

REMARKS OF CHAIRMAN WILLIAM McC. MARTIN BEFORE
GEORGETOWN UNIVERSITY BANKERS' FORUM

In my remarks this afternoon, I plan to take seriously a responsibility for prompting, if not provoking, this group's discussion. With this purpose in mind, I want to deal more with the problems currently presented to monetary policy than with solutions the Fed has tried to apply.

Our central economic problem has been well enough publicized for all to know. Domestically, despite a vigorous revival from the 1960-61 recession and the ensuing further expansion, we still struggle with an undue margin of unemployed human and physical resources. Internationally, we continue to combat a large payments deficit problem.

Some observers feel that our domestic unemployment could be further reduced by a more stimulative monetary policy; other observers believe that our payments deficit could be significantly reduced by a policy of lessened ease. Whenever a problem breaks into two seemingly conflicting parts, reasonable men may and will differ in their views of the appropriate course of action.

The Federal Reserve Act wisely provides that decisions on monetary policy be taken not by a single person but by two bodies, the seven-member Board of Governors and the twelve-member Federal Open Market Committee. Also, it wisely provides that all votes on policy actions taken in these bodies be recorded and published in the Board's Annual Report. Thus, the world knows -- as it should know -- that many decisions on important as well as unimportant matters are reached by majority vote rather than unanimously.

I consider this a good thing because it would be a symptom of intellectual stagnation if problems as difficult and moot as those now confronting the Federal Reserve did not give rise to differences of opinion. But such differences do not necessarily mean differences in basic attitudes. I am sure that I speak for all members of the Board of Governors and the Federal Open Market Committee when I say that every member of these bodies recognizes the importance of both a vigorous and sustained growth in our domestic economy and of reasonable balance in our international payments. Every member agrees that, from the purely domestic point of view, conditions may exist under which easier credit and lower interest rates would not be advantageous, just as, from an international point of view, conditions may exist under which less easy credit and higher interest rates would not be desirable.

Problems arise mainly because, from either viewpoint, we cannot always be certain what conditions actually are, and how they might change in response to monetary measures. Inevitably, we must reach our policy decisions on the basis of information that is neither complete nor current, and frequently also contradictory. Let us take the simple question of whether or not our monetary policy so far has been one of ease. I personally believe that it has been so. I do not know of any credit-worthy businessman who has been unable to expand his activities for lack of the necessary bank credit. I do not know of any well-managed bank that has had to keep down its business loans to good credit risks because of insufficient reserves. And I do believe that, in trying to be stimulative, we may have over-stayed the market and permitted some deterioration in credit standards.

But quite a few reasonable people believe that the situation is not as easy as it seems to me. They point out that money supply, counting only currency and demand deposits, has risen more slowly than economic activity. They point out that the prime rate has failed to decline, and that some indicators of bank and business liquidity are low. Thus, they have been hesitant to risk a lessening of ease -- not because of any fundamental disagreement on policy goals, not because of dogmatic adherence to an easy-money philosophy, but simply because their interpretation of available data leads them to somewhat different conclusions about the existing situation and about the prospective effects of our action.

Moreover, the differences of opinion among us are basically differences of degree. One of us may feel that a slight lessening of ease would promise a modest but significant reduction in our payments deficit while not threatening any significant slowing down of our domestic economy. Another one may feel that the same action would not promise significant international improvement, and at the same time would pose some small but not negligible threat to the continuation of our domestic expansion. It is not a question of black or white, it is a question of slight differences in shades of grey -- differences which will lead to divergent conclusions as long as every individual has his own eyes and his own mind.

The wisdom of our Federal Reserve Act, which this coming December will celebrate its 50th Anniversary, is shown in the scope it gives to such divergences in analysis and opinion. For I believe the monetary policy stemming from this interplay of divergent forces and judgments has been as good as, or better than, any policy that could have been devised by a single mind.

Under our system any member of the Board or the FOMC has to persuade at least a majority of his colleagues of the need to change course. And since the members represent many shades of responsible and informed opinion on monetary matters, evidence that may seem conclusive to one may seem insufficient to another; any change in policy will therefore tend to be gradual, until enough evidence is accumulated to persuade even the more skeptical that the time had come to proceed in a new direction.

Thus, for the past 10 months or so, the Federal Reserve has gradually lessened monetary ease without any abrupt shift in policy. From a level of \$400 million in the last quarter of 1962, net free reserve holdings of member commercial banks have gradually declined to about \$100 million. This significant reduction, which certainly has been working to curtail the spill-over of credit into foreign hands, has been accomplished without any noticeable effect on domestic credit availabilities and domestic economic activity.

By mid-year, the reduction in free reserves had begun to exert some upward pressure on short-term money rates. In June, the Treasury bill rate advanced close to the 3 per cent discount rate. In mid-July, just before the President's announcement of further steps to help correct the U.S. payments deficit, the discount rate of the Federal Reserve banks was raised from 3 to 3-1/2 per cent. This increase was followed by a further step-up in money market rate levels of almost 1/2 per cent, but it has not brought about a marked reduction in credit availability.

Since the lessening of ease was accomplished without sudden jerks, there was no undue market effect on longer-term rates. Even the rise in short-term lending rates to bank customers has mainly been restricted to loans to security dealers. Long-term rates have edged up about 1/8 of 1 per cent, only one-fourth as much as money market rates. This relationship, incidentally, is about the same as that which has prevailed in many other periods of expansion. While debt management and System open market operations have been designed to help maintain this proportion between increases in short-term and long-term rates, it would be wrong to attribute the result to manipulation of the market. The pattern of interest rate development has been so frequently experienced in our financial history that it may be considered part and parcel of our market mechanism. The purpose of debt management and open market operations has been to keep the market equilibrium from being upset by speculation or other disturbing incidents, rather than to put the market into an unnatural and unsustainable position.

As you know, when the Board approved a higher discount rate, it also raised the maximum rates which member banks may pay on time deposits with maturities of 3 to 12 months. This action was desirable in order to enable the banks, first, to compete with money market paper at the new rate level, and second, to compete more successfully with banks in foreign financial centers and especially with the so-called Euro-dollar market. But here again, the changes were not disruptive. The secondary market in certificates of deposits had already to some extent anticipated the new rate level. In this manner, sudden shifts, and therefore uneconomic windfall gains or losses, have been kept to a minimum,

It is too early to know how far the Federal Reserve policy has helped to correct the U.S. payments deficit. It seems, however, that our action is gradually taking effect. There are increasing reports of U.S. corporations cutting back on the placement of funds in deposits in foreign currencies or Euro-dollars, although as yet there has been no significant reflux of funds previously placed abroad.

In these remarks, I have touched only upon the main problem confronting our monetary policy today. You realize, I am sure, that Federal Reserve action has not been confined to these points. Internationally, for instance, the Federal Reserve has continued to expand its network of swap arrangements with foreign central banks that are primarily designed to guard against the consequences of disruptive large or sudden movements of volatile funds. And more important, the System has continued to be watchful lest the monetary sector generate excess liquidity that would support cost and price increases and thus undermine not only the competitive position of U.S. industry abroad but also the continued sustainable growth of our economy at home.

Nobody, and least of all the Federal Reserve, can expect to make difficult decisions free of public criticism. Whenever this criticism is offered in a constructive vein, it is welcome and indeed vitally needed. For this reason I hope that your discussion will frankly consider all aspects of our policy actions, those of which you disapprove as well as those -- if any -- of which you approve. We shall learn from your comments, and not only the Federal Reserve but the entire financial community will be the better for it.