BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

September 7, 1962.

TO: Federal Open Market Committee

FROM: Mr. Young

There is enclosed a copy of a memorandum to Chairman Martin from Mr. Knipe on Policy, bank credit extension, etc., in the last sixteen months, which is being sent to you for your information.

Ralph A. Young

Ralph A. Young, Secretary,
Federal Open Market Committee.

Enclosure

September 6, 1962.

To: Chairman Martin

From: James L. Knipe

Policy, bank credit extension, etc., in the last sixteen months.

During the sixteen months of national economic growth, from March 1961 through July 1962, the Federal Reserve carried out an entirely different policy from the ones it had used in comparable earlier periods. This time, nearly one and one-quarter billion dollars of Nonborrowed Reserves were added by System action, whereas in 1958-59 more than half a billion dollars of Nonborrowed Reserves had been withdrawn; in 1954-55 nearly half a billion dollars of Nonborrowed Reserves had been withdrawn; in 1952-53 nearly one and one-half billion dollars of Nonborrowed Reserves had been withdrawn.

The mechanics of adding the reserves were, as always, to hold a generally high level of Free Reserves as an encouragement to the constant growth of Required Reserves--a growth which resulted from the commercial banks constantly adding to their loan and investment accounts, thereby creating new deposits.

As a result of this extraordinarily easy policy, the commercial banks were able to do something they had never done before in comparable periods. They were able to build up their loan accounts, this time by $10.4 billion, while adding to their investment accounts. Always before, they had had to hold their investment accounts unchanged (1958-59 and 1952-53), or reduce them sharply (1954-55), to make room for the mushrooming, profitable loans. But this time, their investment accounts also grew, by $8.9 billion.

The loan growth (seasonally adjusted) in this current period, amounting to $10.4 billion, was in line with the three earlier periods in absolute amount, but was somewhat lower as a percentage of its base.

Aside from the long-continued ease of the System, the other unusual aspect of the banking situation this time was that depositors switched demand deposits into time deposits almost as fast as the commercial banks could create the new demand deposits. As a result, Demand Deposits (seasonally adjusted) grew by only $2.0 billion, while Time Deposits increased by $16.1 billion.

This process, of course, increased the "credit mileage" which the commercial banks could get out of the System's long and generous offerings of added Nonborrowed Reserves. The total assets added by the banks amounted to $19.2 billion (seasonally adjusted), of which perhaps $6.0 billion were possible as a consequence of the altered percentage of Time and Demand Deposits. In March 1961, the relation of Total Assets to Required Reserves was 10.5 to 1, whereas by July 1962 it had gone up to 11.1 to 1. On the incremental growth of assets, it amounted to 15.3 to 1.

During the sixteen months, the relationship of Demand Deposits to Time Deposits changed from 60.0-40.0 per cent, to 55.7-44.3 per cent.

*

Money Supply, narrowly defined, grew by $3.3 billion, or 2.3 per cent, at an annual rate of 1.7 per cent. Money Supply, broadly defined, grew by $19.4 billion, 8.9 per cent, at an annual rate of 6.6 per cent.

cc: Mr. Molony
Mr. Cardon