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Current Issues of United States Financial Policy*

STATEMENT *by* ALFRED HAYES

President, Federal Reserve Bank of New York

The United States has achieved, thus far in 1962, a substantial expansion in domestic economic activity as well as a further improvement in its international payments position. During the first half of 1962, production, employment, and incomes all achieved record levels. Available data for July clearly indicate that the expansion is continuing. Nevertheless, it must be admitted that progress in speeding up the country's rate of economic growth has been less rapid than many of us considered possible at the beginning of the year, and in our international accounts we cannot be satisfied until the balance-of-payments gap has been eliminated.

Economic performance must be appraised, not only against the past, but also against what might be achieved if we made reasonably full use of human and material resources. Measured by this latter yardstick, our recent performance cannot be rated wholly satisfactory. Although the percentage of people out of work has dropped substantially during the current upswing, I do not question that we must aim for a more ambitious target. In short, unemployment has been and remains too high.

Business outlays on new plant and equipment must expand sharply if the economy is to move into higher ground. Business investment has in fact rebounded smartly from its recession lows, but in this vital area, too, the rate of improvement has been short of the need. An important stimulus has now been given to business investment by a revision in the depreciation schedule, and another would be provided by the enactment of the investment credit proposal now before Congress. These changes, and the promise of reduced corporate tax rates next year, are desirable not only as likely to produce expansion in the economy but also as a means to achieve greater productivity and lower costs in an increasingly competitive world market.

We are concerned that the forward thrust of the economy has been losing some of its force, even if one excludes from consideration the temporarily depressing effects of the unraveling of the steel situation. On the other hand, the generally stable level of prices, coupled with unused industrial capacity at home and ready availability of goods from abroad, has militated against the accumulation of large inventories as a hedge against shortages and higher prices. The fact that we have avoided excessive inventory accumulation during the current expansion is encouraging, since it diminishes the danger that such accumulation might set off a recessionary movement or contribute to such a movement if the business tide should turn for other reasons.

Throughout the current business expansion, and despite some criticism at home and abroad, the Federal Reserve has maintained conditions of monetary ease. As a matter of fact, an examination of business annals is unlikely to produce another example of a strong recovery proceeding so far in an atmosphere of ready availability of credit. Large amounts of bank reserves have been made available, more than offsetting the losses resulting from the gold outflow. Banks remain comfortably liquid and anxious to lend. Bank holdings of mortgage loans and municipal obligations spurted by a total of $6 billion over the first seven months of the year, more than during any other similar span of time. Instalment lending has also increased substantially. At the same time, loan demand and securities flotations by business borrowers have been disappointing, despite the fact that interest rates for such credit are little changed from those prevailing at the trough of the recession. One important reason for the lackluster performance of bank lending is the moderate business demand for inventories. A look at the volume of reserves supplied by the System together with the maintenance of a relatively high level of free reserves since the beginning of the recession should be persuasive evidence that the Federal Reserve authorities have been consistently replenishing reserves which the banks have put to work. It is true that the money supply—narrowly defined as checking

* Statement before the Joint Economic Committee of the Congress of the United States, August 16, 1962, during hearings on the state of the economy and on policies for achieving maximum employment, production, and purchasing power.

accounts and currency—has increased comparatively slowly of late, but this development has to be viewed together with an unprecedented spurt in commercial bank time and savings deposits. Such deposits, which for most holders provide almost as much financial maneuverability as checking accounts, have spurted by $10 billion, or 12 per cent, so far this year. The public's holdings of short-term United States Government securities, which can be readily turned into cash, have also expanded substantially.

So long as the shortfall of economic activity from what I regard as a reasonable goal persists, it seems to me that monetary policy should properly remain concerned with maintaining the maximum degree of credit ease consistent with its other objectives.

At the same time, we must keep in mind that attainment of our economic goals depends on many factors, of which credit and monetary conditions, over which the central bank exerts direct influence, represent only one—though an important—element. The job of instilling new vigor into the business expansion must, I believe, be done largely by means other than monetary policy.

I should like to turn now more specifically to developments in our international position.

The balance of payments, as you know, has shown some needed improvement in the first half of 1962. However, a part of the improvement, although by no means all of it, has occurred because of a temporary flow of funds, now reversed, from Canada to the United States as pressures developed on that country's currency. It is therefore clear that unremitting efforts to make further progress in reducing the over-all deficit remain the order of the day. The Administration, as you are aware, is pursuing a multipronged attack on the problem, including an export promotion program, reduction of military spending abroad, negotiations for both additional foreign defense purchases in this country and a wider sharing of aid to underdeveloped countries, and further "tying" of United States aid to those nations. Right now, as well as over the longer term, emphasis must be kept upon increasing the competitiveness and productivity of the United States economy. For this reason, the recent record of lower unit wage costs has been most welcome, especially at a time when wage pressures continue strong in Western Europe and elsewhere.

