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.

dealer financing requirements connected with the Treasury refunding superimposed upon seasonal needs for funds associated with corporate tax and dividend payments. Because of these developments, it was agreed that the Account Manager would have to give particular emphasis to the tone and feel of the market in managing the System Account. The current policy directive issued to the Federal Reserve Bank of New York was as follows:

It is the current policy of the Federal Open Market Committee to permit the supply of bank credit and money to increase further, but at the same time to avoid redundant bank reserves that would encourage capital outflows internationally. This policy takes into account, on the one hand, the gradualness of recent advance in economic activity and the availability of resources to permit further advance in activity. On the other hand, it gives recognition to the bank credit expansion over the past year and to the role of capital flows in the country's adverse balance of payments.

To implement this policy, operations for the System Open Market Account during the next 3 weeks shall be conducted with a view to providing moderate reserve expansion in the banking system and to fostering a moderately firm tone in money markets.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bryan, Deming, Ellis, Fulton, King, and Shepardson. Votes against this action: Messrs. Mills, Mitchell, and Robertson.

In explaining his dissent, Mr. Mills said that he considered the forestalling of further declines in the money supply to be an overriding necessity. In his view, therefore, a higher level of free reserves should be an objective of System policy. Mr. Mitchell dissented for reasons similar to those he had expressed at recent meetings. Mr. Robertson felt that greater monetary ease at this juncture could stimulate additional employment of resources domestically without prejudicing the international position of the dollar. In the credit field, he believed there was room for more aggressive loan competition among banks, at lower rates of interest. In his view, the ability of the economy to accommodate such additional credit stimulus was demonstrated, in part, by the relative absence of the kinds of credit abuses that could be engendered or remedied by changes in general credit controls. In

the field of public liquidity, he observed there was a clear need for renewed growth in the money supply. Although there had been times this year when the effects of a lagging money supply might have been cushioned by accelerated growth in time deposits and other liquid assets, such growth had since slowed. Furthermore, the channeling of private saving into financial claims, especially short-term Treasury securities, meant that the funds of businesses and consumers were being funneled into something less than the most stimulating channels, and Mr. Robertson felt that the prevailing interest-rate structure—fostered by existing monetary policy—must bear some of the responsibility for such a deflationary orientation of savings flows. He believed that greater monetary stimulation at this time—when there were unutilized human and material resources and when the gold stock was ample to protect against rumor-spawned speculative raids on the dollar—would contribute to a prosperous and more rapidly growing economy that would command renewed and more deeply rooted respect for both this country's economic system and its currency.

October 2, 1962

1. Authority to effect transactions in System Account.

Hesitation in the economy, apparent at the preceding meeting of the Committee, became clearer as final reports of August developments were examined, and the limited information available for September suggested little or no improvement in that month. The economy appeared rather delicately balanced between forces making for mild contraction and those making for further modest expansion. Unemployment, which rose in August to 5.8 per cent of the labor force, continued at that higher rate in September. Business psychology was appraised as not being optimistic; there was renewed weakness of stock market prices, and business fixed capital investment was indicated as lacking in vigor.

Consumer buying also was showing little significant change, with preliminary estimates suggesting a slight decline in total

retail sales in September. Industrial commodity prices had not been rising, and wage increases were indicated to have been smaller than in earlier postwar expansions.

In the financial area, total bank credit expansion in August was fairly sizable and business loans showed somewhat more strength. Private demand deposits, which had declined in August, rose somewhat in the first half of September. Time and savings deposits continued to expand.

In capital markets, the volume of new municipal and corporate offerings was relatively light, and yields tended to slide off from summer levels. Yields on Treasury notes and bonds also tended downward, while 3-month bill rates ended the period at about the 2.75 per cent level, little changed from the start of the period. The effective rate on Federal funds continued in the 2.75-3 per cent area.

Improvement in the U.S. balance of payments this year was viewed as likely to be disappointingly small. In the first 3 quarters of the year, the deficit continued uncomfortably large and would have been even larger if substantial debt prepayments had not been received. Moreover, the deficit involved a greater gold loss than in 1961.

