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.

Treasury; and that Chairman Martin be authorized to refer to this development in his testimony before the Joint Economic Committee scheduled for January 30, 1962.

Votes for this motion: Messrs. Martin, Hayes, Balderston, Irons, King, Mills, Shepardson, Swan, Wayne, and Fulton. Votes against this motion: Messrs. Mitchell and Robertson.

(Note: See Record of Policy Actions taken by the Committee on February 13, 1962, for entry covering the action of the Committee instituting the program of foreign currency operations through the approval of certain authorizations, guidelines, and directives.)

February 13, 1962

1. Authority to effect transactions in System Account.

Reports at this meeting suggested that, while the prospects for continued economic expansion remained good, there had been some recent hesitation in the forward movement of the economy. Retail trade figures showed slight declines from the advanced November level in both December and January after adjustment for usual seasonal changes, and preliminary indications were that the industrial production index for January would be not above—possibly below—the December figure. In surveys of consumer buying intentions the demand for automobiles appeared stronger than a year earlier, but this was counterbalanced by apparent weakness in demand for household durable goods. A slight further reduction in the unemployment rate was attributed to lack of growth in the labor force rather than to strength in employment. Prices continued stable.

Total loans and investments of commercial banks had declined about the usual seasonal amounts in recent weeks, after the large December increase. On balance, during the past 2 or 3 months bank credit continued to show a moderate expansion, when allowance was made for the wide seasonal movements occurring around the turn of the year. The most striking develop-

ment in banking since the year-end was a sharp increase in time deposits, accompanied by a smaller but substantial decline in demand deposits, after seasonal adjustment. In the last half of January the conventionally defined money supply was about $1 billion less than in the second half of December on a seasonally adjusted daily average basis, and about 2.5 per cent larger than in the comparable period of the preceding year. The total of the money supply and time deposits at commercial banks, however, was about 7 per cent above a year earlier.

Interest rates for the most part remained firm. Treasury bill rates declined less than seasonally after rising more than seasonally in December, yields on medium- and long-term U. S. Government securities generally maintained the higher levels reached in December or early January, and high-grade corporate bond yields continued to show little change. Yields on State and local government bonds declined sharply, however, apparently partly as a result of heightened bank interest in longer-term tax-exempt issues as a medium for investment of their growing time deposits. Yields on long-term U.S. Government bonds exceeded those on high-grade municipals by the largest margin in many years.

In the money market, Federal Reserve float declined from the high levels that had been partly responsible for an unanticipated degree of market ease prior to the January 23 meeting of the Committee. Open market operations since then had been directed mainly at maintaining steady conditions while the Treasury completed its scheduled refunding. There were reports at this meeting that the Treasury might engage in an advance refunding operation shortly.

With respect to the international accounts, incomplete data indicated that net transfers of gold and dollars to foreigners declined sharply in January and early February from the average fourth-quarter rate. The accounts still showed an adverse balance, however, and remained a source of serious concern. Net gold sales to foreigners evidently were continuing to run in the neighborhood of $100 million per month.

After considering these domestic and international developments, the Committee concluded that it would be appropriate to continue its recent credit policy for the coming 3 weeks. On the one hand, domestic developments did not appear to be of such nature as to require a shift toward greater ease. On the other hand, the apparent pause in the forward progress of the economy militated against a move toward lesser ease such as might have otherwise been indicated on the basis of balance of payments considerations. The possibility of a Treasury advance refunding also was a factor in favor of holding the posture of monetary policy unchanged. Accordingly, the Committee issued the following current economic policy directive to the Federal Reserve Bank of New York:

It continues to be the current policy of the Committee to permit further bank credit and monetary expansion so as to promote fuller utilization of the economy's resources, together with monetary conditions consistent with the needs of an expanding domestic economy, taking into account this country's adverse balance of payments as well as a possible Treasury financing.

