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.

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

January data (the latest available), was running below both the fourth quarter and the first quarter of 1961.

The outflow of gold approximated $300 million in the current quarter, although some part of that amount might be viewed as offset by an increase in U.S. holdings of foreign convertible currencies. Reductions in the United Kingdom bank rate suggested a decrease in British interest-rate levels, but it was not clear whether or to what extent funds hitherto attracted to the United Kingdom would flow to New York.

Differences among Committee members with respect to the type of policy called for by these developments were generally small. Most members felt that the balance of payments situation continued to call for a domestic interest-rate structure that would not encourage outflows of funds, and thus were concerned about the declining tendency in interest rates. This tendency, it was noted, might well be accentuated by continuing to provide reserve availability to facilitate expansion in bank credit domestically, which most members also regarded as desirable. Some of the members, having in mind the modest nature of the expansion in domestic activity, were inclined to ease slightly. A few members, in fact, would have preferred taking more decisive easing action, but one member recommended a policy of less ease. The majority, however, concluded that on balance no significant change in policy should be made. The two changes made in the wording of the current economic policy directive were intended to make clear that the general policy in effect in the preceding period and now being continued was designed to effect slightly more expansion in reserve availability than had actually developed. The policy directive issued to the Federal Reserve Bank of New York read as follows:

> In view of the modest nature of recent advances in the pace of economic activity and the continued underutilization of resources, 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.

> 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 and monetary expansion, taking account of the desirability of avoiding sustained downward pressures on short-term interest rates.

Votes for this action: Messrs. Martin, Balderston, Bryan, Ellis, Mitchell, Robertson, Shepardson, Clay, Scanlon, and Treiber. Vote against this action: Mr. Mills.

Mr. Mills dissented on the ground that the long maintained high level of free reserves had forced excessive liquidity into the economy and thereby had laid the foundation for future inflationary difficulties. Moreover, he felt that monetary policy by its declared purpose of holding interest rates on Treasury bills at a level intended to deter transfer of funds abroad had set a floor under bill rates and, in his opinion, had encouraged speculative operations in all maturities of U.S. Government securities. Mr. Mills felt that these and other difficulties could have been avoided by policy objectives geared solely to providing adequate credit availability—an amount that would have resulted in a somewhat firmer interest-rate structure but which still would have permitted sufficient bank credit expansion. He believed that the assumption that there must be close coordination between growth in the money supply and growth in gross national product was erroneous, and monetary policy should pay close attention to encouraging constructive commercial bank lending and investing practices.

April 17, 1962

Authority to effect transactions in System Account.

Information regarding developments in the domestic economy that had become available in the period since the preceding meeting of the Committee provided some definite signs of improvement. However, uncertainties remained about the course of developments in a number of strategic areas, such as resi-