

FEDERAL RESERVE BANK OF NEW YORK



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Treasury and Federal Reserve Foreign Exchange Operations

This joint interim report reflects the Treasury-Federal Reserve policy of making available additional information on foreign exchange operations from time to time. The Federal Reserve Bank of New York acts as agent for both the Treasury and the Federal Open Market Committee of the Federal Reserve System in the conduct of foreign exchange operations.

This report was prepared by Charles A. Coombs, Vice President in charge of the Foreign Department of the New York Reserve Bank. It covers the period March 1961-September 1962.

The resumption of foreign exchange operations by the United States Treasury in March 1961 and by the Federal Reserve System in February 1962 has been part of a cooperative effort by Treasuries and central banks on both sides of the Atlantic to create a first line of defense against disorderly speculation in the foreign exchange markets. Recognizing that the dollar is the cornerstone of the entire international currency system, this cooperative effort has mainly taken the form of arrangements between the United States and other leading industrial countries adapted to the special needs of the countries involved. Continuous, close consultation among all of the Treasuries and central banks concerned has avoided any conflicts of policy or operations within the group as a whole.

BACKGROUND TO OPERATIONS

Under fair weather conditions, speculation can and does play a highly useful role in the foreign exchange market by helping to correct temporary deviations of spot and forward rates from the levels appropriate to underlying payment trends. Thus a decline in the spot or forward rate of one currency resulting from a temporary market imbalance may stimulate new demand for that currency by alert traders expecting a rebound in the rates.

On the other hand, when the exchange markets become seriously unsettled by political or economic uncertainties, normally beneficial speculation may quickly become transformed into a perverse, and sometimes even sinister, force. The latter type of speculation may be motivated, on the one hand, either by a natural desire to protect capital

values or, on the other hand, by the prospect of a quick capital gain. In such periods of market anxiety, abrupt declines in the spot or forward rate for a given currency may take on a grossly exaggerated significance, the exchange market may become a prey of purely imaginary fears, and selling or buying pressures on the exchanges may quickly acquire cumulative force. Even minor speculative squalls may have disturbing effects upon the normal flow of trade and payments, while very severe attacks have on occasion forced governments into unwanted changes of currency parities.

Official foreign intervention in markets. Although foreign central banks have for many years intervened in their foreign exchange markets to protect their currencies against speculative disturbances, the United States had refrained from such operations from the end of World War II until early 1961. This difference of approach goes back to the Bretton Woods Agreements. Under the Articles of Agreement of the International Monetary Fund, member countries agreed to establish par values for their currencies in terms of gold or the United States dollar and to limit fluctuations in their exchange rates to no more than 1 per cent above or below the par value. In many cases, foreign countries have fulfilled their obligation to the IMF by purchasing or selling United States dollars against their own currencies in order to keep their exchange rates from rising above the "ceiling" or falling below the "floor". Foreign central banks may also operate in the exchange markets between the margins, and many central banks do so to prevent sharp movements in the

rates. As the exchange rate moves upward (or downward), a country may buy (or sell) dollars against its currency to slow the rate movement, or even to halt it completely at some point within the official margins. Such purchases and sales, by ironing out sharp fluctuations in rates, help to maintain orderly conditions in the exchange markets, thereby facilitate the flow of trade and payments, and contribute materially to the maintenance of confidence in currencies.

Foreign official intervention on the exchanges is generally conducted through purchases and sales of United States dollars, the principal reserve currency. Such exchange intervention results in changes in official holdings of dollars, increasing them when the demand for the foreign currency is strong and reducing them when demand is weak. Most major countries hold only a part of their reserves in dollars—sometimes a very small part; the rest is held mainly in gold. If exchange intervention is undertaken on a large scale, such countries may acquire more dollars than they wish to hold; if so, they will convert their excess dollars into gold. Conversely they may have to sell gold to acquire the dollars necessary for support operations.