Some sentiment expressed during this meeting favored a modification of monetary policy in the direction of additional ease because of concern about the lack of vigor in the domestic economy. However, after taking into account the continuing balance of payments deficit as well as the supply of bank credit already available to meet credit demands, the majority view favored a continuation of current policy for the next 3 weeks. This policy contemplated that reserves needed for seasonal purposes would be supplied freely and that the Account Management, in conducting open market operations, would continue to be guided to a considerable extent by money market developments. The current policy directive issued to the Federal Reserve Bank of New York was in the same form as that issued at the meeting on September 11.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bryan, Deming, Ellis, Fulton, and Shepardson. Votes against this action: Messrs. Mills and Mitchell.

Messrs. Mills and Mitchell concurred in the generally held view regarding the seriousness of the balance of payments problem. However, with the domestic economy operating below desired levels of resource utilization and future trends uncertain, they saw justification in moving toward a somewhat greater degree of monetary ease than was implied in a continuation of current policy, even though this might result in some downward pressure on short-term interest rates.

2. Authority to purchase and sell foreign currencies.

The continuing authority directive to the Federal Reserve Bank of New York with respect to System foreign currency operations, as originally adopted by the Federal Open Market Committee on February 13, 1962, and most recently amended by the Committee on July 10, 1962, was further amended at this meeting, effective immediately, to increase from $750 million to $1 billion the maximum amount of foreign currencies authorized to be held at any one time and to add the Austrian schilling to the list of foreign currencies that the New York Bank was authorized and directed to purchase and sell. At this date the Federal Reserve System had reciprocal currency (swap) agreements outstanding in the total amount of $700 million with the Bank of France, the Bank of England, the Netherlands Bank, the National Bank of Belgium, the Bank of Canada, the Bank for International Settlements, the Swiss National Bank, and the German Federal Bank. In addition, there was in prospect the execution of similar agreements with the Bank of Italy and the Austrian National Bank that, if entered into on the basis contemplated, would increase to $800 million the total U.S. dollar equivalent of foreign currencies involved in such arrangements. In addition, the System continued to hold a modest quantity of foreign currencies acquired from the Treasury Stabilization Fund

at the outset of the Federal Reserve program of foreign currency operations.

As amended, the continuing authority directive read as follows:

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
Belgian francs
Canadian dollars
Austrian schillings

Total foreign currencies held at any one time shall not exceed $1 billion.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bryan, Deming, Ellis, Fulton, Mills, Mitchell, and Shepardson. Votes against this action: None.

October 23, 1962

Authority to effect transactions in System Account.

During the evening preceding this meeting of the Committee, the President had announced emergency actions to deal with the crisis that had developed due to the build-up of offensive military weapons in Cuba. The crisis had become apparent suddenly, but in the short time available to receive reports it appeared that the reaction in markets was cautious, though nervous, with the result that no waves of selling or buying had developed. In the corporate security market one large financing proceeded as scheduled the morning of the meeting. The Special Manager of the System Open Market Account for foreign currency operations had

contacted the monetary authorities of major industrial countries by the time of the meeting, and those authorities stood prepared to coordinate such intervention in foreign exchange markets as might become necessary to cushion the impact of any unusual flows of funds that might develop internationally.

The Committee discussion reflected grave concern about possible consequences of the Cuban crisis, but until further information became available no change in monetary policy seemed called for on that account. Economic and financial tendencies, as they had been developing prior to the President's statement, had led to some comment in business and financial quarters about a possible early cyclical turndown in activity. While the general view was that information available to date did not support such a conclusion, at the same time it was clear that the economy at best had been moving sideways in recent weeks. The margin of unutilized manpower and industrial capacity continued large.

In financial markets the impact of the recently announced reduction by the Board of Governors of 1 percentage point in reserve requirements on time and savings deposits at member banks, to become effective shortly, remained to be seen, and the Cuban crisis rendered appraisal of the situation particularly difficult. Sluggishness in the economy, however, appeared to be generating an increasing volume of business and consumer liquidity without a corresponding change in private credit demands. As a consequence, both short- and long-term interest rates had continued to ease prior to the Cuban crisis.

The U.S. balance of payments position deteriorated in the third quarter and even more so in the first half of October. The net capital outflow on private account continued large, especially to Canada. Exports had declined in August contrary to expectations, and the export surplus was the smallest in many years. Increasing concern was reported about prospects for a continuation of economic expansion in Europe; if the European boom should be topping out, U.S. exports would be adversely affected.

In view of the uncertainties presented by the international