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.

Mr. Robertson, who dissented for the same reasons he had expressed at the June 19 meeting, stated that he was in full agreement with Mr. Mitchell's position. He felt that the economic information presented to the Committee indicated that the date of such meeting was precisely the wrong time for adopting a less easy monetary policy and that the move should now be reversed.

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 adopted by the Federal Open Market Committee on February 13, 1962, and most recently amended by the Committee on June 21, 1962, was further amended at this meeting, effective immediately, to increase from $500 million to $750 million the maximum amount of foreign currencies authorized to be held at any one time. By this date, reciprocal currency (swap) agreements totaling $450 million had been entered into by the Federal Reserve System with five foreign central banks—the Bank of France, the Bank of England, the Netherlands Bank, the National Bank of Belgium, and the Bank of Canada; and there was in prospect the execution of similar agreements with the Bank for International Settlements, the Swiss National Bank, and the German Federal Bank that would, if executed, raise the total U.S. dollar equivalent of foreign currencies involved in such agreements to $700 million. In addition, the System held some $33.5 million equivalent 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

Total foreign currencies held at any one time shall not exceed $750 million.

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

July 31, 1962

Authority to effect transactions in System Account.

Incomplete and scattered data for July suggested mild improvement in the economy, following indications of a slackened pace of expansion in June. The unemployment rate was down slightly, auto and department store sales recovered to about the May levels, and early clues as to the course of industrial production offered hope of some increase. On the other hand, manufacturers' appropriations for fixed capital purposes were indicated to have declined in the second quarter.

In credit and money markets the atmosphere was one of considerable uncertainty. Bank credit, seasonally adjusted, declined substantially in July, partly because Treasury cash financing was much smaller than usual for that month. Security loans for all purposes were sharply lower. Business loan demand showed little change, while bank holdings of real estate loans and of securities other than U.S. Governments continued to increase substantially.

The private money supply, although aided by shifts from Government to private deposits, remained at roughly the level that had been maintained since late 1961. Time and savings deposits (not included in the money supply, as conventionally defined) apparently continued to grow in July, but at a slower pace than earlier in the year. Because of smaller demand deposit growth, reserves required to support private deposits, after moving up during the first 3 weeks of July, turned down again in the latest week. Free reserves had shown large week-to-week fluctuations since the preceding meeting of the Committee but had averaged about $450 million. Money market conditions, however, had been slightly less easy than might have been expected with that average level of free reserves; Federal funds traded mostly in the 2¾-3 per cent range, while short-term Treasury bills fluctuated within the 2⅞-3 per cent range.

The over-all balance of payments deficit for the second quarter turned out to have been larger than estimated earlier. Much of the improvement from the first quarter reflected a temporary capital inflow stemming from deterioration of confidence in the newly established rate for the Canadian dollar. The outlook for the third quarter appeared to be for little or no improvement in the U.S. payments position, partly because it would be adversely affected by the reflow to Canada that was beginning to set in following the provision of special credits to Canada by the International Monetary Fund, the United States, and the United Kingdom. The London market for gold was unusually active, and official support to the market was heavy throughout much of the 3-week period preceding this meeting. On July 23 the President, in the course of a news conference that was telecast to Europe, reaffirmed the intent of the United States not to devalue its dollar. Thereafter, gold and foreign exchange markets were less active, and the position of the U.S. dollar in European centers improved.

A minority of the Committee favored a policy of greater monetary ease as a means of stimulating domestic economic expansion or of helping to stave off possible setback in the economy. However, the majority, after weighing such considerations as the continued evidence of adequate domestic liquidity on one side and the unsatisfactory prospects for the balance of payments on the other, and noting that a Treasury financing was currently in progress, concluded that an "even keel" policy was appropriate

for the forthcoming period. Accordingly, the current policy directive issued to the Federal Reserve Bank of New York was in the same form as the directive issued at the meeting on July 10, 1962.

