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Statement of

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Chairman, Board of Governors of the Federal Reserve System

before the

Joint Economic Committee

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Mr. Chairman:

My comments today on economic and financial developments will be directed toward the two central problems on which the nation's efforts should be focused in 1962. One is domestic; the other, international. The first problem is to move economic activity higher and unemployment lower. The second is to strengthen our position for dealing with the adverse balance of international payments of the United States.

For the time being, at least, some of the requirements for dealing with these two problems may seem to be in conflict. But for the long pull, the more basic needs are the same, because they are the fundamentals on which all enduring economic growth must be based.

The prime need is a steady increase in productive efficiency. But achieving it carries other requirements. Among them are investment in new and improved plant and equipment to turn out better products at lower costs; savings, to facilitate that investment; and stability in the value of our money, to induce those savings.

That, of course, is just part of the chain reaction that can be set into motion by progress in meeting these needs.

The surest way to get sales expansion leading to expansion of output, and output expansion leading to expansion of job opportunities, is to give the consumer a break by offering him more for his money.

In my judgment, much of our postwar economic trouble has been brought about by pricing consumers out of the market instead of into it. Increasing our productive efficiency offers the most promising avenue for correcting that process by providing a gain for business and labor to share with the consumer--as business and labor should do, in their own long-term interests.

These are matters that seem to me worth bearing in mind in considerin the problems and performance of the economy, domestic and international, in recent times.

Taken as a whole, 1961 was a year of vigorous economic advance--happily free from an accompanying upswing in general prices, a fact that bolsters prospects for further growth.

Total economic activity, as measured by gross national product data, and industrial production both moved into new high ground. Gross output rose about 7-1/2 per cent from the fourth quarter of 1960, and 8 per cent from 1961's first quarter low. Industrial production advanced 12 per cent over the year, and 13 per cent from the February low. The consumer price index moved up approximately one-half of one per cent, but wholesale price indexes dipped below their year ago levels.

Meanwhile, credit expansion in general was greater than in any previous year except 1959. Funds advanced in credit and equity markets totaled about $50 billion, well above the $40 billion of 1960 although far below the $61 billion of 1959, a year of record-breaking credit demand. Interest rates moved within a relatively narrow range.

Credit expansion by commercial banks approximated $15 billion, a record surpassed only in 1958, and then by a narrow margin. Loans accounted for some $6 billion of that total, although loan demands were moderate as they usually are in the early phases of an economic recovery. Investments, also following a characteristic course, increased about $9 billion.

But even though the number of people holding jobs rose again to record level, unemployment failed to respond to general improvement in demand as rapidly or as greatly as had been hoped. Not until near the end of 1961 did unemployment show an encouraging drop, to about 6 per cent of the labor force from the 7 per cent level at which it had held for almost a year. Even so, the number of long-term unemployed continued relatively large, totaling about 1.5 million in the seasonally adjusted figures at the end of the year.

With the rising levels of income and business activity now taking place, total employment should expand further this year and absorb into gainful activity many of those currently classified as unemployed as well as new entrants into the labor force. To assist this process, we must stay attentive to changes in the composition of the working force, a matter to which your Committee is alert, as demonstrated by the development of much pertinent new information at recent hearings of your Subcommittee on Economic Statistics.

In 1961, from the recession's February low to the end of the year, about one million persons were added to nonfarm payrolls. This virtually restored the level of nonfarm employment to the pre-recession high. Yet in manufacturing industries, although employment in December 1961 was well above the low point of the previous winter, there were one-half million fewer factory workers than when the recession began in the spring of 1960. At the same time, industrial production was greater than ever before in our history.

Thus some of the employment patterns of the recession and recoveries since 1953 seem to be repeating themselves. After each recession, total employment has rebounded to new record levels, but fewer factory workers have been needed to produce an increased volume of goods. The decline in the number of blue-collar job opportunities even while white-collar job openings were increasing has been an important factor causing the rise in persistent unemployment since 1953. If we are to realize the full benefits of our increasing productivity, we must solve the difficult problems of transition and adjustment for the displaced workers, many of whom lack the skills and training required in the expanding sectors of the economy.

The fact that long-term unemployment has been disturbingly large over the last decade, even during periods of high-level activity and rising prices, indicates that the problem it poses is too complex to be solved by any single or simple approach.