Bringing our international payments into balance and keeping them under close control is a necessary condition for protecting the dollar's position as the world's leading currency and as the keystone of a stable international currency and payments system. The rebuilding of foreign monetary reserves and the redistribution of international gold reserves have resulted in a decline in our gold stock and in a rapid rise of foreign short-term claims on the United States. These short-term claims are like money in the bank to those that own them; and, just as any of us would, they look to the banker, the United States, to provide assurance that the bank is being managed wisely. If we expect people to keep their money in United States dollars, we must give them both confidence in the soundness of our currency and some inducement to stay with us, rather than moving to another currency or to gold. It is for this reason that the System has cooperated in efforts to avoid unnecessarily low short-term interest rates and thus to reduce disruptive short-term capital outflows and their actual or potential effects on our gold stock. In this connection, I should like to emphasize my strong conviction that, if we achieve a balance in international payments and avoid actions that damage confidence, our gold stock is ample for our requirements both as a major trading nation and as bankers for the world.

I was surprised, by the way, that several witnesses have proposed to this Committee that the United States extend a "gold guarantee" to foreign holders of dollars. I wish to emphasize my strong conviction that such a "guarantee" would be an exceedingly harmful measure, besides being ineffective. In my judgment, this type of "protection" would be illusory and, in any case, is not warranted in view of the Government's determination to maintain the gold price and to take the basic measures needed to assure attainment of this objective. Indeed, a guarantee would merely becloud this larger issue.

The potential of monetary policy in protecting a currency against sudden speculative pressures is well recognized; hence Federal Reserve policy must remain flexible and prepared to deal with any contingency. We should try to avoid conditions of excessive credit ease that make reserves so ample that our banks and other lenders are induced to seek more remunerative outlets abroad because credit availability greatly exceeds domestic loan demands.

Rate differentials are an important, but not the only, reason for international capital movements. For instance, the sheer size, efficiency, and ease of access of our capital and short-term credit markets constitute a strong attraction to foreign borrowers. And, as you know, a variety of rate differentials are involved, both hedged and unhedged, while their respective significance in pulling in or repelling money may change over time. The Federal Reserve System has to be continuously alert to the pressures on the dollar which may arise from rate and credit developments, or from any other cause. In essence, the challenge to monetary policy in recent years has been to provide an adequate availability of credit to support a sustainable growth of our economy while guarding against a spilling over of excess liquidity into channels that would weaken the international position of the dollar or renew inflationary pressure domestically.

Meanwhile, the external defenses of the dollar have been strengthened so that monetary policy will not be overburdened while more basic balance-of-payments adjustments are still taking place. Such a strengthening would have been required, it might be added, even without a United States payments problem. Convertibility has greatly increased the volume and volatility of internationally movable funds; this is a natural consequence of the considerable degree of our success in approaching the kind of world we have been seeking to achieve since World War II. Nevertheless, it does mean that proper resources must be at hand to meet sudden shifts of funds and pressures that may be expected to be temporary. There is encouraging evidence that this problem can be handled through such avenues as the activity of the Treasury and the Federal Reserve in the exchange markets, the increasingly close central bank cooperation of the past eighteen months, and the IMF expansion agreement (still requiring final Congressional action, of course), which will vastly enlarge our access to currencies that we may need. Official United States exchange operations undertaken so far have basically been designed to protect the United States dollar against disturbingly large pressures at a time when we are making steady progress toward bringing our balance of payments into equilibrium.

Treasury operations in convertible currencies began in the spring of 1961 when the Federal Reserve Bank of New York, acting for the Treasury, undertook operations in the market for German marks designed to deal with the abnormal conditions that had developed following the revaluations of the German and Dutch currencies in March 1961. This operation was followed by other Treasury transactions in Swiss francs, Italian lire, and Dutch guilders, which are continuing up to the present. The Federal Reserve System, with the full concurrence of the Treasury, concluded that the central bank of this country should play a more active and direct role in defending the international value of the dollar. The Federal Open Market Committee therefore authorized the Federal Reserve Bank of New York on February 13, 1962 to undertake transactions in foreign currencies for System Open Market Account in accordance with the Committee's instructions. Since that time the System has acquired a substantial amount of convertible foreign currencies, primarily through a series of reciprocal currency agreements with foreign central banks, and has begun to use these resources in defense of the dollar.

The possibility of acquiring substantial amounts of foreign currencies through such currency swaps with foreign central banks rests upon a mutuality of interest. That interest is to make the present international financial system, under which world trade and investments are expanding rapidly, work reliably and efficiently. Therefore countries relying upon the dollar as an important part of their international reserve assets are glad to participate in arrangements that reduce the possibility of temporary and capricious pressures on the dollar. Furthermore, since currency swaps and stand-by agreements are tantamount to a mutual credit facility, foreign countries as well as ourselves obtain access to additional resources in case of need. Over the years ahead, these arrangements can also make a useful contribution to world liquidity needs.

In carrying out exchange transactions for both the Treasury and the System, we have made a point of establishing the closest and most harmonious possible relations with foreign central banks—an indispensable requirement when working in the exchange markets for their currencies. We have found that, with this cooperation, our use of foreign currency resources has in fact been effective; we have helped to strengthen the dollar in the exchange markets, reduced cumulative or snowballing speculative flows, and eased the immediate impact upon the United States gold stock of foreign central bank accumulations of dollars.

