FORTY-EIGHTH

Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System

COVERING OPERATIONS FOR THE YEAR

1961

Digest of Principal Federal Reserve Policy Actions, 1961

Period	Action	Purpose of action
January	Limited net sales of U.S. Government securities from Federal Reserve portfolio to about $500 million. Member bank borrowing at Reserve Banks averaged only $50 million.	To encourage bank credit and monetary expansion by absorbing only part of seasonal inflow of reserve funds not otherwise offset by a large gold outflow.
February-August	Bought substantial amounts of U.S. Government securities with maturities over 1 year, following February 20 announcement that System open market operations would include securities outside the short-term area. These purchases were partly offset by net sales of short-term securities. Total System holdings of Governments increased about $700 million. Member bank borrowings averaged $75 million.	To encourage bank credit and monetary expansion while avoiding direct downward pressure on short-term interest rates, thereby moderating pressures on the U.S. balance of payments from outflow of short-term capital attracted by higher interest rates abroad.
September-December	Bought or sold at different times varying amounts of U.S. Government securities, including securities with longer maturities. Total System holdings of Government securities increased about $1.6 billion. Member bank borrowings at Reserve Banks remained generally low.	To continue to encourage bank credit and monetary expansion while allowing for changing reserve needs due to seasonal and other factors, including a large gold outflow, and while continuing to give consideration to the balance of payments problem.
December	Raised, effective Jan. 1, 1962, maximum interest rates payable by member banks on any savings deposit from 3 to 3½ per cent, and to 4 per cent on those left in the bank for 1 year or more; also raised maximum rates on time deposits with a maturity of 6 months to 1 year from 3 to 3½ per cent, and to 4 per cent on those deposits with a maturity of a year or longer.	To enable banks to compete more effectively for savings and other time deposits, including foreign time deposits, thus moderating pressures on the U.S. balance of payments, and, over the long run, to offer additional incentive for the accumulation of savings required for financing future economic growth.

employed and the rate of unemployment remained close to the midwinter level, just under 7 per cent of the labor force on a seasonally adjusted basis. While retail sales were being maintained, there was not yet evidence of a real push in terms of increased consumer buying. The moderate level of demand and the availability of unused resources had been accompanied by generally stable prices.

In the financial area, recent bank credit developments had been about in line with expected movements for the current phase of the business cycle. There had been a large volume of financing in the capital markets, with a steady flow of investment funds into new issues. Bank liquidity had shown improvement in recent weeks, particularly at money market banks, and the demand for bank credit continued to be moderate. For a considerable time, the rate on 3-month Treasury bills had been within the range of 2⅛ to 2⅝ per cent, most of the time between 2¼ and 2½ per cent. International financial developments, especially the developing pressure on the British pound sterling and the continuing moderate deficit in the U. S. balance of payments, caused a number of Committee members to feel that it would be desirable if short-term interest rates could be maintained within the recently prevailing range.

In view of the current levels of liquidity and of resource utilization, and in the absence of inflationary price pressures, it was considered appropriate, during the forthcoming period, to continue to encourage expansion in bank credit and the money supply. Consequently, the consensus of the Committee was that open market policy should be directed toward maintaining substantially the same degree of reserve availability as had prevailed recently, with the understanding that any doubts arising in the operation of the System Open Market Account would continue to be resolved on the side of ease.

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

The Federal Reserve Bank of New York was authorized, between this date and the next meeting of the Committee, within

the terms and limitations of the directive issued at this meeting, to acquire intermediate- and/or longer-term U. S. Government securities of any maturity, or to change the holdings of such securities, in an amount not to exceed $500 million.

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

In renewing this special authorization, the Committee noted that there had been no occasion to operate in longer-term issues during the past 2 weeks. However, it was concluded that it would be advisable to continue to have the authority available, for use in the judgment of the Account Manager as circumstances might arise.

Messrs. Allen and Robertson dissented from continuing this special authorization for reasons similar to those they had expressed at earlier meetings.

July 11, 1961

1. Authority to effect transactions in System Account.

The Committee's directive to the Federal Reserve Bank of New York was renewed without change. It thus directed that open market operations be conducted with a view to encouraging expansion of bank credit and the money supply so as to contribute to strengthening of the forces of recovery, while giving consideration to international factors.

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

In June the prerecession highs of mid-1960 had been reattained, or even surpassed, in a number of the major over-all measures of economic activity. Gross national product, expressed in current dollars, had risen from a seasonally adjusted annual rate of about $500 billion in the first quarter of the current year to a currently estimated $513 billion in the second quarter, about $8 billion above the previous peak reached in the second quarter of 1960. The quarter-to-quarter increase reflected a turnaround from substantial inventory liquidation to moderate inventory accumulation, as well as an increase in consumer spending for goods and services. Exports remained high, although no longer providing stimulus to the economy. Government spending—including Federal, State, and local—was rising further, but at a somewhat slower pace than earlier. As to industrial production, preliminary data suggested that the June index had reached 110 per cent of the 1957 average, compared with a low of 102 in February 1961 and a prerecession level of 110 in mid-1960. At the same time, the general average of wholesale prices had continued to drift down and the consumer price index had shown almost no change since October 1960. Both employment and unemployment increased in June, in line with the typical pattern for that time of year, but the rise in employment was considerably sharper than usual. Seasonally adjusted, the unemployment rate continued at 6.8 per cent, the level around which it had fluctuated for several months.