It is evident that our economy requires continuing, sustainable growth, attended by an ever-rising level of overall demand to provide an ever-rising number of job opportunities for our steadily growing population. But it seems equally evident that we require specific steps to make headway against the problems posed by certain types of structural unemployment that are not readily responsive to general monetary and fiscal measures. Special programs to increase occupational and geographical mobility are necessary for this purpose. Training and retraining under management, labor and Government supervision would greatly benefit workers who need new skills to adapt more readily to changing technology. Both employers and employees would gain from better provision of information on the current and prospective job market-- that is, where job openings may be found, and where qualified workers can be located.

Let me turn now to the second problem cited at the start. The deficit in the balance of international payments, although much reduced from that of the preceding years, rose again in the last part of 1961.

In the first half of the year, the payments deficit had shown encouraging shrinkage. Net sales of gold from U.S. reserves were only $200 million. The main reasons for this fairly good result were clear, even at that time: a low level of imports occasioned by slack demand because domestic business activity was low; an advance debt repayment to us, by Germany, of more than half a billion dollars; and a strengthening of confidence in the U. S. dollar in the wake of a declaration by the President that the Administration was determined to defend the international value of the dollar.

Nevertheless, it was also clear, even at the time, that we could not be complacent. To have the balance of payments in reasonable equilibrium on the average over a period of years means that we need to have a balance of payments surplus, not merely a reduced deficit, at certain times. The first half of 1961, when imports were low, was a time when a payments surplu would have been appropriate. I do not say that this was a realistic possibilit in 1961. The point is simply that the good results of the first half of the year were not good enough, considering the low level of import demand at the time

Balance of payments pressures again turned adverse in the second half of 1961, when the deficit began to rise again. Net sales of gold during the half rose to some $650 million. They might have gone much higher if there ha not been a big increase in foreign holdings of dollar reserves, working balances, and short-term investments in the United States.

The increase in the overall payments deficit in the second half of last year also had its special causes. Confidence in the dollar has been well maintained, and that was not the trouble. The causes of the rise in the deficit lay elsewhere.

For one thing, imports rose sharply from their abnormally low level in the first half of 1961, advancing to levels about in line with the level reached t the Gross National Product in the latter part of the year. Exports held stead while those exports financed by aid programs increased, commercial exports not financed by Government grants and credit fell short of their mid-1960 level. The failure of commercial exports to increase in 1961 tied in with the slowing down last year of European economic expansion. In Europe, there was an especially noticeable reduction in buying of materials and semi-finished goods for inventory.

It is quite possible that imports will rise further, as business activity increases here. However, we can also fairly expect that growth in exports will resume. In fact, the latest export figures, for October and November, were higher than for any pair of months earlier last year.

Sooner or later, we need to get a large increase in our export surplus. To make this increase in the export surplus come sooner rather than later, and to make it big enough to count, let me emphasize again the necessity that we preserve a competitive climate of business in this country, raise our productivity, hold down costs, and see to it that our prices are not out of line with those of other producing countries.

We must also put ourselves into a position to negotiate with our principal trading partners so as to minimize trade barriers that might otherwise keep us from achieving this needed increase in our exports. The task of correcting our balance of payments deficit would become far more difficult if the countries in the European Common Market were to maintain high tariff walls against our goods while progressively moving toward free trade within the Common Market.

In our balance of payments difficulties, however, exports and imports are not the whole story. The essence of the problem is that we have not had a big enough export surplus to cover our commitments on economic aid and military expenditures abroad, and our outflow of private loans and investments abroad. To cover the deficit, we have been called on to sell some gold, and we have had to increase our short-term liabilities to foreigners. This increase in short-term liabilities is dependent upon the willingness of foreigners to build up dollar reserves, working balances, and short-term investments in this country. In reality, it constitutes foreign lending to the United States. We cannot count forever and without limit on that sort of lending to support the position of the U. S. dollar. That is why we must get a better balance between the export surplus and our outpayments for economic aid, for military expenditures, and for private capital outflow from the United States.

In reference to our economic aid commitments and U. S. military expenditures abroad, let me note that a large part of aid is being linked to exports, and ways to obtain offsets for part of the military expenditures abroad are being sought. We must continue to make every effort to get other countries to take a fair share of the burden of these costs. Whatever part of these expenditures cannot be linked or offset must be covered by net earnings in purely commercial trade, investment income, and other private transactions.