You will realize that official United States exchange operations rest upon the assumption that the pressures they have to meet are of a temporary and transitional nature. In a number of important instances, this has already turned out to be the case so that the commitments undertaken could be liquidated without a gold loss. Such success, however, cannot be taken for granted. In particular, an indefinite continuation of large United States payments deficits would assure that the pressure upon the dollar becomes permanent rather than temporary. Hence, these exchange operations in no way detract from the urgency of our task in correcting the payments deficit. Furthermore, while the initial development of close international cooperation has clearly been stimulated by the very strains it is designed to combat, foreign countries are counting upon us, as we are counting upon them, to take the national actions necessary to make certain that such strains upon any one currency will in fact pass.

Thus far we have met to a remarkable degree the challenge of harmonizing the domestic and international aspects of our financial policies. I believe we have the needed flexibility to continue to meet this challenge under the changing conditions that may confront us.

The Business Situation

The pace of economic activity picked up somewhat after midyear. In July, industrial production, nonfarm employment, personal income, retail sales, and new orders for durable goods all increased. Early signs suggest little change in the over-all economic picture in August. To some extent, of course, the improvements which have recently been registered in various statistical series merely reflect the removal or lessened influence of special factors that had depressed the June results, such as the heavy liquidation of steel stocks, the Ford strike, slower Government ordering, and—possibly—reaction to the stock market decline. Relatively little progress has been made in recent months toward the goal of fuller utilization of the economy's capacity. Nevertheless, the currently available data do seem to confirm that the economy has, at least for the time being, weathered an unusual combination of adverse influences better than many people had expected.

New information on spending plans of consumers and businesses largely reflects views formed before the July improvement in the business situation had become evident, and before the President had announced that he would not seek a tax cut until early next year. Consumer spending intentions, according to the Federal Reserve's July survey, were well sustained but not buoyant. Businessmen have not revised upward their earlier plans for a moderate rise in capital outlays in the latter half of 1962, but neither have they cut them back, according to the Government's latest quarterly survey taken in early August. Thus, private spending plans have been maintained, despite the steep stock market decline in May and June and the probable tendency to postpone spending and investment decisions because of the uncertainties in the business and fiscal outlook.

The Government sector is likely to provide increased support to total demand in the near-term future, even without an immediate tax cut. While the President has stated that he does not intend to ask for any increase in appropriations beyond those already requested from Congress, the fact remains that the budget already calls for some rise in Federal spending over the months ahead. Furthermore, the rate of outlays under the budget can to some extent be speeded up should economic conditions warrant. Finally, a substantial additional sum has recently been freed from trust funds for the highway program, which may permit the placing of contracts at a somewhat faster rate than had originally been scheduled.

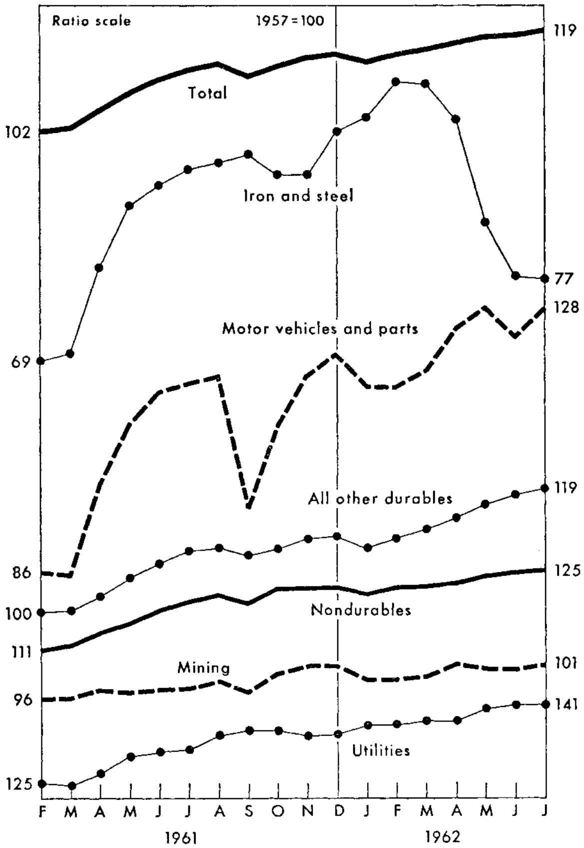
GAINS IN PRODUCTION, EMPLOYMENT, AND ORDERS

The Federal Reserve's seasonally adjusted index of industrial production rose by almost 1 percentage point in July, somewhat more than in June. The better showing in July was attributable mainly to developments in the steel and automobile sectors, but gains continued to be scored in a wide range of industries. Output of motor vehicles and parts reversed the June decline (see chart), as Ford accelerated its schedules following the settlement of its labor dispute. Even more significant was the fact that steel production showed only a slight decline for the month as a whole, in contrast to the substantial decreases during the three preceding months. The weekly series on steel output actually started to move upward after the first week in July, and in August production of steel ingots appears to have risen substantially, after seasonal adjustment. According to steel industry reports, however, steel inventories, though down markedly from their levels earlier in the year, are still somewhat higher than desired and thus are likely to continue to restrain steel production for some time to come. In the auto industry, most assembly lines were shut down for at least part of August for model change-over, but production, after seasonal adjustment, was apparently not much below the high July levels.

