

# FEDERAL RESERVE BANK OF NEW YORK



## MONTHLY REVIEW

FEBRUARY 1962

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Volume 44

No. 2

## Monetary Policy In A Competitive World\*

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The past year has been a complex and difficult one for monetary policy. This in itself is nothing new, but perhaps the set of conditions we faced demonstrated more forcefully than ever that there is no simple set of rules for monetary policy to be followed under all circumstances. Ours is an ever-changing and ever-evolving field—and while there are a few timeless principles, the fast-changing circumstances of our economy mean that for practical purposes we must develop our “art” as we go along. As we start a new year, what can we say of monetary policy’s achievements in 1961 and its prospects in 1962?

In regard to achievements, I hope we have learned not to take too much credit for favorable economic developments, just as I hope we may not be asked to shoulder too much of the blame, as has happened occasionally during the past few years, for undesirable economic events. Most of 1961 was a period of impressive recovery and expansion after the business slump of late 1960 and early 1961. It was quite apparent early in the year that not only the vigorous effort of the private economy but also the energetic collaboration of all branches of Government would be required for the nation to achieve desirable long-term economic growth and adequate use of our human and material resources. While the recession had been mild in terms of the decline from previous peaks, it was not so mild from the standpoint of unused resources. Similarly, while the expansion to date has been quite rapid in regaining and passing previous peaks in output, unemployment remains at an unsatisfactorily high level. Nevertheless, encouraging progress has been made and a favorable monetary environment has undoubtedly helped.

The Federal Reserve System made this contribution to domestic recovery and growth while confronted at the same time with a serious and persistent balance-of-payments problem. This aspect of our total problem is of relatively recent origin, as the growing productive capacity and competitive strength of the Western European and Japanese economies have exposed us for the first time

since World War II to the challenges of an economy open to competition from efficient and vigorous trading partners. And accompanying and magnifying the problem has been the greater ease with which capital funds have flowed among the major countries whose currencies have become convertible.

During 1961 the Federal Reserve System saw to it that banks were amply supplied with reserves. With their total reserves rising by somewhat over 4 per cent during the year, the banks were able to expand credit by a near-record \$15 billion. Demand deposits rose by about 4 per cent and time deposits by some 14 per cent. Besides being in a position to meet all reasonable demands for bank loans, the banks were able to add substantially to their short-term investments. Thus they are now quite comfortably liquid, although not excessively so.

As for interest rates, there has been a relatively moderate increase during this year of vigorous recovery. Yields on long-term Treasury, corporate, and municipal bonds have increased by something on the order of  $\frac{1}{4}$  per cent, while short-term Treasury bill rates have risen about  $\frac{1}{2}$  per cent, most of this latter increase having occurred in the past couple of months. In all maturities, rates are well below the peaks reached in late 1959.

As we have often pointed out in recent years, the Federal Reserve System has by no means set itself a fixed goal with respect to rates. For the past year and a half or more we have found it necessary, however, because of urgent international considerations, to avoid putting undue downward pressure on short-term rates while providing an easy atmosphere in domestic credit markets. This was the most pressing reason behind the broadening of the System’s open market operations in Government securities to include transactions outside the short-term area. But these broader operations had the added merit, on the domestic side, of encouraging increased flows of long-term capital into useful investment channels. By helping to absorb the overhang of Government securities that typically dampens the capital markets in recovery periods, these operations aided in the placement of corporate and municipal debt issues, as well as mortgages. The System’s purchases seemed to be especially helpful to banks, enabling them to move out of intermediate-term Governments without

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\* An address before the thirty-fourth annual midwinter meeting of the New York State Bankers Association, New York City, January 22, 1962.

being deterred by significant capital losses and into either loans or various shorter term investments while waiting for expected loan demands to materialize. Incidentally, these operations have left the System with a portfolio that is still highly liquid; Federal Reserve holdings of under-one-year maturities were greater at the end of 1961 than a year earlier.

Federal Reserve efforts to encourage a short-term rate structure that would tend to create some drag on the outward flow of capital and increase the attractiveness of dollar investments to foreigners have been strongly reinforced by the Board of Governors' recent action to raise the interest rate ceilings on time and savings deposits. Over a period of time, the higher rates our banks can offer to foreign depositors may be of significant help to our international accounts.

In general, the ability of the System to hold steadily to a policy of ease throughout 1961 was a stabilizing and encouraging element in the improving business outlook. If we look for reasons why we were able to hold to such a policy for such a long time, we find first that, since the banks were not flooded with reserves during the preceding recession, there was no vast amount of "slack" to be taken up as soon as recovery commenced. The banks were already on a firm enough rein so that we could leave matters pretty much as they were without inviting dangerous excesses.

Secondly, unlike the situation in some earlier postwar recoveries, commodity prices have been largely free from appreciable upward pressure, and indeed the over-all price picture in the current recovery has been quite gratifying. Wholesale price indexes are now slightly lower than a year ago, while average consumer prices are only slightly higher. Doubtless some of the credit for this happy situation should go to the increasing force of public pressure on wage and price policies—but even more important, and partly responsible for the increased public pressure, is the greatly increased vigor of foreign competition in an open economy such as ours. The persuasive power of a potential loss of sales is cogent indeed.

A third reason for our ability to maintain a policy of monetary ease has been the highly effective cooperation of other arms of Government, notably in the areas of fiscal policy and debt management. Far from limiting the scope of monetary policy, close cooperation of this kind enables monetary policy to make full use of its characteristic adaptability and flexibility. When that intimate cooperation has been lacking, or impossible, the scale of the job left to monetary policy has been just too big for it, and the possibilities for quick modification, if the need arose, were severely limited. Federal fiscal policy during the

past year has involved a much smaller deficit than in the preceding recovery period of 1958-59, and policy has been headed clearly in the direction of a balanced budget for the coming fiscal year. By avoiding heavy Federal Government borrowing, it has been possible to give greater encouragement to other borrowers without risking excessive credit expansion. Moreover, skillful debt management has helped to resist any downward pressure on short-term rates through concentration of the past year's new cash offerings in the short-term area, while leaving the supply of longer term savings available for corporate, municipal, and mortgage borrowers. At the same time, vigorous use of advance refundings, which did not directly tap new long-term investment funds, has offset both the added cash borrowing in the short area and the shortening of the average maturity of the debt that occurs merely through the passage of time. Debt management also reinforced monetary policy through the placing of a larger proportion of the various Government trust funds' debt holdings in longer term issues.

