter, with a view to seeking legislation. He hoped that the matter would be presented not as an effort to obtain authority to do something

that the Federal Reserve thought was right but in such manner as to let the Congress determine, after weighing all of the facts and arguments, whether it wanted the Federal Reserve to do the job. In the meantime, he would suggest that prudence be exercised in conversations with outside parties.

Mr. Shepardson commented that he was not entirely clear about the degree of urgency of the proposed activity. He noted that the Secretary of the Treasury, in one portion of his letter, had referred to the current sensitivity being shown by the foreign exchange markets to the balance-of-payments problem of the United States and the desirability of making progress in this matter as rapidly as feasible. He would certainly favor the proposal that Federal Reserve and Treasury Counsel meet with a view to exploring the matter and developing appropriate proposed legislation. However, it was not clear to him whether there was a feeling on the part of the Secretary of the Treasury that the situation was of such urgency as to warrant moving ahead prior to Congressional action. If such was the case, he would favor moving ahead. If the matter was not regarded as urgent, however, he thought it would be preferable to proceed by the legislative route before any operations were undertaken.

Chairman Martin replied that he could not speak for the Secretary of the Treasury or the Under Secretary for Monetary Affairs. He expected, however, that both of them would share the view of Mr. Hayes that the Federal Reserve ought to go ahead without legislation. On the other hand,

he was not entirely convinced that there was enough to be gained to justify giving up the exploration that needed to be carried out between Federal Reserve and Treasury Counsel on matters such as the division of responsibilities. It might be, of course, that there would be a crisis at any time, but this was difficult to predict. From the standpoint of obtaining general understanding of this problem, he would feel much better to have the matter explored with the Treasury in terms of division of responsibilities and in terms of obtaining Congressional support. In his opinion, that would be better than jumping the gun. The Treasury had experimented in this field through Stabilization Fund operations, but the effectiveness of those operations was open to some doubt. While the Treasury felt that they had been highly successful, there was a division of opinion within the financial community.

Mr. Hayes commented that there was no such division of opinion in foreign central banking quarters, to which Chairman Martin replied that that was a different story. There was no doubt about the matter from the standpoint of international monetary cooperation.

Mr. Shepardson then stated that he thought Chairman Martin had answered his question. As he (Mr. Shepardson) had stated, he would favor exploration of the matter with Treasury Counsel. He would only go ahead with operations on the existing basis if there was information that the problem was more urgent than seemed to him probably was the case.

Mr. King said that he would favor proceeding with exploration of the matter with Treasury Counsel in the manner outlined in the Secretary's letter. He added that the Chairman's thoughts, as the Chairman had just expressed them, coincided with his own. In his opinion, this would be the greatest responsibility that the System would have voluntarily undertaken since he began his service as a member of the Board of Governors. If he were a member of the Congress and the Federal Reserve, in the absence of a pressing need, undertook such an operation without having asked the Banking and Currency Committees to consider the matter, he felt that such a procedure might incur his wrath. Accordingly, he thought that the matter should be carried forward along the lines suggested in the letter from the Secretary of the Treasury. In a crisis he would ignore the rule book and proceed, but in the absence of a crisis he would move forward along the lines that had been suggested. It was important, he thought, if the position was taken that the Federal Reserve was the proper agency to conduct such operations, that the System be sure it took complete control of the operations. In this connection, he had some doubt whether the present System organization--and he would not advocate any rearrangement of the organization--lent itself to the control of such operations. Nevertheless, he would hold that doubt in abeyance and proceed with the exploratory discussions with Treasury Counsel. Absent a crisis, he would like to be recorded against undertaking any operations in foreign currencies until such time as statutory clarification was obtained. He would not want to cross bridges ahead of time.

Chairman Martin commented that if it was felt that a crisis was likely in the near future, it was not particularly logical to say that the Federal Reserve should wait for the crisis to occur. Instead, the System ought to be acquiring some currencies in order to be in a position to deal with the crisis. That was a valid point. However, there could be many differences of opinion on how soon a crisis might occur, whether one would occur, and whether the proposed operations in foreign currencies would be the most effective means by which to handle such a crisis.

Mr. Mitchell said he was encouraged that the Chairman had talked with the Secretary of the Treasury. As he read the Secretary's letter, the Treasury wanted the Federal Reserve System to undertake these operations. However, a crisis did not exist at present. There was no way of knowing when a crisis might occur, but the evidence that a crisis was imminent did not seem strong. There seemed to be time to develop legislation. Therefore, he would consult with the Treasury and develop, as rapidly as possible, draft legislation that was satisfactory to the Federal Reserve. It would be advisable, he thought, for whoever was conducting these negotiations with the Treasury to report back to the Committee regularly, even between meetings, as to the kind of program that was under consideration. For example, he was not sure whether the plan would contemplate Federal Reserve holdings of foreign securities.