Total nonfarm employment (as measured by the Bureau of Labor Statistics payroll survey) also advanced in July, on a seasonally adjusted basis, slightly bettering the moderate rise in the previous month. The gains, however, were centered in the service, trade, and construction industries —the improvement in construction mainly reflecting the termination of several major strikes in California. In the manufacturing sector, both employment and average weekly hours declined slightly.

An encouraging development during July was the 5 per cent (seasonally adjusted) rebound in new orders received by manufacturers of durable goods. This "leading" series had declined in four of the preceding five months. An

RECENT DEVELOPMENTS IN INDUSTRIAL PRODUCTION
Seasonally adjusted



Source: Board of Governors of the Federal Reserve System.

important part of this downtrend, however, had apparently been caused by the fall-off in steel orders and, in June, by a failure of Government orders to show their usual fiscal-year-end bulge. Although it is not known to what extent the July recovery merely reflected a "catching up" in military orders, the fact that gains were recorded by most major industries may indicate some strengthening in orders not related to military activities.

DEVELOPMENTS IN KEY DEMAND SECTORS

Recent data covering actual and planned spending by consumers and business firms present a mixed picture. Consumer spending rebounded in July, as retail sales rose more than 3 per cent, seasonally adjusted. The gain, which brought total retail volume to a level slightly above the previous all-time peak registered in April, largely reflected a sharp increase in sales by durable goods retailers. Automobile dealers had a particularly good month, and sales of most other durable items also moved upward. In the first twenty days of August new car sales appear to have declined from the high July rate, but August department store sales continued close to the previous month's near-record level.

The central question in the consumer sector is whether spending, after having increased considerably since early spring, can be expected to show much further forward push in the months ahead. According to the Federal Reserve's quarterly survey referred to earlier, buying intentions in July followed a mixed pattern. Since the survey was taken only shortly after the stock market low, it is encouraging that there was no significant evidence of any deterioration in purchase plans. Moreover, there was apparently more-than-usual strength in intentions to buy household durables. On the other hand, reports of plans to buy new cars within six months were unchanged from April to July of this year, in contrast to increases in the corresponding period of the expansion years 1959 and 1961. Plans to buy used cars declined in July, but they had been abnormally high in April.

In the private housing sector, demand has apparently fallen off somewhat from the high levels attained earlier this year. The number of private nonfarm housing units started declined sharply in June and failed to recover in July. However, the number of building permits issued, though below the high levels reached earlier this year, increased somewhat in both June and July, and there continues to be a sizable backlog of unused permits; normally, only a small proportion of permits fails to eventuate into starts. Furthermore, demand continues to be supported by a relatively easy mortgage market.

Perhaps the sector of demand most subject to uncertainty in the months ahead is business expenditures for new plant and equipment. The August Commerce Department-Securities and Exchange Commission survey of plans for business capital outlays points to a moderate rise in plant and equipment spending throughout the balance of the year. Spending plans for the second half of 1962 showed little revision, in the aggregate, from those reported three months earlier. In July, capital spending appears to have continued upward. On the other hand, new orders received by machinery and equipment manufacturers and contract awards for commercial and industrial construction (expressed in dollar terms) registered little change on a seasonally adjusted basis. Moreover, the National Industrial Conference Board's July survey showed a 14 per cent drop in net capital appropriations of large manufacturing corporations in the second quarter, the first decrease in the current cyclical upswing. Past experience with this survey indicates that turns in the appropriations series tend to precede turns in capital expenditures by the same firms by six to nine months. Part of the spring decline in appropriations, of course, may have reflected the uncertainties created by the steel situation, the stock market break, and other factors that caused a "wait and see" attitude on the part of businessmen. It remains to be seen whether the stronger showing of the economy than many had expected, as well as the promulgation of new depreciation rules and a more definite prospect of tax reform next year, will bring about a strengthening of outlay plans.

The Money Market in August

The money market continued moderately firm over most of August. Federal funds traded mainly at 2¾ and 3 per cent, with the effective rate at 3 per cent on most days. Rates posted by the major New York City banks on call loans to Government securities dealers were quoted within a 3 to 3½ per cent range throughout the period. Nationwide reserve availability was somewhat lower on average than in other recent months.

Prices of Treasury notes and bonds rose over the month, as market sentiment was influenced by the results of the Treasury's August refinancing and by the growing expectation that the Administration would not seek a tax cut this year, confirmed in the President's address of August 13. The market for Treasury bills was firm during most of August, but rate movements for the month as a whole were small, in part due to continuing additions to the supply of bills by the Treasury in the weekly auctions. The markets for corporate and municipal bonds strengthened in active trading, reflecting many of the same factors that were responsible for upward price movements in Treasury issues as well as a light calendar of new offerings.