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, while minimizing downward pressures on short-term interest rates. In view of the possibility of a Treasury financing, emphasis shall be placed on maintaining a steady money market.

Votes for this action: Messrs. Martin, Balderston, Irons, King, Mills, Mitchell, Robertson, Shepardson, Swan, Wayne, Fulton, and Treiber. Votes against this action: None.

2. Authority for program of System foreign currency operations.

Since March 1961 the U.S. Treasury, through its Stabilization Fund and with the Federal Reserve Bank of New York acting as agent, had been conducting foreign exchange operations as part of a cooperative effort by treasuries and central banks on both sides of the Atlantic to create a first line of defense against disorderly speculation in the foreign exchange markets. For several months prior to this meeting the Federal Open Market Committee had been studying the question of the desir-

ability of instituting a program of Federal Reserve operations in foreign currencies, which would be supplemental to and in collaboration with the activities of the Treasury. At the Committee meeting on January 23, 1962, a motion had been approved (with Messrs. Mitchell and Robertson dissenting) favoring in principle the initiation of such a program on an experimental basis. That motion also authorized representatives of the Committee to consult with the Treasury for the purpose of exploring guidelines for such operations, in light of the recent Treasury experience, and developing plans for effective working relations in this field between the Treasury and the Federal Reserve. The results of the discussions that had been authorized were reported at this meeting. Accordingly, after further deliberation the Committee approved, effective immediately, an authorization regarding open market transactions in foreign currencies, a statement of guidelines for System foreign currency operations, and a continuing authority directive on System foreign currency operations. The authorization, the guidelines, and the continuing authority directive, in the form in which they were adopted by the Committee, are shown at the conclusion of this policy record entry. As to each of the items, the vote of the Committee was as follows:

Votes for the action: Messrs. Martin, Balderston, Irons, King, Mills, Mitchell, Robertson, Shepardson, Swan, Wayne, Fulton, and Treiber. Votes against the action: None.

Although Messrs. Mitchell and Robertson had dissented at the meeting on January 23, 1962, from the motion approving in principle the initiation of a program of System foreign currency operations, they voted affirmatively on the actions taken at this meeting. Their affirmative votes were on the ground that the actions taken by the Committee at this meeting involved merely the implementation of a basic decision that had already been made by a majority of the Committee.

Mr. Mitchell's dissent at the January 23 meeting from the motion favoring in principle the initiation of a program of System foreign currency operations had been based on his belief that the institution of any such program by the System should be preceded by analysis by outside experts, public discussion, and legislative clarification of the System's statutory authority to acquire, hold, and sell foreign currency assets.

Mr. Robertson's dissent had been based on both legal and economic considerations. He regarded the legality of the proposed operations in foreign currencies as questionable, inasmuch as the Federal Reserve Act provided no general and positive authorization therefor. He felt that an *incidental* power—such as the power to maintain foreign accounts—should not be relied upon as an authorization to exercise the broad policy functions contemplated by this proposal. Furthermore, he believed the operations would be inconsistent with the express intent of Congress to confer upon the Treasury's Exchange Stabilization Fund a limited authority for operations to stabilize the exchange value of the dollar. Over and above such questions as to authority, Mr. Robertson thought it would be unwise for two separate agencies of the U.S. Government to be engaged in buying and selling foreign exchange, and he felt that the balance of considerations clearly favored any such operations being conducted by the Treasury.

Mr. Robertson also believed that a number of practical economic factors argued against instituting Federal Reserve operations in foreign currencies. Acquisitions by the United States of foreign exchange in such operations would be matched by an increase in foreign claims on the dollar. With the U.S. balance of payments currently in deficit, and with foreign recipients of increased dollar claims already taking a portion of such increases in gold, actions that would add to such dollar claims would run the risk of aggravating rather than minimizing the drains on U.S. gold reserves. In the foreign exchange markets themselves, he felt that any continual central bank intervention could have damaging influences upon private market processes, perhaps stimulating new phases of speculative activities and doing more to reduce confidence in the dollar than the reverse. He believed

that the best defense of the dollar consisted of continuance of Treasury maintenance of a fixed buying and selling price for gold, accompanied, if necessary, by action by the Exchange Stabilization Fund (augmented, if desirable, by congressional appropriation) on any occasions of dangerously disorderly foreign exchange markets, and undergirded by sound policies designed to eliminate unsustainable deficits in the U.S. balance of payments.