It is certainly not possible to have any precise idea now what the coming year holds for monetary policy. The business expansion seems to be moving ahead at a healthy pace at the moment, strengthened by an apparently increased willingness on the part of consumers to step up their purchases. This increased willingness, it may be noted, has developed in an environment of essentially stable prices—and by the same token it could be adversely affected by a change in this favorable climate. As regards business spending, while plans for capital outlays in 1962 appear moderate, they may very well be revised upward if retail sales improve further. Corporate profits, another major influence on business spending, seem to be improving rather more quickly than seemed likely a few months ago. Spending by various levels of Government is also pushing higher. The unemployment situation, on the other hand, is still a long way from satisfactory.

Naturally, the Federal Reserve will have to provide reserves for further expansion of bank credit and the money supply, although I would not expect these reserves to be provided as abundantly in a buoyant economy as they were in 1961. Further, the extent to which the System makes reserves available would certainly be affected by any re-emergence of inflationary pressures reflecting generally excessive demand, or other causes. Future Federal budget policies will also have a distinct bearing on the scope for continued monetary ease. In this connection, the prospect of a balanced Federal budget in fiscal year 1963 is certainly encouraging.

Above all, we shall have to be mindful of balance-of-payments developments, and it is to this topic that I wish

to address most of my remaining comments. I must say, first of all, that the latest statistics in this area are on balance disappointing, even though they have some encouraging aspects. On the encouraging side, our international payments showed only a small deficit in the first half of 1961, after excluding the effects of special debt repayments. But this marked improvement over the substantial and persistent deficits of the previous three years was partly a fortuitous result of different business-cycle phasing here and abroad; our own imports were held down by recession, while booming conditions abroad boosted the demand for our exports. It is also encouraging that in the most recent half year our exports have performed exceedingly well despite some slowing-down of the European boom, but our own imports naturally have risen as our economy gained strength. I am informed, too, that preliminary fourth-quarter data indicate an improvement in our combined trade, Government, and long-term capital accounts as against the third quarter. At the same time, however, there has apparently been a substantially increased outflow of short-term capital, with the result that the over-all deficit widened again in the fourth quarter following the substantial deficit that had emerged in the third quarter. While part of the recent worsening—perhaps much of it—appears to reflect temporary, reversible factors, the situation certainly is one that requires the most careful watching, with the Federal Reserve and, I am sure, all other branches of the Government as well prepared to take resolute action if there should be developments ahead that represent more than a temporary setback on the road to our goal of balance-of-payments equilibrium.

Monetary policy clearly must pay increasingly close attention to this problem, and it will be increasingly free to do so as the domestic business situation strengthens. Let me emphasize, however, that there is no simple solution to our international monetary problem. The causes of our balance-of-payments deficits are complex, and there are other vital objectives in the international area that must not be neglected while the balance-of-payments deficit is being corrected. Nor would I want to give the impression that there is any basic or irreconcilable conflict between policies designed to achieve sturdy economic growth at home and those aimed at maintaining a viable international balance. In the short run there will certainly have to be compromises among our objectives from time to time, but over the long pull the same policies are needed to achieve both our internal and external goals.

Indeed, the more competitive world in which we now live, and which makes our day-to-day monetary problems considerably more difficult, is in my judgment already

proving itself to be a greatly improved world from the standpoint of our own national interest. We in the United States are already benefiting, through broader export markets and greater domestic price stability, from increased two-way trade with larger and stronger partners in the Free World. We have much to gain from the building of a still broader and freer trading area among the advanced nations—one which should permit more effective mobilization of aid to the less developed countries and, more important, a better market for the raw materials produced by those countries. Without question, to achieve the superior growth rates needed to give the Free World its full economic and military strength depends in good measure on a substantial further lowering of national barriers to international trade and investment.

In the face of these considerations it would be inexcusable to seek a solution of our troublesome balance-of-payments problem through such measures as import restrictions, higher tariffs, or exchange controls. Even if balance in our international accounts could be achieved in such a manner (and frankly I believe that retaliatory measures would more than offset potential gains), this would be small return for the inevitable loss in our real income and world position—political and military as well as economic. But if we firmly reject, as we must, solutions of this kind, we must also accept the burdens and responsibilities inherent in the new environment in which we live. We must be willing not merely to recognize foreign competition as an economic fact, but also to make an aggressive effort to compete more effectively in all markets, both with new and improved products and with lower costs. And, regarding the latter, let me say that while the role of monetary policy in helping to hold back inflationary pressures is difficult and unpopular—particularly when those pressures originate elsewhere than in excessive demand—the responsibility is nonetheless one that cannot be shrugged off. Of course, this is not the job of monetary policy alone—nor even of monetary policy primarily; wholehearted cooperation from Government, industry, and labor is a necessity in this area.

Success along these lines, together with more skillful and effective export promotion, will enable us to achieve a trade surplus high enough to take care of our heavy net military outlays abroad, our economic assistance payments, and the outflow of private long-term investment. At the same time, we must make sure that the drains from these latter sources are no larger than necessary. In this connection, I am much heartened by the progress which the Government has already made in arranging for our allies to purchase in this country more of the military equipment for mutual defense. Progress has also been made in

achieving a better sharing of the foreign aid burden. In my opinion, more can surely be done along these lines. It might also be worthwhile to give further study to the question whether our existing tax laws now make it unnecessarily attractive to invest in relatively well-developed foreign countries.

Measures of this kind are of the utmost importance to achieve the basic payments equilibrium that we must have. Of course, even after such an equilibrium is achieved, there will be swings from time to time in response to different business developments in this country and abroad. But to some extent we could expect to see such cyclical swings in trade offset by opposite swings in capital movements, largely short term, which would be influenced by relative levels of interest rates and credit availability here and abroad. In fact, the proper role of our monetary reserves—including our drawing privileges at the International Monetary Fund as well as our gold—is to cushion the effects of such swings in payments.