Mr. Young replied that this would be contemplated under draft legislation. Under the present plan, without legislation, it would not be contemplated.

Mr. Mitchell then said that he was in favor of moving ahead and that he felt the matter should be pushed forward as hard and as fast as possible.

Mr. Fulton stated that he would be in favor of proceeding in accordance with the suggestion in the Secretary's letter. He would dislike to see the System get into an operation of this kind before the Congress had unequivocally given the System the authority and had expressed the opinion that the Federal Reserve was the agency to do the job. Exploration with the Treasury seemed to him highly desirable, with a view to seeking legislation on a unified basis.

Mr. Bopp expressed agreement with the comments made by Mr. Fulton.

Mr. Balderston said that he would like to see two steps taken concurrently. The first would be consultation between the legal staffs of the Treasury and the Federal Reserve, as suggested in the letter from the Secretary of the Treasury. The second would be the development of guidelines in this area that would correspond to the continuing authority directive in the domestic area. Then, as soon as Congress gave the green light, the System would be in a position to begin operations in foreign currencies without further discussion and delay.

Mr. Balderston also referred to the point, previously mentioned, that the System might be ineffectual in meeting a crisis if it waited until the crisis actually occurred. For this reason he felt that, as a precautionary measure, action should be taken promptly to acquire currencies

of key countries. At various times of the year such currencies could be obtained advantageously despite the fact that this country was now in a deficit situation.

Mr. Balderston commented that the aggregate of dollars spent in the acquisition of foreign currencies would be small relative to the amounts placed in foreign hands in the form of investing and spending abroad. Protective steps should be taken before a crisis occurred, as illustrated by this year's experience of the United Kingdom. Had sterling been bought for the Federal Reserve System's portfolio when it was low in price last spring, perhaps it would not have been necessary for the United States to sell the United Kingdom $300 million of gold in November.

Chairman Martin stated that on the basis of the comments that had been made, it appeared that the sentiment favored going forward with the proposal by authorizing consultation with the legal staff of the Treasury, as suggested in the Secretary's letter. After referring to the point that had been raised about initiating foreign currency operations in advance of a crisis, the Chairman indicated that he would like to clarify his own position. He thought that the proposed operations in foreign currencies would be a very desirable activity. He also thought, however, that the System ought to be very careful about giving the idea that these operations were going to solve fundamental problems. It should be recognized, for example, that if the Federal Reserve had held $300

million of sterling the British might have taken the gold anyhow. Further, the British might not have taken the steps toward a solution of their payments problem that they took in the interim. No one could know such things for certain. In any event, however, either in the Government securities market or in the foreign exchange market, it was still necessary to deal with fundamentals. One must not be misled into thinking that any of these ideas, good as they were, were going to solve the whole problem. The problem was not that simple. On the other hand, every practical device should be used.

With reference to Mr. Balderston's comment about the need for working out a directive for foreign currency operations similar to the continuing authority directive in the domestic area, Mr. Hayes said he felt that this had largely been done. The Secretary of the Committee had been working along those lines for some time. The only point he would like to add to the discussion was that he thought the Treasury should review carefully the documentation concerning the details of the proposed operations to see whether it saw anything wrong. The advice of the Treasury on the technical aspects of the proposal should be obtained.

Chairman Martin said he understood from today's discussion that Counsel would be authorized to refer any of the documentation to the Treasury for review. He agreed that the staff had done a good job in putting this material together. Further, there had been excellent cooperation on the part of the Treasury. It was only at the December 5

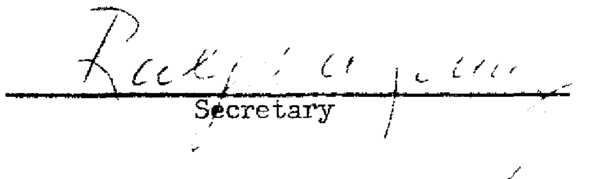
Committee meeting that he was authorized to discuss the subject with the Treasury, and the letter since received from the Secretary was in his opinion a good letter. It provided a satisfactory basis on which to proceed without impairment of the position of either the Treasury or the Federal Reserve.

No disagreement with the comments of Chairman Martin was indicated.

At the conclusion of the discussion, the legal staff of the Committee was authorized to confer with the legal staff of the Treasury for the purposes suggested in the letter from the Secretary of the Treasury.

It was agreed that the next meeting of the Open Market Committee would be held on Tuesday, January 9, 1962.

The meeting then adjourned.



Secretary