The majority of the Open Market Committee favored initiation of an experimental program of System foreign currency operations on the ground that such operations held the promise of being useful in accomplishing the basic purposes and specific aims set forth in the Authorization of the Committee, as cited hereinafter. As to the question of legal authority, the majority noted an opinion of the Committee's General Counsel, which had been concurred in by the General Counsel of the Treasury and the Attorney General of the United States, that the Federal Reserve Banks were authorized under existing law to engage in open market transactions in foreign exchange subject to the direction and regulation of the Federal Open Market Committee and, for this purpose, to open and maintain accounts with foreign banks subject to the consent and under regulations of the Board of Governors of the Federal Reserve System.

The documents hereinbefore referred to as having been approved by the Federal Open Market Committee at this meeting were as follows:

Authorization Regarding Open Market Transactions in Foreign Currencies

Pursuant to Section 12A of the Federal Reserve Act and in accordance with Section 214.5 of Regulation N (as amended) of the Board of Governors of the Federal Reserve System, the Federal Open Market Committee takes the following action governing open market operations incident to the opening and maintenance by the Federal Reserve Bank of New York (hereafter sometimes referred to as the New York Bank) of accounts with foreign central banks.

I. Role of Federal Reserve Bank of New York

The New York Bank shall execute all transactions pursuant to this authorization (hereafter sometimes referred to as transactions in foreign currencies) for the System Open Market Account, as defined in the Regulation of the Federal Open Market Committee.

II. Basic Purposes of Operations

The basic purposes of System operations in and holdings of foreign currencies are:

(1) To help safeguard the value of the dollar in international exchange markets;
(2) To aid in making the existing system of international payments more efficient and in avoiding disorderly conditions in exchange markets;
(3) To further monetary cooperation with central banks of other countries maintaining convertible currencies, with the International Monetary Fund, and with other international payments institutions;
(4) Together with these banks and institutions, to help moderate temporary imbalances in international payments that may adversely affect monetary reserve positions; and
(5) In the long run, to make possible growth in the liquid assets available to international money markets in accordance with the needs of an expanding world economy.

III. Specific Aims of Operations

Within the basic purposes set forth in Section II, the transactions shall be conducted with a view to the following specific aims:

(1) To offset or compensate, when appropriate, the effects on U.S. gold reserves or dollar liabilities of those fluctuations in the international flow of payments to or from the United States that are deemed to reflect temporary disequilibrating forces or transitional market unsettlement;
(2) To temper and smooth out abrupt changes in spot exchange rates and moderate forward premiums and discounts judged to be disequilibrating;
(3) To supplement international exchange arrangements such as those made through the International Monetary Fund; and
(4) In the long run, to provide a means whereby reciprocal holdings of foreign currencies may contribute to meeting needs for international liquidity as required in terms of an expanding world economy.

IV. Arrangements with Foreign Central Banks

In making operating arrangements with foreign central banks on System holdings of foreign currencies, the New York Bank shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee.

The Bank shall instruct foreign central banks regarding the investment of such holdings in excess of minimum working balances in accordance with Section 14(e) of the Federal Reserve Act.

The Bank shall consult with foreign central banks on coordination of exchange operations.

Any agreements or understandings concerning the administration of the accounts maintained by the New York Bank with the central banks designated by the Board of Governors under Section 214.5 of Regulation N (as amended) are to be referred for review and approval to the Committee, subject to the provision of Section VIII, paragraph 1, below.