It follows, too, that the closer we come to equilibrium in our balance of payments, the greater scope we have for adjusting our monetary policy more largely to our domestic needs, relying on various measures of international cooperation to absorb the disequilibrating force of capital flows moving in the wrong direction. The difficulty today is that we do not enjoy a sufficient margin of safety in our balance of payments to give monetary policy the desirable degree of freedom to act without inviting excessive risks. Even a gold stock as large as ours cannot withstand an indefinite stream of losses, nor can we depend on an unlimited willingness of foreign countries to build dollar balances. Hence there is a real need for monetary policy to remain entirely uncommitted and flexible, ready to move if necessary in ways that will help to remedy any significant worsening in our balance-of-payments position.

I would like, finally, to comment on some of the steps taken in the past year which have made 1961 a real milestone in the history of international monetary cooperation. Goaded by the urgent need to minimize the danger of massive speculative forays against one currency or another—a danger greatly increased by the major payments imbalances of several leading industrial countries, including the United States—we have made notable progress in a number of areas. As has often been pointed out, the gold exchange standard has brought great benefits to the postwar world by making possible striking economies in the use of a limited supply of monetary gold. But in building the “banker” role of the key currency countries, which in effect means the United States and Britain, we have also increased the vulnerability of these currencies and countries to wide swings in capital movements.

This vulnerability was strikingly demonstrated by the speculative assault on sterling which followed the German and Dutch revaluations last March. These changes in parities left the foreign exchange markets in a state of shock, so that they were easy prey to speculative rumors of further changes in parities. Within a few days, many hundreds of millions of dollars in various currencies moved across the exchanges, with particularly heavy speculative flows from London to Zurich and Frankfurt. At this critical moment, the central banks meeting each month at the Bank for International Settlements in Basle announced that they were cooperating in the exchange markets. As subsequently revealed, this cooperation took the form of short-term loans, ultimately reaching a total of \$910 million, to the Bank of England from other European central banks. In this connection, I should like to pay tribute to the decisive and statesmanlike approach taken by the various European central banks involved—particularly the National Bank of Switzerland and the German Bundesbank, which received the bulk of the hot money outflow from London. This so-called “Basle Agreement” which provided emergency credit facilities of a necessarily short-term nature will stand, I hope, as a first big milestone on the road toward creating a truly formidable first line of defense for the world’s major currencies.

The lessons of the March revaluations were not lost upon the United States Government. Since then much time and effort has been spent in exploring and developing techniques, in cooperation with foreign monetary authorities, to defend the dollar against similar speculative flows of hot money. Those New York banks which are active in the exchange markets will recall that shortly after the German revaluation the Federal Reserve Bank of New York, as agent for the United States Treasury, began to provide forward marks. This action, which was undertaken in cooperation with the Bundesbank, was designed to deal with an abnormally high premium on the forward mark and, more generally, to exert a stabilizing effect on both the spot and forward markets. At the end of June, more than one billion marks of such forward sales were outstanding, but the speculative tide had already begun to recede before the Berlin crisis and, by mid-December, the entire volume of forward contracts had been liquidated at maturity and the market was again operating smoothly with only token intervention. In effect, the German forward mark operation helped to bridge the gap between heavy speculative buying of marks and the subsequent restoration of a more balanced payments position.

Sizable operations have also been carried out in the forward Swiss franc market, where cooperative measures

undertaken with the Swiss National Bank have succeeded in reducing the unduly high premium on the forward Swiss franc which had been one of the factors impeding outflows of capital from Switzerland. In connection with these operations, the United States Treasury supplemented its holdings of Swiss francs by issuing short-term Treasury obligations denominated in that currency. This technique has proved effective and may well be employed in other situations, if this seems desirable.

At the moment, operations in other European currencies are being given serious consideration and will serve, I hope, to extend still further the perimeter of the first line of central bank defenses against speculative capital movements. Incidentally, I should also like to mention the effective cooperation of various foreign central banks in cushioning exchange market pressures generated by the heavy repatriation of short-term funds to foreign markets for year-end window-dressing purposes. In contrast with the experience of earlier years, such foreign central bank cooperation at the end of 1961 effectively minimized the potentially disturbing effects of these operations upon both market rates and actual reserves.

One important obstacle to a fuller use of such cooperative exchange operations by the United States is that the Treasury's resources for such purposes are quite limited. We may need to consider, therefore, whether the problems in this area may not require that the Federal Reserve System also enter into foreign exchange operations. The last few years have shown that monetary policy does not stop at the water's edge. Short-term capital now can, and does, move across national frontiers in the hundreds of millions of dollars within a span of a few weeks. And indeed, such movements can have marked repercussions on our own money and capital markets in addition to their impact on our gold and exchange reserves.

Effective as they are, measures of immediate counteraction to speculative pressures in the exchange markets clearly have to be backed up by a "second line" of even sturdier defenses since one cannot always count upon an early reversal of such pressures. In this connection, the already large lending facilities of the International Monetary Fund are in the process of being augmented further. Through a network of stand-by credit arrangements, the Fund will be in a position to obtain an additional \$6 billion of the world's leading currencies if and when any major crisis endangers the world payments system.

The successful completion of these negotiations by the

ten major industrial countries involved must be a great source of satisfaction to all who are interested in seeing our international monetary mechanism bolstered to withstand any foreseeable contingencies. One may reasonably expect, therefore, that the required legislative approval can be obtained promptly in all countries concerned, including the United States. Of course it is also to be hoped that the mere existence of these facilities will make it unnecessary to use them.