The Treasury announced on August 14 that it was calling for redemption on December 15, 1962 the partially tax-exempt 2¾ per cent Treasury bond of 1960-65, dated December 15, 1938. There are about $1½ billion of these bonds—the last remaining tax-privileged Treasury issue.

MEMBER BANK RESERVES

Operating factors absorbed a substantial amount of reserves during the month, attributable mainly to a large decline in float, changes in "other deposits" (largely reflecting a midmonth Treasury interest payment to System Account), and movements through gold and foreign accounts. Reserve drains due to market factors were, how-

CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, AUGUST 1962

In millions of dollars; (+) denotes increase, (—) decrease in excess reserves

Factor	Daily averages—week ended Aug. 1	Aug. 8	Aug. 15	Aug. 22	Aug. 29	Net changes
Operating transactions						
Treasury operations*	+ 113	— 63	— 102	+ 51	+ 48	+ 47
Federal Reserve float	— 622	— 196	+ 129	+ 405	— 397	— 681
Currency in circulation	+ 90	— 127	— 121	+ 56	+ 133	+ 31
Gold and foreign account	— 114	— 3	+ 19	+ 8	— 38	— 128
Other deposits, etc.	— 28	— 37	— 55	— 74	+ 18	— 176
Total	— 563	— 425	— 130	+ 449	— 238	— 907
Direct Federal Reserve credit transactions						
Government securities:						
Direct market purchases or sales	+ 362	+ 602	— 34	— 270	+ 129	+ 789
Held under repurchase agreements	—	—	+ 17	— 5	— 12	—
Loans, discounts, and advances:						
Member bank borrowings	+ 11	+ 86	— 26	+ 26	— 83	+ 14
Other	—	—	—	—	+ 4	+ 4
Bankers' acceptances:						
Bought outright	+ 3	+ 1	— 3	— 3	— 3	— 5
Under repurchase agreements	— 3	— 1	—	—	—	— 4
Total	+ 373	+ 689	— 46	— 252	+ 35	+ 799
Member bank reserves						
With Federal Reserve Banks	— 190	+ 264	— 176	+ 197	— 203	— 108
Cash allowed as reserves†	+ 26	— 287	+ 176	— 4	+ 90	+ 1
Total reserves†	— 164	— 23	—	+ 193	— 113	— 107
Effect of change in required reserves†	+ 24	+ 78	+ 85	— 205	+ 45	+ 27
Excess reserves†	— 140	+ 55	+ 85	— 12	— 68	— 80
Daily average level of member bank:						
Borrowings from Reserve Banks	70	156	130	156	73	117‡
Excess reserves†	435	490	575	563	495	512‡
Free reserves†	365	334	445	407	422	395‡

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 August 29, 1962.

ever, partly offset by the effects of System open market operations. From the last statement week in July to the final week in August, System Account average outright holdings of Government securities rose by $789 million, while average holdings under repurchase agreements remained unchanged. From Wednesday, July 25, through Wednesday, August 29, System holdings of Government securities maturing within one year rose by $1,173 million, while holdings maturing in more than one year declined by $210 million.

Over the five statement weeks ended August 29, free reserves averaged $395 million, compared with $457 million in the four statement weeks ended July 25. Average excess reserves fell by $45 million to $512 million, while average borrowings from the Federal Reserve Banks rose by $18 million to $117 million.

THE GOVERNMENT SECURITIES MARKET

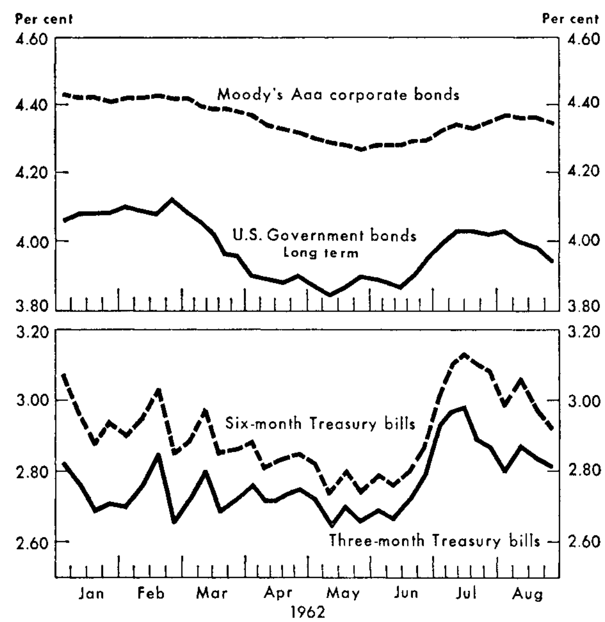
In the market for Treasury notes and bonds, prices moved sharply upward on August 2 in response to the Treasury's announcement that allotments would be only 12.5 per cent on the new 3½ per cent certificates of August 1963 and 22 per cent on the new 4 per cent bonds of February 1969. Subscriptions for these issues were larger, and allotments lower, than most market observers had expected. By contrast, the $316 million of public subscriptions for the new 4¼ per cent bonds of 1987-92 was smaller than the market had generally anticipated. Nevertheless, this news also tended to have a strengthening effect, since it involved a less-than-expected addition to the supply of long-term issues.