V. Authorized Currencies

The New York Bank is authorized to conduct transactions for System Account in such currencies and within the limits that the Federal Open Market Committee may from time to time specify.

VI. Methods of Acquiring and Selling Foreign Currencies

The New York Bank is authorized to purchase and sell foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the Stabilization Fund of the Secretary of the Treasury established by Section 10 of the Gold Reserve Act of 1934 and with foreign monetary authorities.

Unless the Bank is otherwise authorized, all transactions shall be at prevailing market rates.

VII. Participation of Federal Reserve Banks

All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G (1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

VIII. Administrative Procedures

The Federal Open Market Committee authorizes a Subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board of Governors (or in the absence of the Chairman or of the Vice Chairman of the Board of Governors the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate) to give instructions to the Special Manager, within the guidelines issued by the Committee, in cases in which it is necessary to reach a decision on operations before the Committee can be consulted.

All actions authorized under the preceding paragraph shall be promptly reported to the Committee.

The Committee authorizes the Chairman, and in his absence the Vice Chairman of the Committee, and in the absence of both, the Vice Chairman of the Board of Governors:

(1) With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

(2) To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities;

(3) From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Problems.

IX. Special Manager of the System Open Market Account

A Special Manager of the Open Market Account for foreign currency operations shall be selected in accordance with the established procedures of the Federal Open Market Committee for the selection of the Manager of the System Open Market Account.

The Special Manager shall direct that all transactions in foreign currencies and the amounts of all holdings in each authorized foreign currency be reported daily to designated staff officials of the Committee, and shall regularly consult with the designated staff officials of the Committee on current tendencies in the flow of international payments and on current developments in foreign exchange markets.

The Special Manager and the designated staff officials of the Committee shall arrange for the prompt transmittal to the Committee of all statistical and other information relating to the transactions in and the amounts of holdings of foreign currencies for review by the Committee as to conformity with its instructions.

The Special Manager shall include in his reports to the Committee a statement of bank balances and investments payable in foreign currencies, a statement of net profit or loss on transactions to date, and a summary of outstanding unmatured contracts in foreign currencies.

X. Transmittal of Information to Treasury Department

The staff officials of the Federal Open Market Committee shall transmit all pertinent information on System foreign currency transactions to designated officials of the Treasury Department.

XI. Amendment of Authorization

The Federal Open Market Committee may at any time amend or rescind this authorization.

GUIDELINES FOR SYSTEM FOREIGN CURRENCY OPERATIONS

1. Holdings of Foreign Currencies

Until otherwise authorized, the System will limit its holdings of foreign currencies to that amount necessary to enable its operations to exert a market influence. Holdings of larger amounts will be authorized only when the U.S. balance of international payments attains a sufficient surplus to permit the ready accumulation of holdings of major convertible currencies.

Holdings of a currency shall generally be kept sufficient to meet forward contracts in that currency (exclusive of contracts made under parallel arrangements with foreign monetary authorities which provide their own cover) expected to mature in the following 3-week period.

Foreign currency holdings above a certain minimum shall be invested as far as practicable in conformity with Section 14(e) of the Federal Reserve Act.

2. Exchange Transactions

System exchange transactions shall mainly be geared to pressures of payments flows so as to cushion or moderate disequilibrating movements of volatile funds and their destabilizing effects on U.S. and foreign official reserves and on exchange markets.

The New York Bank shall, as a usual practice, purchase and sell authorized currencies at prevailing market rates without trying to establish rates that appear to be out of line with underlying market forces.

If market offers to sell or buy intensify as System holdings increase or decline, this shall be regarded as a clear signal for a review of the System's evaluation of international payments flows. This review might suggest a temporary change in System holdings of a particular convertible currency and possibly direct exchange transactions with the foreign central bank involved to be able to accommodate a larger demand or supply.

Starting operations at a time when the United States is not experiencing a net inflow of any eligible foreign currency may require that initial System 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 hesi-