The progress of the past year has involved, and indeed has required, increasingly close personal contacts, in the financial area, between representatives of this country and those of the leading countries of Europe. I am thinking of the regular attendance of Federal Reserve representatives at the monthly meetings of the BIS in Basle, Federal Reserve participation in United States delegations to various working groups of the OECD in Paris, and ever more frequent and cordial bilateral meetings with representatives of the other principal trading nations to exchange information and discuss mutual interests. These frank interchanges have brought us a much deeper understanding of the domestic and international economic problems not only of our trading partners, but also of ourselves, as we have seen our own problems ranged alongside those of other countries. If the momentum of all these moves can be maintained, 1962 should produce further noteworthy gains in this vital area of international cooperation. Yet, I would be remiss if I did not remind you once more, at the end of my remarks, of the continuing reality and urgency of our balance-of-payments problem. While the initial development of close international cooperation can be and has been stimulated through the very strains it is designed to combat, the ultimate responsibility of each nation for its own finances is still recognized both here and abroad.

I am aware that time has allowed me only to touch very lightly some of the high spots of the very broad subject I selected for this talk. But I hope you will agree that we are pursuing goals which all Americans feel are worth seeking, and that the seriousness of the problems we face together in the monetary sphere calls for the patient understanding and cooperation of all elements in our society. If we can work together effectively, as I believe we can, we can have confidence that our economy will measure up to its full potential and that the dollar will retain its key position in the arch through which the trade and investments of the Free World move.

## The Business Situation

As the new year got under way, the economy appeared to be expanding at a good though not exuberant pace. Preliminary estimates for the fourth quarter of 1961 indicate a strong advance in gross national product that entirely reflected gains in final demand. In December, to be sure, the rate of increase in industrial production and in various other monthly measures was somewhat less than in the two preceding months, while automobile sales declined from their November high. In January, moreover, department store sales slipped back from the record proportions reached in December, and new car sales apparently continued at the December pace. But such forward-looking indicators as orders received by manufacturers of durable goods, and commercial and industrial construction contracts, made a strong showing during November and December, giving support to the view that over-all activity would continue to move ahead. Another favorable sign was the decline of the unemployment rate in January to 5.8 per cent of the labor force. Late in that month, President Kennedy stated in his *Economic Report* that GNP is expected to amount to \$570 billion in 1962, a rise of about 9 per cent over 1961.

Whether such an advance can be achieved, and whether it will be followed by still further expansion, will be importantly influenced by the behavior of prices. A renewal of the upsurge in prices of the sort experienced in the mid-1950's could well hamper the growth in consumer demand that is essential for a sustained economic expansion. It would also seriously reduce our ability to meet the rising challenge of foreign competition. Although prices have been unusually stable since the business upturn in early 1961, this stability will be put to its real test as the economy reaches higher levels of capacity utilization and as wage contracts in major industries are renewed.

It is clearly desirable that wage contract negotiations in the steel and other industries be completed not only on a noninflationary basis, but also as soon as possible. This will avoid the unsettling effects on the economy that would arise from speculative stockpiling of inventories against the possibility of strikes or price increases. The importance of these considerations was pointed up by the President's announcement that he is urging labor and management in the steel industry to work out an early settlement consist-

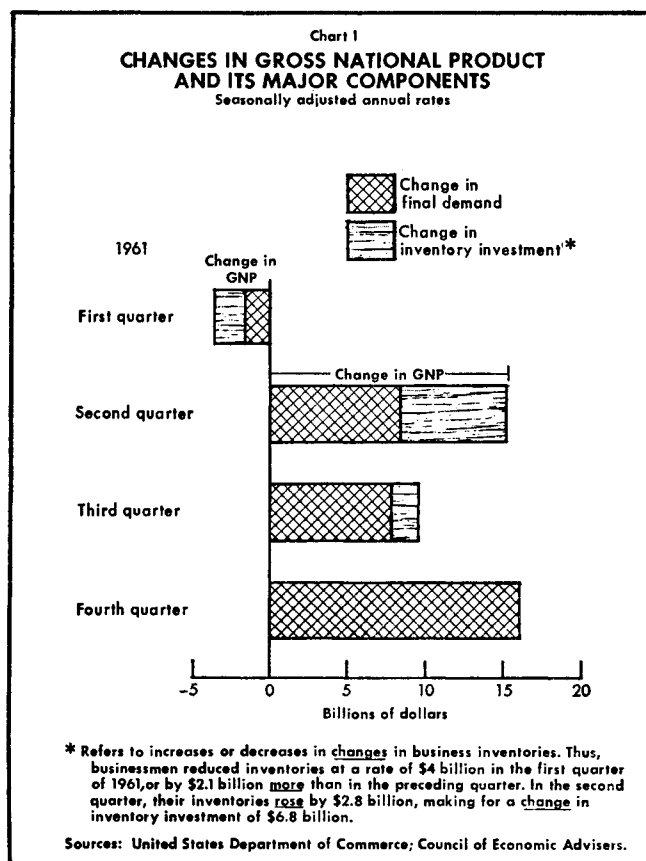
ent with continued price stability. It was further underlined by the attention that the *Annual Report* of the President's Council of Economic Advisers paid to the problem of developing guideposts for judging whether particular wage decisions are inflationary. The Council suggested that, to be noninflationary, wage increases should in general not exceed the trend of average productivity gains for the private economy as a whole.

### THE ADVANCE IN GROSS NATIONAL PRODUCT

Gross national product rose by \$16.2 billion (seasonally adjusted annual rate) during the final quarter of 1961, according to estimates by the Council of Economic Advisers. Significantly, all of the gain was in final demand, with the pace of inventory accumulation remaining unchanged. In each of the preceding two quarters, by contrast, the change in inventory investment had accounted for a significant portion of the over-all GNP advance (see Chart 1). The fourth-quarter step-up in final demand was about twice as large as that in either of the two preceding quarters, with the most striking increases occurring in consumer purchases of durable goods (\$3.2 billion), Federal defense outlays (\$2.6 billion), investment in producers' durables (\$2.0 billion), and net exports of goods and services (\$1.4 billion). The only major component to decline was nonresidential construction, which edged off slightly for the second consecutive quarter. This was more than offset, however, by the rise in business investment in durable equipment.