Prices drifted somewhat lower over the next few days, partially in response to the dampening effect on market psychology of banking statistics for the statement week ended August 1, which revealed a further gold outflow and a fairly substantial increase in business loans at New York City banks. The underlying tone of the market remained firm, however, due in part to a low volume of offerings of both "when-issued" and outstanding securities throughout most of the period preceding the August 15 payment date for the new issues. The growing expectation that the Administration would not ask for a tax cut this year also tended to contribute to market firmness. With this background, the market turned up again on August 8, and prices continued to work higher through August 23, as additional strength—particularly in long-term issues—was imparted by the improved tone in the corporate and tax-exempt markets. Over the balance of the month, price changes were generally small and mixed in a quiet market. For the month as a whole, prices of Treasury notes and bonds ranged from $\frac{1}{32}$ lower to $2\frac{1}{8}$ points higher, with the largest gains in long-term issues which benefited from the strength in the corporate bond market.

Rates on Treasury bills moved lower during the first few days of the month (see chart) under the pressure of a fairly strong investor demand, the effects of which were reinforced by the announcement of the small allotments of the new one-year certificate. At the regular auction on August 6, average issuing rates for the three- and six-month bills were set at 2.802 and 2.990, down about 7 and 9 basis points respectively from the previous week. Although bidding was rather cautious at these lower rate levels, dealers nevertheless found themselves with unexpectedly large awards and, with demand tapering off, rates on most issues moved up over the next two days, erasing much of the previous decline.

While a firmer tone subsequently reappeared, rate movements were irregular and average issuing rates in the August 13 auction were set about 7 basis points above those of the preceding week for both three- and six-month bills. Following the auction, rates again edged somewhat lower under the impact of a continuing nonbank demand, particularly for longer maturities. Thus, in the August 27 auction, average issuing rates declined by 7 basis points

RECENT MOVEMENTS IN BOND YIELDS AND TREASURY BILL RATES



Note: Bond yields are weekly averages of daily figures. Treasury bill rates are average issuing rates. Latest data plotted: week ended August 25 for bonds, auction held on August 27 for Treasury bills.

from the previous week for the six-month bills, although by only 3 basis points for the three-month bills. In this auction, the Secretary of the Treasury invoked his authority to reject any subscription, in whole or in part, by reducing the amount awarded to a subscriber who had bid for an exceptionally high proportion of the three-month bills. In the final auction of the month, held on August 31 in view of the Labor Day holiday, average issuing rates for the three- and six-month bills were set at 2.834 per cent and 2.977 per cent, up 3 and 6 basis points respectively from the previous week but down 4 and 10 basis points from the last auction in July.

OTHER SECURITIES MARKETS

Against the background of a relatively light calendar of current and forthcoming issues, prices of corporate and tax-exempt bonds worked generally higher over the month in the wake of a succession of firming influences. Thus both markets began to strengthen early in the month under the impact of the results of the Treasury's refinancing and the growing conviction that the Administration would not seek a tax cut. The highly successful marketing of a large telephone issue on August 7 was an additional strengthening factor, and the corporate market in particular responded with fairly sharp price advances and a marked step-up in volume. The announcement on August 14 that the Treasury would call for redemption in December the last of its outstanding partially tax-exempt bonds had a buoying effect on the market for tax-exempt issues, as some market observers apparently felt that a significant part of the funds obtained through the call might be reinvested in this market. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds fell by 3 basis points to 4.33 per cent (see chart), while the average yield on similarly rated tax-exempt issues fell by 8 basis points to 3.03 per cent.

With a strong tone prevailing in the market for seasoned bonds, new corporate and tax-exempt issues marketed during the month were generally well received. At the same time, the Blue List of advertised dealer offerings of tax-exempt issues was reduced by $97 million to $382 million at the end of August, the lowest end-of-month level since January. New tax-exempt securities reaching the market in August amounted to approximately $537 million, compared with $592 million in July 1962 and $527 million in August 1961. The largest new offering of the month was the $106.2 million Aaa-rated new Housing Authority bonds of thirty-four local housing authorities. Awarded to several syndicates at an average interest cost of 3.183 per cent (compared with an average cost of 2.963 per cent at the previous sale in April), the bonds were reoffered by the various syndicates at yields ranging from 1.40 per cent for 1963 maturities to 3.50 per cent for bonds maturing in 2003. The issue was very well received. The total volume of new corporate bonds floated during the month came to $438 million, as against $219 million in July 1962 and $214 million in August 1961. The largest new corporate offering during August was an issue in the early part of the month of $100 million 4½ per cent telephone debentures. Reoffered to yield 4.45 per cent, these Aaa-rated bonds, which are nonredeemable for five years, were promptly sold out and moved to premium bids in market trading. In the latter part of August, a $50 million issue of similarly rated utility bonds was reoffered to yield 4.27 per cent. Although it met some initial investor resistance, the issue was largely sold out by the end of the month.