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

In dissenting, Mr. Robertson expressed the view that greater recognition should be given to the possibility of deteriorating domestic economic activity, and that in present circumstances monetary policy could and should be providing additional stimulus. The accumulation of evidence suggested to him that the recent shift in policy toward less monetary ease was generating contractive reserve pressures. He regarded this as incurring real risks in pursuit of illusory benefits; he had seen no evidence of beneficial effects of higher U.S. money rates upon international gold and dollar flows that would justify the domestic economic hazards entailed, in his view, by such a policy. It seemed to him that a more liberal policy of encouraging further expansion in bank reserves, credit, and money, even if accompanied by easier money market conditions, would better serve the long-run objective of a growing, prosperous, and internationally competitive U.S. economy.

Mr. Mitchell dissented largely on the grounds set forth at the meeting on July 10. The economy was continuing to drift along in lacklustre fashion, and in his view the odds were long and lengthening against a vigorous advance in the last half of the year. He believed that a significant obstacle to further expansion in the domestic economy was a protracted imbalance in the money and capital markets created by the continuing effort to use monetary policy to deal with the balance of payments situation. According to his analysis, debt management and monetary policy had created a highly artificial situation in the money and capital markets by holding up the short-term money rate. This had created expectations that long-term rates would rise, despite a preponderance of historical and analytical evidence that they had passed their sustainable peak. He saw a serious threat to the domestic economy, which he felt should be recognized by supplying reserves somewhat more freely, by making it clear that there was no possibility of a discount rate increase under current conditions, and by being prepared to see the short-term rate decline by as much as half of a percentage point.

August 21, 1962

Authority to effect transactions in System Account.

Domestic economic developments in July, as reviewed by the Committee at this meeting, were more favorable than those in the immediately preceding months, and somewhat more favorable than had been suggested by evidence available at the preceding meeting of the Committee. Available data indicated widespread, if moderate, gains in activity. The industrial production index rose nearly a full point; new orders received by durable goods manufacturers rebounded sharply; and personal income, retail trade, and other important measures showed increases. Scattered figures for early August suggested that the July gains in production and sales were being maintained. On the less favorable side, housing starts failed to reverse the drop of June, and final figures for manufacturers' capital appropriations confirmed the sharp second-quarter curtailment that had been reported earlier. Also, while the seasonally adjusted rate of unemployment dropped slightly further in July to 5.3 per cent of the civilian labor force, the lack of growth in the labor force itself was viewed as a cause for concern.

Business loans at banks had apparently expanded somewhat in recent weeks, but the over-all private demand for bank credit continued to be relatively moderate. Required reserves and the money supply both declined in the first half of August, and there was a marked slowdown in growth of time deposits other than savings accounts. Yields on intermediate- and longer-term Treasury securities, which had risen in late June and early July, had declined substantially in the period since the end of July, and

heightened investor interest was apparent in all instruments from Treasury bills to long-term corporate bonds. One reason for the previous advance in yields had been the widespread belief that an early tax cut and a consequent substantial expansion of Federal debt were distinct possibilities. Correspondingly, a major factor in the decline in yields was the fading of this prospect, particularly after the President's statement on tax policy a week before the meeting. The Treasury was reported to be considering undertaking an advance refunding shortly after Labor Day, in view of the currently favorable market circumstances.

International payments of the United States in July were affected favorably by advance debt repayments on the part of France and Italy, and in July and early August were affected unfavorably by the reflux of funds to Canada. After allowance for these extraordinary factors, it appeared that the deficit in the payments balance was running at a rate smaller than in the third quarter of 1961 but larger than had been expected for the third quarter of 1962. It appeared to be at least as high as the adjusted second-quarter deficit, which also had been in excess of advance estimates. However, the position of the dollar in foreign exchange markets appeared to have improved somewhat, and private demand for gold in the London market evidently had declined.

In sum, recent domestic developments appeared moderately encouraging while those with respect to the balance of payments were disappointing; there continued to be substantial room for improvement on both fronts. A majority of the Committee concluded that, on balance, circumstances warranted a continuation of recent monetary policy. Accordingly, the following current policy directive, which reflected no change from the previous directive except to eliminate references to unsettled behavior in financial markets in view of the steadier performance of those markets, was issued to the Federal Reserve Bank of New York:

> 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