So far, I have said very little about private capital movements, apart from the buildup of foreign liquid assets in the United States. One of the big difficulties in the U. S. balance of payments in 1961 was that outflows of long-term and short-term capital were still very large, even though the kind of volatile movement we had in the latter part of 1960 was not much in evidence in 1961.

In fact, net outflows of long-term and short-term capital seem to have been even larger in the second half of last year than they were in the first. Here I am talking mainly about bank loans and acceptance credits, corporate investments in subsidiaries, new foreign issues, and purchases of outstanding foreign securities that offset foreign purchases of U. S. corporate securities. Along with these, there were trade credits, and also some "movements of funds" in the sense of acquisitions of liquid investments or balances abroad, particularly in Canada.

All told, the net outflow of all the various types, including a guess for unidentified movements, seems to have approached $4 billion in the year 1961. This was only moderately less than the outflow in 1960, and it was more than the overall deficit in our balance of payments in 1961. While the deficit in the balance of payments cannot be related to any one single class of outpayments, clearly the capital outflow was an important factor.

Restraining these capital outflows is particularly difficult because they represent various normal kinds of lending and investing. These outflows reflect the ready availability of credit in U. S. markets. Only in part can they be influenced by the level of short-term interest rates. By and large, such differences as did develop last year between money rates here and abroad do not appear to have been a primary determinant of capital movements either from or to the United States. On the other hand, the ready availability of credit at rates competitive with other markets may have exerted an important influence.

In the circumstances prevailing today, the Federal Reserve has found it necessary to balance domestic and international factors in arriving at policy decisions. The System's responsibility for the value of the dollar extends beyond domestic price stability to the value of the dollar in terms of gold and of other convertible currencies. This is partly a matter of restoring basic equilibrium in the balance of payments, and partly a matter of preserving stability in exchange rates in international markets.

Until recently official operations by the United States to maintain the exchange value of the dollar have been limited to purchases and sales of gold by the Treasury's Stabilization Fund--at $35 an ounce--to foreign monetary authorities for monetary purposes. Recent developments, however, have made it desirable for the United States to play an active role in exchange markets themselves.

Persistent deficits in our international payments have put very large amounts of dollars into the hands of foreign holders. This has made the dollar both susceptible and vulnerable to large and sudden movements of funds. Movements of this kind can be touched off by international political uncertainties, or by bearish or bullish reports and rumors about economic and financial developments at home or abroad. With the pound sterling and the main other European currencies again convertible, to a large extent, funds now can move freely and in large volume between New York, London, and the financial centers of continental Europe.

For these reasons, the Secretary of the Treasury decided last March to use the Stabilization Fund for operations in foreign convertible currencies, for the first time since the Second World War. The Stabilization Fund has acquired holdings of some major European currencies, and undertaken transactions in the market with the aim of defending the dollar from speculative forays.

These operations have been conducted on a fiscal agency basis by the Federal Reserve Bank of New York for the account of the Stabilization Fund. The resources of the Stabilization Fund for these purposes are, however, quite limited.

The Federal Open Market Committee and the Board of Governors are fully cognizant of the increasing importance of international financial relations for the working of our domestic monetary system. We further recognize that, under present-day conditions, maintenance of an efficient international payments system based on the interconvertibility of currencies requires close cooperation among the central banks of major industrial countries and with established international financial institutions.

As one step in such cooperation, the System is now prepared in principle and in accordance with its present statutory authority to consider holding for its own account varying amounts of foreign convertible currencies. Towards this end, we are now exploring, in consultation with the Secretary of the Treasury, methods of conducting foreign exchange operations in convertible currencies with due and full regard for the foreign financial policy of the United States.

These System operations, along with those conducted by the Stabilization Fund, would have the primary purpose of helping to safeguard the international position of the dollar against speculative flows of funds. They would not and could not serve as substitutes for more basic action to correct the deficit in this country's balance of international payments.

The problems I have been discussing have weighed heavily with those of us in the Federal Reserve in our endeavors over the last year to keep credit conditions attuned to national needs.

On the domestic side, to help bring about recovery, expansion and sustained growth in production and employment, the Federal Reserve has been operating to bolster the banking system's ability to meet all reasonable borrowing needs.

On the international side, to help hold down the outflow of capital and gold prompted by the continuing balance of payments deficit, the Federal Reserve has been operating to minimize drains stemming from international differentials in interest rates.