Despite the favorable record of economic recovery, questions remained as to the probable speed and extent of expansion, relating mainly to the vigor and strength of future consumer demand and to the unemployment rate. Thus far, the recovery had been quite broadly based and not dependent on sharp growth in limited sectors of the economy.

Private demand deposits, seasonally adjusted, showed no net increase from the second half of May to the second half of June and had shown no increase on balance since the latter half of March. Accordingly, the money supply, narrowly defined to include currency in circulation and privately held demand deposits, was one indicator that had not returned to its peak. Time deposits, however, continued to expand; combined with increased Treasury deposits, this had brought total deposits to a new high level.

As in May, the June increase in bank assets reflected to a considerable extent the acquisition by banks of U. S. Government securities at the time of Treasury cash offerings. Loans did not increase as much as is usually the case in the month of June.

Short-term interest rates continued to fluctuate within the relatively narrow range that had prevailed since the latter part of 1960. Long- and medium-term rates, on the other hand, rose further in June and were near or above the highest levels of the past year, evidently reflecting the continued substantial volume of borrowing by corporations and by State and local governments. The terms of substantial Treasury operations to refund August maturities and to obtain new cash were due to be announced shortly.

The U. S. balance of payments (disregarding a West German debt repayment of nearly $600 million) appeared to have turned more adverse again in the second quarter, but without any large increase in the over-all deficit. The main factors in the change included a moderately reduced trade balance and a continuing net outflow on capital account.

As indicated by the renewal of the existing directive to the New York Bank, there was agreement within the Committee that, in the present circumstances, monetary policy should continue to encourage further expansion in bank credit and the money supply in order to provide additional stimulus to the forces of economic recovery. For the forthcoming period, it was the consensus that open market operations should be designed to maintain approximately the same degree of ease that had recently prevailed, associated with a free reserve level of around $500-$600 million.

While concurring in general with the consensus, Mr. Mills called attention to the inflationary potential that in his opinion was inherent in a policy that fostered constant high levels of free reserves and failed to give sufficient weight to the existence of time deposits as a coordinate of the conventionally defined money supply and a force for injecting excessive liquidity into the commercial banking system by way of creating additional near-money substitutes.

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

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

Votes for this action: Messrs. Martin, Hayes, Balderston, King, Mills, Shepardson, Swan, Wayne, and Johns. Votes against this action: Messrs. Allen and Robertson.

After extensive discussion of the pattern of operations in intermediate- and longer-term securities since this authorization was first given by the Committee on February 7, 1961, it was the consensus that the original criteria for such operations, as indicated in the policy record entry of that date, should not be broadened at this time, considering among other things the inconclusiveness of the evidence concerning the effect of the operations. On the other hand, it was felt by the majority that an interpretation that the System was disengaging from operations in the intermediate- and longer-term areas should be avoided. One member of the Committee, Mr. Mills, voted for renewal of the authorization subject to the qualification that for the present the Management of the Open Market Account should abstain from operations outside the bill market. Messrs. Allen and Robertson voted against renewal of the authorization for the reasons that they had expressed on previous occasions. In addition, Mr. Robertson felt a diminution of private participation in market pricing and distribution was beginning to be apparent and could become worse if the trend of official purchases of intermediate- and long-term Government securities were continued.

August 1, 1961

1. Authority to effect transactions in System Account.

The Committee renewed the directive to the Federal Reserve Bank of New York calling for open market operations with a view to encouraging expansion of bank credit and the money supply so as to contribute to strengthening of the forces of recovery, while giving consideration to international factors.

Votes for this action: Messrs. Martin, Allen, Balderston, King, Mills, Shepardson, Swan, Wayne, Johns, and Treiber. Votes against this action: none.

Although it appeared that the rate of economic expansion in June and July had not been as rapid as in preceding months, the economy was still moving toward higher levels of activity. Employment, income, sales, industrial production, and construction all continued to move upward. At the same time, prices continued stable. There remained a substantial underutilization of plant capacity, along with a high level of unemployment. Total bank credit had increased substantially further due to the acquisition of Government securities by banks as a result of the Treasury's recent financing program, and the bank loan picture was somewhat stronger in July than it had been in June. The money market had been quite easy.

Developments since the July 11 meeting having special significance from the standpoint of the formulation of monetary policy included a request by the President of the United States for substantial additional defense expenditures, giving rise to the prospect of an increased Federal deficit. The prospective stimulus of greater deficit spending upon the domestic economy suggested a need for alertness to lessen the degree of monetary ease in case speculative or inflationary tendencies should develop. The second significant development since the preceding meeting was the raising of the Bank of England's bank rate (discount rate) to 7 per cent, in line with a general governmental program designed to limit expansion of domestic demand in order to cope