FORTY-NINTH

Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System

COVERING OPERATIONS FOR THE YEAR

1962

Period	Action	Purpose of action
January-February	Reduced System holdings of U. S. Government securities by about $500 million through net sales and redemptions. Member bank borrowings from the Reserve Banks averaged less than $100 million.	To permit further bank credit and monetary expansion by absorbing only part of seasonal inflow of reserve funds, mainly from post-holiday return of currency from circulation, while minimizing downward pressures on short-term interest rates.
February	Authorized open market transactions in foreign currencies.	To moderate and offset short-term pressures on the dollar in the foreign exchange market.
March-mid-June	Increased System holdings of U. S. Government securities by about $1.3 billion, of which half represented purchases of securities with maturities of more than 1 year. Member bank borrowings from Reserve Banks continued to average less than $100 million.	To promote further bank credit and monetary expansion while avoiding sustained downward pressures on short-term interest rates.
Mid-June-late October	Increased System holdings of U. S. Government securities by about $200 million with net sales and redemptions of Treasury bills of about $700 million being more than offset by purchases of coupon issues, of which two-thirds were issues maturing in more than 1 year. Member bank borrowings from Reserve Banks averaged less than $100 million.	To permit moderate increase in bank credit and money supply while avoiding redundant bank reserves that would encourage capital outflows, taking into account gradual improvement in domestic economy and possibilities for further advance, while recognizing the bank credit growth of past year and continuing adverse balance of payments.
July	Reduced margin requirements on loans for purchasing or carrying listed securities from 70 to 50 per cent of market value of securities.	To take into account the recent sharp reduction in stock market credit and the abatement in speculative psychology in the stock market.
October	Reduced reserve requirements against time deposits from 5 to 4 per cent, effective October 25 for reserve city banks and November 1 for other member banks, thereby releasing about $780 million of reserves.	To help meet seasonal needs for reserves, while minimizing downward pressures on short-term interest rates, and to provide for the longer-term growth in bank deposits needed to facilitate the expansion in economic activity and trade.
Late October-December	Increased System holdings of U. S. Government securities by about $1.0 billion, with more than half of the net increase in issues maturing in more than 1 year. Member bank borrowing from the Reserve Banks rose gradually over period, but only to an average of about $200 million.	To help further in meeting seasonal needs for reserve funds while encouraging moderate further increase in bank credit and the money supply and avoiding money market conditions unduly favorable to capital outflows internationally. In mid-December open market operations were modified to provide a somewhat firmer tone in money markets and to offset the anticipated seasonal easing in Treasury bill rates.

tem holdings (apart from sums that might be acquired from the Stabilization Fund) be purchased directly from foreign central banks.

It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions in order that System transactions do not conflict with those being undertaken by foreign monetary authorities.

3. Transactions in Spot Exchange

The guiding principle for transactions in spot exchange shall be that, in general, market movements in exchange rates, within the limits established in the International Monetary Fund Agreement or by central bank practices, index affirmatively the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public.

Temporary or transitional fluctuations in payments flows may be cushioned or moderated whenever they occasion market anxieties, or undesirable speculative activity in foreign exchange transactions, or excessive leads and lags in international payments.

Special factors making for exchange market instabilities include (i) responses to short-run increases in international political tension, (ii) differences in phasing of international economic activity that give rise to unusually large interest-rate differentials between major markets, or (iii) market rumors of a character likely to stimulate speculative transactions.

Whenever exchange market instability threatens to produce disorderly conditions, System transactions are appropriate if the Special Manager, in consultation with the Federal Open Market Committee, or in an emergency with the members of the Committee designated for that purpose, reaches a judgment that they may help to re-establish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified, curtailed, or eventually discontinued pending a re-assessment by the Committee of supply and demand forces.

4. Transactions in Forward Exchange

Occasion to engage in forward transactions will arise mainly when forward premiums or discounts are inconsistent with interest-rate differentials and are giving rise to a disequilibrating movement of short-term funds, or when it is deemed appropriate to supplement existing market facilities for forward cover as a means of encouraging the retention or accumulation of dollar holdings abroad.

Proposals of the Special Manager to initiate forward operations shall be submitted to the Committee for advance approval.

For such operations, the New York Bank may, where authorized, take over from the Stabilization Fund outstanding contracts for forward sales or purchases of authorized currencies.

