

CONFIDENTIAL--(F.R.)

JAN 28 1963

To Federal Open Market Committee

January 24, 1963

From Robert W. Stone and
John R. FarrellSubject: Suggested Revision in
Procedures for Allocation
of Participations in the
System Open Market Account

When the present formula for allocation of the System Open Market Account was adopted in March 1962 it was pointed out that although the new procedure for reallocating participations at quarterly intervals (February, May, August, November) would tend more nearly to equalize gold reserve ratios (against notes and deposits combined) of the various Reserve Banks, occasional adjustments might still be necessary if, because of temporary conditions, a Bank's ratio should fall below 30 per cent just before a Federal Reserve weekly statement date or a month-end date. It was also noted that further deterioration in the combined reserve ratios of the twelve Banks might render it desirable to reduce the 30 per cent guidepost specified in the procedures. This point was mentioned again by the Manager of the Account at the Open Market Committee meeting of September 12, 1962. As the Committee knows, reserve ratios have continued to decline (see attached table); indeed, on one day in December the ratio for all Banks combined reached as low as 31.4 per cent.

Individual Banks have had ratios below 30 per cent on a number of Tuesdays and days preceding month ends; and on Monday, January 14, one Reserve Bank had a ratio of only 25.7 per cent, the lowest in recent history. In each such case, special reallocations of securities in the System Account were made. Since the adoption of the current plan last March, there have been 21 such reallocations, 11 since the last regular quarterly reallocation on November 1, 1962. Some of the special reallocations could not be quickly reversed since the ratios of the Banks concerned remained relatively low for extended periods.

As would be expected, the reserve ratio situation was most acute over the year end. There has been some improvement since then with the seasonal

decline in notes and deposits, and the over-all reserve ratio has moved up somewhat (it was 32.5 per cent on January 23). Individual Banks, however, continue to experience low ratios, and special reallocations continue to be necessary (the most recent one was made on January 23). With the gold stock undergoing further erosion, it is likely that rather frequent special reallocations may still be necessary despite the seasonal drop in note and deposit liabilities; and when that seasonal decline comes to an end in the spring, the making of special reallocations in Reserve Bank participations in the Account could become virtually a continuous process.

In order to reduce to a practicable minimum the number of special reallocations in Reserve Bank participations, it is proposed that Sections 2 and 3 of the current procedures be amended by substituting 28 per cent wherever 30 per cent appears in those sections (see attachment). It is felt that such action would reduce, and for a few months perhaps eliminate, special reallocating of the Account. (If 28 per cent had been in effect since the new procedures were adopted last March, rather than 30 per cent, no special re-allocation would have been required.) Setting the figure at 28 per cent should not, at least for the next few months, preclude any Bank from having leeway to avoid a situation in which its ratio falls below 25 per cent on a statement date, although this possibility cannot be entirely dismissed no matter what procedures are used for allocating participations in the System Open Market Account.

It is RECOMMENDED that the foregoing proposal be adopted by the Federal Open Market Committee at its January 29, 1963 meeting.

Attachments

REC'D IN RECORDS SECTION
Attachment 8
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Reserve Ratio of Twelve Federal Reserve Banks Combined

Month-End From Jan. 1957 to Dec. 1962

| | <u>1957</u> | <u>1958</u> | <u>1959</u> | <u>1960</u> | <u>1961</u> | <u>1962</u> |
|----------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| January | 46.0 | 47.4 | 42.2 | 40.6 | 38.1 | 35.7 |
| February | 46.9 | 47.7 | 42.6 | 41.5 | 38.0 | 35.7 |
| March | 46.7 | 47.2 | 42.9 | 41.4 | 37.9 | 35.2 |
| April | 46.7 | 46.7 | 42.4 | 41.2 | 38.0 | 34.7 |
| May | 46.9 | 45.7 | 41.9 | 41.4 | 38.4 | 34.8 |
| June | 47.4 | 44.6 | 42.0 | 40.8 | 37.9 | 34.0 |
| July | 47.2 | 45.0 | 40.7 | 40.2 | 37.7 | 33.7 |
| August | 46.7 | 43.8 | 41.0 | 40.3 | 37.6 | 33.4 |
| September | 47.4 | 44.1 | 41.1 | 39.3 | 37.1 | 33.2 |
| October | 46.9 | 43.3 | 40.6 | 38.7 | 36.7 | 33.2 |
| November | 46.7 | 42.1 | 40.5 | 38.3 | 35.6 | 32.8 |
| December | 46.3 | 40.9 | 39.9 | 37.4 | 34.8 | 31.8 |
| Month-end Average | 46.8 | 44.9 | 41.5 | 40.1 | 37.3 | 34.0 |

January 24, 1963

REC'D IN RECORDS SECTION

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Proposed Procedures with Respect to
Allocations of the System Open Market Account*

1. Securities in the System Open Market Account shall be reallocated on the first business day of February, May, August and November of each year by means of adjustments proportionate to the adjustments that would have been required to equalize the average ratios of the 12 Reserve Banks over the first 85 days of the preceding three calendar months.

2. If a Bank's reserve ratio should be reduced below ²⁸30 per cent as a result of the reallocation, or should fall below ²⁸30 per cent on the next to the last business day (as observed by the Agent Bank) of a statement week or month, its holdings as of the close of business that day shall be adjusted the following day by an amount sufficient to raise its reserve ratio to the average reserve ratio of the 12 Banks combined on the preceding day. Such securities shall be allocated to the Bank in a position to absorb the largest additional amount without reducing its reserve ratio below the ratio of the 12 Banks combined. If that Bank is unable to take the entire amount, the excess shall be allocated to the Bank which can absorb the next largest amount without reducing its reserve ratio below the average for the System.

Any such adjustment will be reversed on the first succeeding Thursday (before the next quarterly reallocation) when it can be accomplished without reducing the Bank's reserve ratio below ²⁸30 per cent, except that if the Thursday is a holiday or the last business day of a month the reversal will be made the following business day. A reversal will restore individual Bank holdings to their established participation percentages before the adjustment occurred, except to the extent that a Bank may have been involved in another adjustment in the interim.

* These procedures, except for the percentage changes now proposed, were approved at the F.O.M.C. meeting March 6, 1962.