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.

crisis and the imminence of a Treasury refunding, there was unanimous agreement that no change should be made in policy at this meeting, although the Committee should be prepared to deal promptly with whatever problems might arise. While, as indicated, the policy decision was to maintain the status quo at this time, the wording of the current economic policy directive was changed to reflect awareness of the Cuban emergency situation and to take account of the forthcoming Treasury financing. As changed, the directive issued to the Federal Reserve Bank of New York read as follows:

It is the current policy of the Federal Open Market Committee to encourage moderate further increase in bank credit and the money supply, while avoiding money market conditions unduly favorable to capital outflows internationally. It is also the Committee's policy to cushion such unsettlement in money markets as may stem from international developments of an emergency or near emergency character. This policy takes into account the potential financial effects of the Government's quarantine on armament imports into Cuba, the imminence of a large Treasury refinancing, and the recent stability of economic activity, with a margin of underutilized resources and an absence of inflationary pressures.

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 steady tone in money markets.

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

November 13, 1962

1. Authority to effect transactions in System Account.

The Cuban crisis, although far from settled, had eased appreciably by the time of this meeting. While the performance of the domestic economy was still unsatisfactory in terms of utilization of manpower and other resources, the economic atmosphere appeared to have improved. The more encouraging domestic

indications included a high rate of auto sales in October following the introduction of new models; preliminary reports from the October survey of consumer buying plans showing increased strength in plans to purchase new cars and household durable goods; and the results of a recent survey of business plans for new plant and equipment outlays for 1963, showing a modest rise over the estimated 1962 total.

In most domestic financial areas a somewhat more stimulative tone had developed in October and early November. Bank credit had again expanded at a rapid rate in October. Business loan expansion continued larger than seasonal, following a strong showing in August and September. The money supply had risen appreciably in October, and there was a further rapid rise in time and savings deposits. Member bank borrowing from Reserve Banks continued moderate, and free reserves averaged above the $400 million level. The large consumer financial savings and corporate cash flows were sources of downward pressure on interest rates. Treasury, corporate, and municipal bond yields had receded during October to around the lows reached in the spring of the year. However, large Treasury financing operations and Federal Reserve open market operations had contributed by early November to raising short-term rates above the low levels of late October.

Preliminary information on the October balance of payments position of the United States was unfavorable, indicating an over-all deficit of $900 million or more. This was the largest for any month on record and more than double the third-quarter monthly average deficit, owing in part to extraordinary transactions including large transfers to Canada, a large royalty payment to Venezuela, and probably some outflow of U.S. funds caused by the Cuban crisis. Some improvement in the balance of payments was indicated for the first week of November. Despite the sharp deterioration in the October payments position, the dollar remained relatively steady in foreign exchange markets and no serious pressure developed in the London gold market, reflecting in part the increasingly close cooperation among leading central banks. Gold sales to foreigners in October were small in relation to the deficit in the balance of payments in that month.

Within the Committee, differences in views were more clearly marked than for some time as to the appropriate course for monetary and credit policy. Some members of the Committee favored moving in the direction of slightly less ease. Their views reflected serious concern about the balance of payments problem, which they believed could be alleviated to some extent by moderately higher interest rates in this country. They suggested that monetary ease had already provided ample liquidity to the domestic economy and that greater ease would be more likely to find expression in speculative tendencies and increased outflows of funds to other countries than in significant stimulation of economic expansion. On the other hand, other members of the Committee emphasized the protracted sluggishness in the domestic economic situation and the absence of inflationary tendencies. Also, they felt that small increases in interest rates would be of little help in dealing with the balance of payments problem. Hence, these members were inclined toward somewhat more ease than currently prevailed. A third group, constituting a majority of the Committee, felt that recent changes in domestic and international conditions had not yet been so pronounced as to call for any change at this time in the current Committee policy, which called for encouraging a moderate further increase in bank credit and the money supply, while avoiding money market conditions unduly favorable to capital outflows.