5. Exchange Rates

Insofar as practicable, the New York Bank shall purchase a currency through spot transactions at or below its par value, and should lower the rate at which it is prepared to purchase a currency as its holdings of that currency approach the established maximum.

The Bank shall also, where practicable, sell a currency through spot transactions at rates at or above its par value, and should raise the rate at which it is prepared to sell a currency as its holdings of that currency approach zero.

Spot transactions at rates other than those set forth in the preceding paragraphs shall be specially authorized by the members of the Committee designated in Section VIII of the Authorization for Open Market Transactions in Foreign Currencies.

CONTINUING AUTHORITY DIRECTIVE
ON SYSTEM FOREIGN CURRENCY OPERATIONS

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines on System Foreign Currency Operations issued by the Federal Open Market Committee on February 13, 1962:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs

Total foreign currencies held at any one time shall not exceed $500 million.

March 6, 1962

1. Authority to effect transactions in System Account.

The data on the domestic economy presented at this meeting showed mixed tendencies and suggested in general that the hesitation noted at the preceding meeting was continuing. There evidently was some modest improvement in employment in February, and the seasonally adjusted unemployment rate declined to 5.6 per cent from 5.8 per cent in the previous month. Construction activity was off slightly from a January level that had been revised downward since earlier reports. February production figures were available as yet for only a few products, including steel ingots and automobiles, both of which showed declines. It appeared likely, however, that the over-all index of industrial production in February would recover the 1 point loss of January, or at least would not decline. New orders received by manufacturers of durable goods had risen to a new high in January and were appreciably above sales in that month.

Partial figures for banks in leading cities suggested that total bank credit might have increased in February, after adjustment for usual seasonal changes. Time deposits at commercial banks continued to expand rapidly, although the rate of increase probably was not so high as earlier. Demand deposits increased on a seasonally adjusted basis in the first half of the month, but the situation in the second half was still uncertain.

The Treasury extended the maturities of about $5 billion of its securities in an advance refunding operation during the latter part of February, after refunding some $11 billion of maturing securities earlier in the month. The security markets also absorbed a substantial volume of new corporate issues and an exceptionally large volume of State and local government issues. Yields on high-grade corporate bonds continued to show little change, and those on long-term municipal bonds firmed at low relative levels in the second half of February after their earlier sharp declines. Long-term Government security yields declined somewhat in the latter part of the month but medium-term yields declined more, with the difference reflecting in part the shift of securities from the medium- to the long-term area in the advance refunding. Treasury bill rates also declined after the middle of February, but later rose somewhat.

Incomplete data on the U.S. international payments situation

suggested a marked improvement in the first 2 months of 1962, with the available figures indicating a deficit close to zero in January and relatively low in February. It was not clear, however, to what extent this improvement was real and to what extent transitory; many of the underlying figures, including those for exports and imports, were not yet available for the months in question. Some of the January improvement was due to a reversal of the earlier recorded outflow reflecting short-term lending, and some to a reversal of the year-end window dressing by foreign banks. It was noted that figures for the first quarter had appeared reassuring in 1961 also, and that there might be seasonal forces favoring the first-quarter picture.

There were no marked differences among Committee members with respect to the type of policy called for by these developments. However, some members while not advocating a substantial shift in policy, were impressed by the probability of continuing deficits in the international accounts and by the underlying elements of strength that they saw in the domestic economy. Therefore, they leaned toward a slightly reduced degree of ease. Others felt that in view of the recent domestic hesitation and the apparent improvement in the international accounts it would be appropriate to increase the degree of ease slightly, with less emphasis on minimizing downward pressures on short-term rates. The majority favored no change in policy, and at the conclusion of its deliberations the Committee voted unanimously to issue the following current economic policy directive to the Federal Reserve Bank of New York:

> In view of the continued underutilization of resources, and particularly of the evidence of some hesitation in the pace of business activity, it remains the current policy of the Federal Open Market Committee to promote further expansion of bank credit and the money supply, while giving recognition to the country's adverse balance of payments and the need to maintain a viable international payments system.
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> To implement this policy, operations for the System Open Market Account during the next 3 weeks shall be conducted with a view to maintaining a supply of reserves adequate for further credit expansion, taking

account of the desirability of avoiding undue downward pressures on short-term interest rates.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bryan, Deming, Ellis, Fulton, Mitchell, Robertson, and Shepardson. Votes against this action: None. (Mr. King stated subsequently that if he had been present at the point in the meeting when this action was taken he would have voted in favor of the directive.)