A key feature of the October-December GNP change was the upsurge in personal consumption expenditures. Such outlays climbed by 2½ per cent in the October-December quarter, following a rise of 1½ per cent during each of the two previous quarters. While about half of the fourth-quarter advance in consumer spending reflected a very considerable step-up in purchases of durable goods, spending on nondurables also rose more rapidly than in the earlier quarters. Expenditures for services, which have been increasing steadily for many years, continued to advance at about the same rate as before.

The sharp rise in durable goods purchases during the quarter to a large extent reflected increased sales of new automobiles. Such sales rose 9 per cent in November, to



a seasonally adjusted rate of almost 7 million cars a year, partly on the strength of sales that had been deferred in September and October because of shortages stemming from strikes in the auto industry. In December, sales receded to a rate of 6 million cars, but this was still well ahead of the rate for any month prior to the fourth quarter. During the first three weeks of January, automobile sales continued at approximately the December pace, after allowance is made for the usual seasonal decline. Sales of appliances and most other durable goods, as well as of nondurables, continued to rise in December, while the ratio of total retail purchases to personal income, although down from November, was higher than in any other month since March.

Federal Government outlays on defense, as indicated earlier, provided a substantial lift to GNP during the fourth quarter. The \$2.6 billion increase in such spending contrasted with a third-quarter rise of \$0.2 billion, and was larger than any preceding quarterly increase during the ten years since the Korean war. Moreover, since Defense Department contract awards and obligations had risen sharply during the summer, and since it ordinarily

takes many months before the full impact of new contracts on defense output is felt, this component of GNP is likely to rise further during the current and subsequent quarters. It is noteworthy, however, that according to the estimates in the *Budget* and in the *Annual Report* of the Council of Economic Advisers, Federal purchases of goods and services in 1962—including those for defense—will on average rise more slowly than in 1961.

A further advance in fixed capital investment by business also seems likely. Seasonally adjusted outlays for commercial and industrial construction turned up at the end of the year, and the volume of contract awards for such construction rose markedly in November-December. Moreover, while new orders for machinery and equipment declined in December, they had moved uninterruptedly upward during the four preceding months, probably indicating there will be a continuing rise in production of such items for some months ahead.

The outlook for investment in housing is more uncertain. Private nonfarm housing starts declined in December for the second month in a row, but new building permits for such construction rose strongly. While the permit series is less comprehensive than the starts series, it is also less erratic. Requests for Government-backed mortgage financing, moreover, showed a substantial advance in December. The divergent movements of these various indicators leave it unclear whether or not housing outlays, which gained markedly in January, will be moving up further.

Although inventory investment did not contribute to the fourth-quarter rise in GNP, this does not mean that inventories were not being accumulated. It rather signifies that business firms were adding to their stocks at the same rate as before. This rate could increase in the current quarter if final demand advances at a good clip. It is worth noting in this connection that a study by the Department of Commerce shows that manufacturers' stocks at the end of 1961 generally were at a comparatively low level relative to sales and new orders. Much will depend, of course, on the extent to which accumulation of steel inventories is spurred by anticipations of a strike. The heavy volume of steel orders in recent weeks suggests that such anticipations have already had some influence on steel buying.

#### PRODUCTION, EMPLOYMENT, AND INCOME

The Federal Reserve's seasonally adjusted index of industrial production advanced by 1 point in December, and gains in production continued to be widespread. Schedules for January auto production point to a slight decline from



the high December level, after allowing for the usual seasonal rise, but the adverse effect from this source on the over-all rate of industrial output may be more than offset by a continuing advance in the output of steel and other products.

Despite the December rise in industrial output, total employment declined slightly. In January, however, employment rose back to about the November level, and the unemployment rate, seasonally adjusted, fell below 6.0 per cent for the first time in sixteen months. Nonagricultural employment in December, as measured by the payroll survey, remained at about the November level. While employment in manufacturing continued to rise modestly, it fell in most other major industries. For the nonmanufacturing sectors that had been the hardest hit by the recession—construction, transportation, and mining—the December declines meant continuation of a downward drift that the business recovery has yet to reverse.

The lack of strength in employment held the rise of personal income in December to \$2 billion (at a seasonally adjusted annual rate), the smallest advance in three months. Close to half of the increment came from a large increase in dividend payments, while the rise in wage and salary disbursements was only about one quarter as large as in November.