Activities in pursuit of these dual objectives were carried out in the open market for United States Government securities. Before taking up these operations, however, I would like to mention one other recent Federal Reserve action.

On December 1, the Board and the Federal Deposit Insurance Corporation announced an increase in the maximum rates that banks may pay--if they choose--on savings and time deposits. The change became effective on January 1 of this year. In general terms, the action authorized banks to pay 3 1/2 per cent on any savings deposit, and 4 per cent on those left in the banks for a year or more; also, to pay 3 1/2 per cent on time deposits with a maturity of 6 months to one year, and 4 per cent on those with a maturity of a year or longer. There are some 50 million of these savings and time accounts in the 6,100 member banks of the Federal Reserve System alone.

This action was taken after extensive study and consideration. In arriving at its decision, the Board was influenced by a variety of factors. One of considerable weight was the fact that some short-term balances were being attracted away from American banks by higher rates paid on such balances in other parts of the world, and that this process contributed, in some measure, to our continuing balance of paymen ts problem. Another was the question of whether there could be any longer any justification for restricting the rate of interest that commercial banks may pay on savings deposits to a level substantially below that paid by other institutions on similar accounts. Finally, but by no means less importantly, we were concerned over the longer run impact of a maximum rate that might limit artificially the rewards received by small individual savers, whose saving, as I have said before, plays such an important role in financing the investment vital to our economic growth.

The changes that have been made in rates offered by the banks since the action took effect have been designed, for the most part, to encourage genuine saving. If this continues to be the case, the result should be an increase in the volume of funds available for long-term investment in mortgages, in State and local securities issued to finance expanded community facilities, and in securities issued by business to finance expansion of productive resources.

Your Committee may be interested in the results so far of the authorization for payment of higher rates on savings. Based on a survey in mid-January of a sizable sample of Federal Reserve member banks, it appears that about two-thirds of all member banks are offering some rate in excess of the 3 per cent maximum rate previously in effect.

Regular or passbook savings accounts represent about three-fourths of total time and savings deposits at member banks. Some 40 per cent of the banks, holding 70 per cent of total time and savings deposits, raised their rates on regular savings accounts above 3 per cent. About half of these banks, or 20 per cent of the total, went to the newly authorized 4 per cent for deposits held over one year. The other half, generally, are paying 3-1/2 per cent on savings accounts.

With respect to time certificates of deposit and other time deposits, arrangements vary widely from bank to bank. But many banks are now offering up to 4 per cent on one-year certificates, including a sizable number which have not moved up to the 4 per cent rate on savings accounts. Rates of 3 to 3-1/2 per cent are being offered on six-month deposits, including the negotiable certificates offered by many of the larger banks.

Some 60 per cent of the member banks still pay rates on regular savings accounts of 3 per cent or less. If experience with a previous change in permitted maximum rates can be used as a guide, any further move toward increased rates on these accounts is likely to be gradual, as it was after the preceding change in 1957.

Now I should like to devote the rest of my remarks primarily to Federal Reserve operations in the Government securities market during 1961.

To assure ready availability of credit in the American economy, the Federal Reserve supplied the banking system in 1961 with reserves in amounts sufficient not only to offset the credit-tightening effect of gold drains and currency withdrawals but also to provide additional reserves to meet requirements against expanding deposits. Member bank required reserves increased in 1961 by about $1 billion, while Federal Reserve holdings of Government securities increased by $1.5 billion in consequence of open market purchases. The reserves thus supplied made possible the near-record expansion of bank credit in 1961.

As a result of that expansion and of increased financial saving by the public, liquid assets held by consumers and business increased substantially in 1961. In consequence, the overall liquidity of the economy showed an increase about in line with the expansion in overall economic activity. Although total liquid assets of the public increased by about 6-1/2 per cent during 1961--compared to the 7-1/2 per cent increase in Gross National

Product--demand deposits and currency, the more active elements that usually are termed the "money supply," increased by only about 3-1/2 per cent. The pace of increase in the money supply, however, accelerated substantially in the latter part of the year.