2. Review of continuing authorizations.

This being the first meeting of the Federal Open Market Committee after the election of new members from the Federal Reserve Banks for the year beginning March 1, 1962, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. Among other actions, it voted unanimously to reaffirm the authorization to the Federal Reserve Bank of New York covering open market transactions in foreign currencies and the continuing authority directive for these operations, both of which were first adopted at the meeting of February 13, 1962, and are quoted in the entry for that date. The Committee also decided to consolidate the substance of its previous continuing authority directive covering operations in U. S. Government securities and bankers' acceptances, first adopted on December 19, 1961, with that of several separate authorizations last reaffirmed on March 7, 1961. The latter included authorizations relating to repurchase agreements in Government securities, transactions in bankers' acceptances, the rate to be charged on special certificates of indebtedness purchased directly from the Treasury, and the effecting of transactions on a cash as well as a regular delivery basis. Accordingly, the following new continuing authority directive was issued to the Federal Reserve Bank of New York:

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 U.S. Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. 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 of the kinds designated in the regulation of the Federal Open Market Committee in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, 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 U.S. Government securities with maturities of 24 months or less at the time of purchase, and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, 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; provided that in the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

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 dis-

cretion, 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 rate charged on such certificates shall be a rate ¼ of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases; and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed $500 million.

Mr. Robertson dissented from the foregoing action for the same reasons that he dissented on December 19, 1961, from the adoption of the continuing authority directive. In substance, he felt that it was an inadequate directive, without sufficient guidance and restrictions. A detailed statement of his views is set forth on pages 93-94 of the ANNUAL REPORT of the Board of Governors for the year 1961.

March 27, 1962

Authority to effect transactions in System Account.

The domestic economic situation continued in February and early March to reflect expansion in over-all activity but at a much slower rate than in the final quarter of 1961. Some key monthly series, including industrial production and nonfarm employment, recovered in February following declines in January, and the unemployment rate declined slightly further. The decline in housing starts continued in February. Preliminary information indicated little change in retail sales, though with some evidence of more than a seasonal rise in department store and automobile sales appearing in the early weeks of March. Gross national product was tentatively estimated at an annual rate of $548 billion to $550 billion for the first quarter of 1962, compared with $542 billion in the fourth quarter of 1961.

The performance of the economy thus far in 1962 appeared sluggish in relation to the high rates of increase that had been projected in late fall and early winter, and in relation to what was needed for satisfactory reduction in levels of unemployment.

To some extent this sluggishness appeared attributable to temporary factors, such as unusually severe weather conditions.

The slower rate of economic expansion had been reflected in credit markets. Bank loan expansion had been large, but not unusually so for the March tax period. Bank investments in U. S. Government securities had declined more than usual for this time of year, but holdings of other securities had increased. While time deposits at banks continued to show sharp gains, demand deposits, seasonally adjusted, appeared to be little changed.

The volume of public offerings of corporate and municipal securities had not been so large during March as in February, but those offered had been generally well received and a larger volume appeared in prospect for April. Prices of common stocks had shown little net change, with trading volume moderate.

Despite the fact that the money market had been relatively firm because of seasonal and liquidity needs, yields on U.S. Government and other fixed-income securities declined. Yields on long-term Treasury bonds dropped below 4 per cent for the first time since November 1961, and average yields on 3-5 year issues were the lowest since May 1961. Treasury bill yields had declined from mid-February levels but remained close to the 1961 highs reached at the end of the year. Rates on Federal funds were generally at or only slightly below 3 per cent. Free reserves had averaged a little lower in March than in February, partly because of a tendency for actual reserve levels to turn out below projections. In addition, intermittent downward pressures on short-term interest rates exercised some restraining influence on System operations to supply reserves.

Preliminary information on the U.S. balance of payments in the first quarter suggested a marked reduction in net payments as compared with the fourth quarter of 1961, but the deficit appeared slightly larger than in the first quarter of 1961. The improvement from the preceding quarter apparently reflected mainly a smaller volume of short-term capital outflows, partly for technical reasons related to year-end window-dressing operations by banks abroad. The trade surplus, judging by the