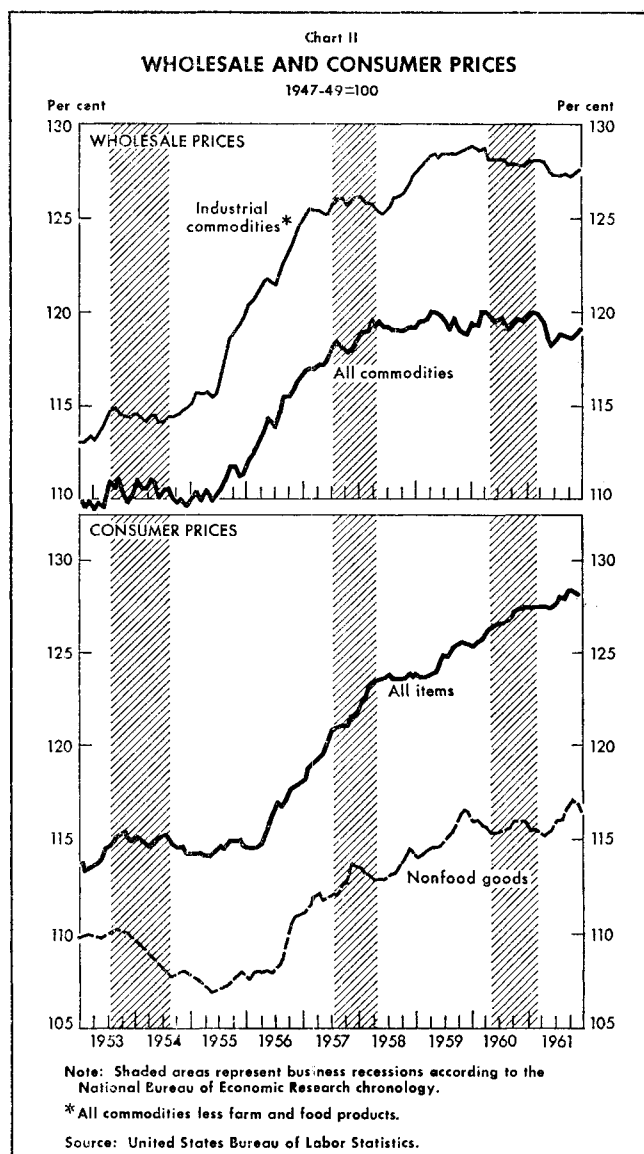
#### PRICE MOVEMENTS

After eleven months of economic expansion, prices have continued to show marked stability. The wholesale price index of all commodities, which has been generally stable since early 1958, was in fact lower in December 1961 than it had been at the February 1961 business cycle trough (Chart II). Wholesale industrial prices, moreover, were at about the same level in December as in February, after allowance is made for the seasonal decline between these two months. This was in contrast to earlier postwar expansions when such prices invariably rose during the first ten months. In the 1958-59 expansion, for example, industrial prices rose markedly, and only an offsetting drop in prices of farm products and processed foods kept the over-all index from rising.

Consumer prices of commodities other than food rose moderately between February and December—slightly less than in the comparable phase of the 1958-59 expansion. The 1½ per cent rise in the price of services over the period also was slightly smaller than the advance in 1958-59 and compares with much larger increases in most other postwar years.

Many of the factors restraining price increases during 1961 also existed in the periods following the previous

two recessions, including an easing of farm prices and excess industrial capacity. Some other factors probably have been more powerful in holding back price advances in the current than in earlier expansion periods. One of these is foreign competition—from actual imports and the ever-present threat of larger imports if domestic prices get out of line. Such competition has no doubt reinforced consumer resistance to higher prices on automobiles and other “big ticket” items. In addition, there has apparently been a growing awareness by manufacturers of such items that price increases in recent years have tended to limit sales. Finally, wage rates have not been rising as fast in recent years as they had earlier,



partly because of the greater difficulty of passing on higher production costs to consumers.

Raw materials prices have also come under more intense pressures. The growing overlap of uses for different raw materials, for example, has widened competition between aluminum and steel, steel and reinforced concrete, metals and plastics, and rubber and nonrubber synthetics. During last autumn, moreover, prices of many world-traded commodities sagged as manufacturers in a number of countries abroad curtailed their purchases—either because demand for their own products was weakening or because, as in Japan and the United Kingdom, balance-of-payments difficulties forced the adoption of fiscal and monetary measures that curbed imports.

The second year of business expansion is, of course, a more severe testing period for price stability than the first year. In the expansion following the 1954 recession, for example, the price rise was moderate until about a year after the trough. (The second year following the 1958 recession provides a poor reference because of the distortions introduced by the steel strike in the second half of 1959.) In 1955-56, bottlenecks developed in certain sectors and led to price rises that spread throughout the economy. Industrial capacity now, however, appears to be better balanced to meet an increase in demands, and

foreign competition is more vigorous. While these elements in the price picture are relatively favorable, the course of prices over the coming year will in large measure depend on the pace of productivity gains, on policies followed on the fiscal and monetary fronts, and on the degree of restraint exercised by management and labor.

#### PERSPECTIVE ON 1961

The Federal Reserve Bank of New York has just published *Perspective on 1961*, a twelve-page review of economic and financial developments. Many businessmen and teachers find *Perspective* useful as a layman's summary of the economic highlights treated more fully in the Bank's *Annual Report*. Copies of *Perspective* are available without charge in quantity to teachers for classroom distribution and in limited quantities to others as long as the supply lasts. Requests should be addressed to the Publications Section, Federal Reserve Bank of New York, 33 Liberty Street, New York 45, N. Y.

### The Money Market in January

The condition of the money market varied between moderate firmness and ease during January. A relatively firm tone prevailed in the early days of the month, in part reflecting the lingering effect of year-end firmness in the money market associated with strong credit demands which had built up over December. However, as these pressures receded, an easier trend was evident over the rest of the month. The effective rate for Federal funds thus remained close to the 3 per cent ceiling during the first few days of the month but generally fluctuated between 2 and 2½ per cent thereafter, save for two occasions toward the end of the biweekly reserve-averaging periods of country banks (January 10 and 23), when inflows of funds from these banks to the money centers and an unseasonably high level of float combined to push the rate as low as ¼ per cent. Similarly, dealer loan rates posted by the major New York City banks generally held

in the neighborhood of 2½-3 per cent, but fell to the 1¼ per cent area during these intervals. In the market for Treasury bills, rates rose early in the month to 2.82 per cent and 3.07 per cent on three- and six-month issues, respectively, the highest levels reached in well over a year, but adjusted gradually downward during the balance of the period. Rates on both directly placed and open market commercial paper followed the same pattern.

In the market for Treasury notes and bonds, prices fluctuated narrowly during the month, and interest centered on the Treasury's refunding and "new money" borrowing operations. On January 9, the Treasury auctioned \$2 billion of one-year bills, dated January 15, 1962, at an average issuing rate of 3.366 per cent. The proceeds of the bill issue were used to repay \$1.5 billion one-year bills maturing January 15 and to raise \$0.5 billion of new cash. The Treasury raised another \$1 billion of new cash later

in the month by offering on January 15 additional amounts of the outstanding 4 per cent bonds dated October 1, 1957 and maturing October 1, 1969. The bonds were reopened at a price of 99¾ to yield 4.04 per cent, with commercial banks permitted to make payment by crediting Treasury Tax and Loan Accounts. Subscriptions to this offering were moderate, a large share coming from smaller banks, and the Treasury allotted 60 per cent of the amount subscribed above \$50,000. Federally sponsored agencies were also borrowers of long-term funds during the month, with the Federal National Mortgage Association (FNMA) taking \$200 million and the Tennessee Valley Authority (TVA) \$45 million. In addition, the International Bank for Reconstruction and Development (IBRD) borrowed \$100 million in United States dollars.