After extensive discussion of these various views, the following current economic policy directive was issued to the Federal Reserve Bank of New York:

In view of the recent stability of economic activity, with a margin of underutilized resources and an absence of inflationary pressures, it is the current policy of the Federal Open Market Committee to encourage moderate further increase in bank credit and the money supply, while avoiding money market conditions unduly favorable to capital outflows internationally. It is also the Committee's policy to cushion such unsettlement in money markets as may stem from international developments of an emergency or near emergency character.

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 steady tone in money markets.

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

In voting on the directive, Messrs. Balderston and Fulton indicated that they would have preferred a lesser degree of ease, while Messrs. Mills and Mitchell indicated they would have preferred a greater degree of ease. They voted for the directive, however, on the ground that its wording would permit the degree of change that they would have preferred.

In voting against the adoption of the directive, Mr. Hayes called attention to the slightly better performance of the domestic economy in the recent period, the substantial recent increases in bank credit, the downward market pressures on interest rates of all maturities, and the lack of significant progress with regard to the balance of payments. In his view, with the international balance of payments problem so pressing, and with the nation's liquidity so ample, he could see no reason for pursuing a policy only slightly less easy than at the bottom of a recession nearly 2 years earlier. Accordingly, he advocated making a modest but definite move toward less ease.

2. Amendment of Authorization and Guidelines for System foreign currency operations.

The Committee's Guidelines for System Foreign Currency Operations and its Authorization Regarding Open Market Transactions in Foreign Currencies (approved on February 13, 1962, and reaffirmed on March 6, 1962) were amended in minor respects to provide for somewhat greater flexibility of operations and to provide expressly for reciprocal currency arrangements on a standby basis. The amendment in the Guidelines took the form of deleting certain words in the first paragraph of Section 2, Exchange Transactions, and inserting two subsequent paragraphs, with the result that the first three paragraphs of the Section were changed to read as follows:

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

In general, these transactions shall be geared to pressures connected with movements that are expected to be reversed in the foreseeable future; when expressly authorized by the Federal Open Market Committee, they may also be geared on a short-term basis to pressures connected with other movements.

Subject to express authorization of the Committee, the Federal Reserve Bank of New York may enter into reciprocal arrangements with foreign central banks on exchange transactions ("swap" arrangements), which arrangements may be wholly or in part on a standby basis.

The changes in the Authorization were in paragraph (1) of Section III, relating to specific aims of foreign currency operations. As amended, paragraph (1) provided that such operations were to be conducted, within the basic purposes set forth in Section II:

To offset or compensate, when appropriate, the effects on U.S. gold reserves or dollar liabilities of disequilibrating fluctuations in the international flow of payments to or from the United States, and especially those that are deemed to reflect temporary forces or transitional market unsettlement.

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

December 4, 1962

Authority to effect transactions in System Account.

A distinct improvement in business psychology had developed in the weeks preceding this meeting, although key measures of

economic activity continued to show little change from the levels existing since midyear. The change in business and financial sentiment both reflected and contributed to the sharp rise that had occurred in stock market prices since late October. Also, both sentiment and stock prices presumably had been influenced by the release of tension as the Cuban crisis eased, as well as by speculation about the effect of an anticipated tax reduction. Total retail sales advanced again in November. New car purchases were at a very high level, although below the October rate.

Other economic information becoming available since the preceding meeting of the Committee was mixed. The industrial production index in October remained at the level at which it had been since July. New orders received by durable goods producers rose in October, and new housing starts recovered most of their September decline. On the other hand, the rate of unemployment rose fractionally in November, returning to the high August-September level. Plans for business investment showed no change in outlays from the third to the fourth quarter, but indicated a small decline for the first quarter of 1963. Commodity price averages continued to register little change; the flurry of advances in some sensitive prices during the Cuban crisis had been largely reversed.

Total bank credit and business loan expansion remained strong. The private money supply in October and November rose sharply above the level existing for many months, and time and savings deposits also rose substantially further.

In contrast to bank credit, capital market financing continued light. Estimates for the fourth quarter indicated declines from a year earlier of one-fourth in corporate security offerings and of one-fifth in State and local financing.

Money markets continued generally steady, with interest rates, particularly in the short-term area, tending to move up slightly. It was noted that, beginning about mid-December and continuing for several months, seasonal forces would be working toward lower interest rates as demands for financing usually are low