The stability that prevailed in interest rates was one of the striking parts of the financial scene. Interest rates showed only a moderate increase in the 1961 business upturn, just as they had shown only a moderate decline during the downturn that began in the spring of 1960. Accordingly, since mid-1960 interest rates have moved within a relatively narrow range well above the low levels reached in 1958 and below the high levels reached in late 1959. To some extent, Federal Reserve policies and operations, in addition to Treasury operations, were responsible for this stability. Although the Federal Reserve supplied reserves adequate to enable expansion of bank credit on the scale earlier described, it sought to avoid downward pressure on short-term interest rates. The Treasury, a heavy borrower, obtained most of its new money in the short-term sector of the market, thereby putting upward pressure on short-term rates.

Let me note that factors other than official monetary and debt-management policies played an important part in keeping the general level of interest rates during the 1960-61 recession above levels reached in earlier recessions. These factors included the mildness of the latest recession and the large volume of new security issues floated by corporations and State and local governments in the first half of 1961. Although 1961 did not witness as great a decline in interest rates--at least in long-term rates--as 1958, neither did it witness a sharp speculative rise and subsequent fall such as that which characterized 1958.

I should like to add, at this point, something on the way the Federal Reserve System went about supplying bank reserves. Because of the nation's international payments problem, the System sought to provide these reserves in a manner that would minimize their effect upon short-term rates, to which international money flows are particularly sensitive.

To this end, the Federal Reserve in early 1961 extended the area of its open market operations to include purchases of longer-term securities as well as short-terms, in which open market operations formerly had been confined as a general rule. The purchase of long- instead of short-term securities, when circumstances warranted, served at least to relieve the short-term market from the direct impact of these purchases on yields, and transfer that direct impact to the longer-term area.

The $1.5 billion addition to Federal Reserve holdings of Government securities that I mentioned earlier reflects merely the net result of gross transactions totaling vastly more. Most purchases or sales, in fact, are made to adjust the availability of bank reserves in accordance with temporary variation in needs, chiefly of seasonal character.

In its gross transactions over the course of 1961, the Federal Reserve purchased about $7 billion of Treasury bills and other issues maturing in less than two years, not including those acquired for brief periods under repurchase contracts. Over the same period, it sold or redeemed at maturity a slightly larger amount of such issues. Purchases of issues maturing within two to five years aggregated about $1.5 billion, while purchases of those maturing in over five years amounted to nearly $800 million, nearly all in the five-to-ten-year area. Sales of issues in these groups were negligible. The System also acquired some securities maturing in over a year by participating in refunding offers of such securities in exchange for maturing issues, but the effect of any such shifts upon the maturity distribution of the System portfolio was more than offset by the approach to maturity of other issues held.

Treasury purchases of long-term Government securities for investment accounts exceeded in amount those by the Federal Reserve. They were, mostly, of issues maturing in over 10 years. The Treasury, in addition, borrowed much of its new money in the short-term area, thus helping to maintain short-term interest rates and minimize the flow of short-term funds abroad.

Most of the purchases of longer term securities by the Federal Reserve and the Treasury were made during March, April and May, when aggregate new issues of securities by corporations and by State and local governments were in heavy volume. Official (Federal Reserve and Treasury) operations in that sector of the market doubtless helped to keep interest rates from rising in the face of large demands, and thus to facilitate the flotation of these corporate, State and local issues.

The significance of these operations from the standpoint of market impact may be indicated by relating their volume to total market transactions in each maturity category of Government securities. Official market purchases of Treasury bills and other issues maturing in less than one year, although making up the bulk of Federal Reserve and Treasury operations, comprised in 1961 only about 4 per cent of total dealer sales of such securities (excluding those to other dealers). The proportion for issues maturing in one to five years averaged 9 per cent for the year, although in some months official purchases exceeded 30 per cent of dealer sales in this area. In the five-to-ten-year area, the proportion amounted to more than 20 per cent for the year as a whole and in the period from March through July was more than a third of the total. For securities maturing after 10 years, official purchases comprised over 30 per cent of all market purchases for the year and nearly two-thirds of total purchases in the second quarter, when the bulk of the official purchases were made.

In conclusion, I should like to stress that, along with its problems, 1962 also brings us opportunities. Foremost among them is the opportunity to achieve further progress toward higher economic activity, lower unemployment, and restored equilibrium in our international balance of payments.

We can make the most of that opportunity by working--all of us--to bring about conditions that will generate the chain reaction that I described at the outset--a process that leads from dollar stability to savings, investment, rising productive efficiency, lower costs, better prices, greater buying demand, increased production, and expanding employment. The prospects for progress are excellent. Let us apply ourselves to the realization.

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