After the close of business on February 1, the Treasury announced that it will offer holders of four issues of Treasury notes, totaling \$11.7 billion and maturing on February 15 and April 1, 1962, the right to exchange them for either of the following securities: 3½ per cent Treasury certificates of indebtedness dated February 15, 1962 and maturing February 15, 1963, priced at par; or 4 per cent Treasury notes dated February 15, 1962 and maturing August 15, 1966, priced at par. Subscription books for the exchange will be open February 5 through 7. Cash subscriptions will not be received.

#### MEMBER BANK RESERVES

Market factors released reserves to member banks over the five statement weeks ended January 31. The usual post-holiday decline in currency in circulation was the largest single source of reserves, providing about \$1.4 billion over the entire period. In addition, a lower average level of required reserves, largely reflecting a somewhat more than seasonal decline in bank loans, released about \$551 million of reserves. These factors more than offset the effect of a seasonal decline in float aggregating \$1.3 billion. The drop in float proceeded more slowly than usual, in part because of bad weather conditions that delayed the movement of checks.

System open market operations absorbed reserves during most of January. Over the period December 27, 1961 to January 31, 1962, average System holdings of Government securities fell by \$583 million, as outright holdings were reduced by \$535 million and holdings under repurchase agreements dropped by \$48 million.

Over the five statement weeks ended January 31, free reserves averaged \$509 million, compared with \$462 million in the preceding four-week period. Average excess reserves increased by \$64 million to \$625 million, while

average borrowings from the Federal Reserve rose by \$16 million to \$116 million.

#### THE GOVERNMENT SECURITIES MARKET

Prices of Treasury notes and bonds during January held fairly close to the levels of late December. Over the month as a whole, prices were generally 2¼/32 lower to 10/32 higher.

The relative price stability which characterized the market for the Treasury's coupon obligations was the outcome of a rough balancing of expectations concerning the course of interest rates in the near-term future. During the first half of January, prices tended to drift fractionally lower in response to widely publicized predictions that growing credit demands would soon lead to rising interest rates, including particularly an increase in the prime lending rate at commercial banks. Moreover, the announcement of the

Changes in Factors Tending to Increase or Decrease Member Bank Reserves, January 1962  
In millions of dollars; (+) denotes increase, (-) decrease in excess reserves

| Factor                                            | Daily averages—week ended |              |              |              |              | Net changes  |
|---------------------------------------------------|---------------------------|--------------|--------------|--------------|--------------|--------------|
|                                                   | Jan. 3                    | Jan. 10      | Jan. 17      | Jan. 24      | Jan. 31      |              |
| <b>Operating transactions</b>                     |                           |              |              |              |              |              |
| Treasury operations*                              | + 60                      | + 61         | - 62         | - 3          | + 7          | + 63         |
| Federal Reserve float                             | - 171                     | - 296        | - 189        | - 84         | - 359        | - 1,299      |
| Currency in circulation                           | + 255                     | + 255        | + 275        | + 318        | + 278        | + 1,379      |
| Gold and foreign account                          | - 83                      | + 44         | - 36         | + 12         | -            | - 63         |
| Other deposits, etc.                              | - 6                       | + 46         | - 28         | - 18         | + 10         | + 6          |
| <b>Total</b>                                      | <b>+ 53</b>               | <b>+ 108</b> | <b>- 37</b>  | <b>+ 224</b> | <b>- 264</b> | <b>+ 84</b>  |
| <b>Direct Federal Reserve credit transactions</b> |                           |              |              |              |              |              |
| Government securities:                            |                           |              |              |              |              |              |
| Direct market purchases or sales                  | - 125                     | - 3          | - 216        | - 222        | + 31         | - 535        |
| Held under repurchase agreements                  | + 163                     | - 144        | - 48         | - 19         | -            | - 48         |
| Loans, discounts, and advances:                   |                           |              |              |              |              |              |
| Member bank borrowings                            | + 125                     | - 277        | + 5          | - 25         | + 16         | - 156        |
| Other                                             | + 13                      | -            | + 5          | + 8          | + 6          | + 32         |
| Bankers' acceptances:                             |                           |              |              |              |              |              |
| Bought outright                                   | + 1                       | -            | + 2          | - 1          | - 3          | - 1          |
| Under repurchase agreements                       | + 4                       | - 3          | - 1          | -            | -            | -            |
| <b>Total</b>                                      | <b>+ 181</b>              | <b>- 427</b> | <b>- 254</b> | <b>- 260</b> | <b>+ 52</b>  | <b>- 708</b> |
| <b>Member bank reserves</b>                       |                           |              |              |              |              |              |
| With Federal Reserve Banks                        | + 234                     | - 319        | - 291        | - 36         | - 212        | - 624        |
| Cash allowed as reserves†                         | + 220                     | - 191        | + 54         | - 49         | - 37         | - 3          |
| <b>Total reserves†</b>                            | <b>+ 454</b>              | <b>- 510</b> | <b>- 237</b> | <b>- 85</b>  | <b>- 249</b> | <b>- 627</b> |
| <b>Effect of change in required reserves†</b>     | <b>- 288</b>              | <b>+ 394</b> | <b>+ 233</b> | <b>+ 177</b> | <b>+ 35</b>  | <b>+ 551</b> |
| <b>Excess reserves†</b>                           | <b>+ 166</b>              | <b>- 116</b> | <b>- 4</b>   | <b>+ 92</b>  | <b>- 214</b> | <b>- 76</b>  |
| <b>Daily average level of member bank:</b>        |                           |              |              |              |              |              |
| Borrowings from Reserve Banks                     | 341                       | 64           | 69           | 44           | 60           | 116‡         |
| Excess reserves‡                                  | 726                       | 610          | 606          | 698          | 484          | 625‡         |
| Free reserves‡                                    | 385                       | 546          | 537          | 654          | 424          | 509‡         |

Note: Because of rounding, figures do not necessarily add to totals.

\* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for five weeks ended January 31, 1962.