Recent Monetary Policy Measures Abroad

In recent months, the monetary authorities in the major industrial countries abroad continued their efforts to correct imbalances in their countries' payments positions and to mitigate swings in domestic economic and credit conditions.[1] In countries with strong balances of payments and little or no danger of domestic inflation, the authorities generally sought to reduce domestic interest rates in order to bring them more closely into line with rates elsewhere and thereby moderate the international movement of short-term funds. But even where monetary policy decisions were taken against the background of domestic inflationary pressures, the authorities generally sought measures that would be least likely to aggravate short-term capital inflows.

[1] For a discussion of monetary policy abroad during December 1961-March 1962, see "Recent Monetary Policy Measures in Western Europe", this *Review,* April 1962, pp. 64-66.

CHANGES IN FOREIGN CENTRAL BANK DISCOUNT RATES SINCE MID-1961

In per cent

Date of change		Country	New rate	Amount of change
1961:	July 1	Turkey	7½	−1½
	July 22	Japan	6.94*	+0.37
	July 25	United Kingdom	7	+2
	August 24	Belgium	4¾	−¼
	September 29	Japan	7.3*	+0.37
	October 5	United Kingdom	6½	−½
	November 2	United Kingdom	6	−½
	December 7	South Africa	4½	−½
	December 28	Belgium	4½	−¼
1962:	January 9	Philippines	6	+3
	January 18	Belgium	4¼	−¼
	March 8	United Kingdom	5½	−½
	March 22	Belgium	4	−¼
	March 22	United Kingdom	5	−½
	March 30	Finland	8	+1¼
	April 6	Sweden	4½	−½
	April 25	Netherlands	4	+½
	April 26	United Kingdom	4½	−½
	May 26	Rhodesia and Nyasaland	5	−½
	June 8	Sweden	4	−½
	June 13	South Africa	4	−½
	June 25	Canada	6	†
	August 9	Belgium	3¾	−¼

* "Basic" rate for commercial bills.

† From November 1956 through June 21, 1962, the discount rate of the Bank of Canada had been set at ¼ per cent above the latest average tender rate for Treasury bills. The rate stood at 5.17 per cent on June 21, 1962.

In the United Kingdom, Belgium, Sweden, and South Africa, the authorities in recent months reduced discount and other interest rates (see table). The Bank of England on April 26 lowered its discount rate to 4½ per cent from 5, the third such cut this year. The reduction was aimed primarily at restraining the inflow of foreign funds, which was estimated by the Bank of England at $560 million in the first quarter of 1962. Although this latest reduction represented another step toward more normal levels from the peak 7 per cent of July 1961, it was generally not interpreted as evidence of a definite change in the direction of monetary policy. Subsequently, however, there were some signs of a moderate easing of credit. On May 31, the Bank of England announced a reduction in the special deposits required of commercial banks—to 2 per cent from 3 for the London clearing banks and to 1 per cent from 1½ for the Scottish banks. Three days later, the authorities reduced the minimum downpayment on instalment purchases from 20 to 10 per cent for all goods except automobiles.

Effective August 9, the National Bank of Belgium lowered its basic discount rate to 3¾ per cent from 4, the fifth ¼ per cent reduction in less than a year. By cutting the discount rate and allowing short-term rates to fall, the Belgian central bank continued to move toward a closer alignment of the Belgian discount rate with those of the other Common Market countries, while discouraging foreign short-term funds from contributing further to the already easy money market conditions. The two reductions in the Swedish discount rate—to 4½ per cent from 5 on April 6 and to 4 per cent on June 8—were part of the reversal of the anti-inflationary policy that had been adopted in early 1960 when an excessive rate of capital investment, together with other factors, had generated inflationary pressures and adversely affected the country's balance of payments. Since then, the pace of advance in economic activity has slackened and balance-of-payments deficits have given way to surpluses that have raised official gold and foreign exchange reserves to a new peak. On June 13, the South African Reserve Bank reduced its discount rate to 4 per cent from 4½ in the light of the continuing favorable balance-of-payments developments that brought further gains in the country's international reserves and financial liquidity.

In France and Italy, monetary policy in recent months has mainly sought to encourage funds to shift from the money market into longer term investment and, more particularly, to induce the banks to shift out of government paper into private medium- and long-term credits. In France, the National Credit Council on April 11 reduced by ¼ per cent the interest rates on one- to five-year publicly offered Treasury securities. It also cut from 17½ per cent to 15 the ratio of deposits that banks must hold in short-term Treasury bills. In Italy, the authorities have abandoned the "tap" issue of Treasury bonds in unlimited quantities, which had sometimes led to cash receipts in excess of the Treasury's requirements. Future flotations will be restricted to the Treasury's cash needs, and interest rates will be set each time to conform with current market conditions. The Bank of Italy will, moreover, prescribe the proportion between cash and Treasury bonds in the banks' compulsory reserve requirements.