Administration's intention to request a rise of the "ceiling" on the public debt also contributed to the slight decline in prices. Immediately after midmonth, however, the market firmed and prices recovered somewhat, apparently in reaction to the weakness in stock prices and to the Administration's proposal of a balanced budget for the fiscal year 1963. In addition, there was evidence of a growing feeling in some quarters, perhaps because loan demands were not so buoyant as had been anticipated, that the business advance might proceed without engendering sharp increases in interest rates, at least for the present. As the close of the month approached, the market for Treasury notes and bonds drifted slightly lower, mainly reflecting uncertainties with respect to the terms of the Treasury's impending February refinancing operation.

The reopening of the 4 per cent bonds of 1969, announced on January 11, caused only a mild reaction in the market, despite the fact that a security of shorter maturity was expected. Immediately prior to the announcement of the terms of the financing, these bonds were quoted at 100 $\frac{2}{32}$  bid, to yield 3.90 per cent. On Friday, in adjustment to the announcement of the Treasury's offering price, the outstanding bonds declined by  $\frac{25}{32}$  to 99 $\frac{29}{32}$ . Subsequently, however, the outstanding 4 per cent bonds of 1969 declined another  $\frac{1}{4}$  of a point to 99 $\frac{21}{32}$  bid, while other issues maturing from 1966 to 1980 came under moderate selling pressure as some investors apparently desired to switch out of these issues to purchase the reopened bonds. The Treasury's announcement on January 17 of a 60 per cent allotment on subscriptions (somewhat larger than the market expected) evoked only a mild and brief reaction. Toward the end of the month, the new bonds declined somewhat in price, together with other longer term issues.

With the money market still relatively firm from year-end credit and liquidity pressures, Treasury bill rates rose over the first part of January. In the first two weekly auctions the average issuing rate on the three-month issue was set at 2.823 and 2.770 per cent, compared with 2.703 per cent in the pre-New Year auction, while the rate on the six-month bill rose from 2.941 per cent to 3.073 and 2.970 per cent. The rates set in the first auction were the highest since the fall of 1960. Although the demand for bills, particularly by nonbank investors, was well maintained through this period—in fact, throughout the month—upward rate pressures arose from the \$0.5 billion increase in supply of one-year bills auctioned January 9, as well as from expectations that the Treasury financing scheduled for later in the month would fall in the relatively short-term area.

Later in the period bill rates adjusted downward, partly

in response to the fact that the Treasury did not offer short-term securities in its cash financing, and partly in response to the strong bank and nonbank demand that had developed. Thus, in the regular weekly auction on January 22, average issuing rates were set at 2.688 per cent and 2.875 per cent on three- and six-month bills, respectively, down about 9 basis points in each case from the previous week. The rate on the new one-year bills also moved downward from their average issuing rate of 3.366 per cent to reach 3.27 per cent by the end of the month.

On Wednesday, January 24, the Treasury announced that it would raise \$100 million in new cash by increasing the amount of 91-day bills to be sold in its regular weekly auction on January 29. Despite this additional quantity of three-month bills, a good interest developed in the auction and rates on outstanding bills rose only slightly. Average issuing rates were set at 2.705 per cent and 2.939 per cent for the 91-day and 182-day bills, respectively.

#### OTHER SECURITIES MARKETS

The volume of new publicly offered corporate bonds during January amounted to \$270 million, compared with \$165 million in December and \$170 million in January 1961. Long-term Federal agency issues amounted to an additional \$245 million. Early in the period, prices for corporate issues moved fractionally higher as a consequence of the limited number of new offerings. Prices eased slightly toward midmonth, as the flow of new offerings increased and as the new financing calendar (including agency issues) built up. The calendar took a sharp jump with the announcement on January 16 of a forthcoming fifteen-year \$200 million FNMA issue, which reached the market on January 23. In addition, the following issues were also marketed toward the end of the month: \$45 million 4 $\frac{1}{2}$  per cent bonds of the TVA maturing in twenty-five years; \$100 million 4 $\frac{1}{2}$  per cent bonds of the IBRD due in 1982; and \$30 million Commonwealth of Australia 5 $\frac{1}{2}$  per cent bonds due in 1982. Although these large issues were competitive with corporate offerings and made substantial demands upon investors, they were generally very well received.

Among the larger corporate offerings was a utility issue of \$60 million (Aaa-rated) 4 $\frac{5}{8}$  per cent refunding mortgage bonds, due in 2002 and reoffered on January 9 to yield 4.50 per cent. The bonds, which have no protection against immediate call or refunding, met with an unenthusiastic investor response. Subsequently the syndicate distributing the issue was terminated and these bonds were traded at somewhat lower prices. As the month progressed, the market for seasoned corporate bonds

was generally quiet and prices moved sideways, as investors seemed reluctant to commit themselves. Toward the end of the period, however, the market strengthened, encouraged somewhat by the favorable investor response to Government agency and international financings. The average yield on Moody's seasoned Aaa-rated corporate bonds declined to 4.42 per cent over the month, 2 basis points below the end-of-December level.

The volume of new tax-exempt issues rose to \$890 million in January, compared with \$545 million in December and \$650 million in January 1961. Prices of new and outstanding issues nevertheless continued to display firmness, partly in response to further buying by commercial banks seeking to improve earning power in the light of higher rates being paid on savings deposits. Reflecting the generally good demand, the Blue List of advertised dealer offerings was around the \$300 million level during most of the month, the lowest since early 1961. The most

sizable public offering in the tax-exempt sector was a \$100 million (Aa-rated) State of California issue which was reoffered to yield from 1.90 per cent in 1964 to 3.40 per cent in 1987. This issue was accorded an excellent reception.

Rates on private short-term instruments moved up early in the month in sympathy with Treasury bill rates. Major finance companies raised their rates on 60- to 89-day directly placed paper by  $\frac{1}{8}$  per cent effective January 2, and again on January 9, bringing the new rate to 3 per cent. Also on January 9 commercial paper dealers raised their rates on prime 4- to 6-month paper by  $\frac{1}{8}$  of a percentage point, bringing the new rate to  $3\frac{3}{8}$  per cent (offered). Following the decline in Treasury bill yields later in the month, rates on directly placed paper were lowered by  $\frac{1}{8}$  per cent, and open market commercial paper rates were reduced in two steps by a total of  $\frac{1}{4}$  per cent. Rates on bankers' acceptances were unchanged.