Monetary measures introduced by the German authorities have reflected a German external position that is noticeably less strong than last year and a "basic" balance of payments (current account and long-term capital account) that has been in deficit since mid-1961. These measures were designed to induce the credit institutions to hold their liquid reserves more in domestic rather than in foreign short-term assets. In the view of the German Federal Bank, the banks' recent practice of using their foreign short-term assets as their primary liquidity reserve and the resulting fluctuations in these assets had tended to "impair the informative value of data concerning changes in the central monetary reserves and to cause a certain disturbance in foreign money markets". Accordingly, the German central bank increased the rate charged German banks on 31- to 60-day dollar swaps to 1 per cent from the ½ per cent which prevailed earlier this year. Between the end of March and August 1, the Federal Bank also increased its selling rates for open market paper in five steps of ⅛ per cent each, thereby raising yields to 2½ per cent on 60- to 90-day Treasury bills and to a range of 2⅜ to 3⅜ per cent on other open market paper. These measures have clearly been rather moderate in nature, apparently in view of some slackening in private investment and in order to avoid creating incentives for a renewed inflow of funds from abroad.

In Austria, the Netherlands, and Switzerland, the authorities have acted to restrain continuing inflationary pressures in recent months. In Austria, the liquidity of the economy increased further as a result of large balance-of-payments surpluses, substantial increases in government expenditures, and a reduction in personal income taxes effective July 1. Following similar measures taken in February, the Austrian National Bank on August 1 raised the credit institutions' minimum reserve requirements by ½ per cent to 10 per cent for time and sight deposits and to 8 per cent for savings deposits. In addition, the central bank placed 200 million schillings ($8.5 million) of 3½ per cent Treasury bills with the banks for one year, following a similar sale of 560 million ($21.5 million) earlier this year. Moreover, the National Bank cautioned that the continued large balance-of-payments surpluses might well occasion further restraining measures this fall.

In the Netherlands, the authorities acted to offset the expansion of bank credit, which had exceeded the ceilings set under the gentleman's agreement between the central bank and the commercial banks. On April 25, the Netherlands Bank raised its discount rate to 4 per cent from 3½, the first rate change since November 1959. The increase reportedly was also prompted by the desire to bring Dutch money market rates more closely into line with those then prevailing in other Western European countries. In addition, the July 1961 credit agreement, due to expire at the end of April, was extended through August, with the permissible rate of credit expansion remaining unchanged at ½ per cent per month.[2] At the same time, the authorities moved to reduce some of the strain on the country's tight capital market by limiting new foreign borrowing in the Netherlands during the balance of 1962.

In Switzerland, faced since June with a renewed influx of foreign funds, credit continues to be regulated mainly by last April's gentleman's agreement between the Swiss National Bank and the leading banks and banking associations. Under the terms of the agreement, which expires at the end of 1963, banks with a balance-sheet total of SF 10 million ($2.3 million) or more are to restrict new loans granted during April-December to a certain percentage of the increase in credits in either 1960 or 1961. For the whole of 1962, the expansion of business credit must not exceed 65 per cent, and that of mortgage credit 85 per cent, of the increase in the chosen base year. More recently, the Swiss National Bank, in the process of making funds available under the reciprocal currency agreement with the Federal Reserve System,[3] reduced the liquidity of the Swiss commercial banks. The $50 million received by the Swiss National Bank under the July 16 swap was passed on to the banks in exchange for Swiss francs, with the banks in turn investing the dollars in United States Treasury bills. Swiss francs advanced by Swiss banks also had a role in the currency swap executed under the Federal Reserve System's arrangement with the Bank for International Settlements. Thus, from the Swiss point of view, these operations provided a means to absorb excess liquidity from the Swiss banks.

In both Canada and Japan, monetary policy was tightened in midyear, primarily in response to external factors. As part of a series of measures in defense of the Canadian dollar—which included temporary surtaxes on a wide range of imports and a reduction in the budget deficit and which were bolstered by $1 billion in foreign credits—the Bank of Canada moved toward higher interest rates on June 25 by reintroducing a fixed discount rate, at 6 per cent; since November 1956, the rate had fluctuated at ¼ per cent above the weekly Treasury bill rate. However, for loans to money market dealers the rate is to be determined as heretofore. In Japan, the Ministry of Finance as of June 11 requested the foreign exchange banks to keep a 20 per cent reserve (the rate is variable at the discretion of the authorities) against such short-term foreign liabilities as deposits in foreign currencies (e.g., Euro-dollars), unsecured borrowings from foreign banks, and nonresident yen deposits. The reserves must be kept in the form of liquid foreign assets such as cash, deposits, call loans, and short-term bills of foreign governments. The measure, mainly intended to curb inflows of foreign short-term capital, should also help to reinforce the tightness of Japan's current domestic monetary policy. At the same time, the authorities asked the foreign exchange banks not to guarantee foreign borrowing by foreign branches and subsidiaries of Japanese firms in excess of the amount outstanding on May 24.

[2] A reduction in reserve requirements to 7 per cent from 8 on August 22 was merely intended to facilitate the take-over by a syndicate of Dutch banks of a $70 million United States bank credit to KLM, the Dutch airline.

[3] For a discussion of this and other agreements, see "Foreign Exchange Markets, January-June 1962", this *Review,* August 1962, pp. 106-109.