Role of dollar convertibility into gold. The willingness of foreign central banks to acquire and hold dollars as part of their reserves depends on the assured convertibility of such dollars into gold at a fixed price. As part of the Bretton Woods system, this assurance is provided by the United States, which undertakes to maintain a fixed par value for the dollar by standing ready to buy or sell gold against dollars at a fixed price of \$35 per ounce in whatever amounts may be requested by foreign monetary authorities. This system of defining and maintaining the parity of the dollar in terms of gold, while the parities of other currencies are maintained by buying and selling dollars, has greatly encouraged the development of an international gold exchange standard. Under this system the United States serves as banker for the dollar exchange reserves, now more than \$11 billion, of eighty-two countries throughout the world.

As banker for the international currency system, the role of the United States until recent years has been largely passive. Although foreign central banks resisted declines in their currency rates toward their floors, they had no obligation or incentive to resist similar declines in the dollar against their own currencies. As the dollar came under pressure from time to time in world exchange markets, the dollar rate therefore tended to slip to the floor. At this point foreign central banks would then fulfill their obligation to take the surplus supply of dollars off the market. If they wished, they would then convert part or all of these dollars into gold.

Currency crisis of 1960. This passive stance by the United States, in which both the rates for the dollar against foreign currencies and the accumulation of dollar reserves by foreign central banks were left entirely to market forces, and to the unilateral decisions of foreign monetary authorities, gave rise to no serious problems for many years after the war. By 1960, however, successive United States balance-of-payments deficits had brought about both heavy gold losses and sizable increases in our dollar liabilities to foreigners. At this point, the dollar became subject to rumors of impending changes in United States international financial policy, with widespread doubts developing abroad as to whether the United States Government could and would maintain the \$35 price for gold.

The resultant wave of speculation against the dollar was effectively stemmed in early 1961 by a Presidential pledge to maintain the gold price, to make our entire gold reserve available to defend the dollar, and, if necessary, to draw upon the IMF as a supplementary source of reserves. Most fundamental of all, of course, was announcement of action to correct the balance-of-payments deficit, and this program has subsequently shown gradual but solid results.

Effects of revaluation of mark and guilder. Meanwhile, the recovery of confidence in the dollar remained vulnerable to sudden shocks, and these were not long in coming. On the week end of March 4, 1961, the German Government announced the upward revaluation of the mark by 5 per cent. Shortly after that, the Netherlands Government announced a similar change in the guilder parity.

However effective these moves may ultimately prove to be as a contribution to international balance-of-payments equilibrium, their immediate effect was a shattering blow to market confidence in the system of fixed currency parities. All major currencies immediately became labeled as candidates for either revaluation or devaluation, and an unparalleled flood of speculative funds swept across the exchanges.

Speculation on a revaluation of the Swiss franc became particularly intense, with the result that more than \$300 million flowed into that country in four days. Most of the dollars acquired by the Swiss National Bank and other continental financial centers were the counterpart of a major speculative attack on sterling, with the Bank of England suffering heavy reserve losses.

At this critical juncture, the central bank Governors attending the monthly meeting of the Bank for International Settlements in Basle announced that their central banks were cooperating in the exchange markets. The scale of this cooperation in credits to the Bank of England reached a total of more than \$900 million and played a

vital role in providing a breathing space during which more fundamental measures could be taken by the British Government.

TREASURY INTERVENTION IN THE MARKET

Although the dollar emerged relatively unscathed from the first speculative attacks, the massive reshuffling of foreign-owned funds resulted in heavy accumulations of dollars by certain foreign central banks, with the possible consequence of sizable drains upon United States gold reserves. Anticipations of a second revaluation of the German mark generated a continuing heavy flow of funds to Frankfurt, with the result that the dollar reserves of the German Federal Bank rose to \$4.1 billion by March 31 as compared with its gold reserves of \$3.2 billion.

Operations in German marks. The disruptive effect of such speculation on the normal flow of German trade and payments was reflected in a scramble by non-Germans with contractual liabilities in marks to anticipate their requirements. Meanwhile, German residents sought to hedge against contracts payable to them in dollars or other foreign currencies. The forward exchange market could hardly cope with such an abrupt swing in expectations, with the result that the premium on the forward mark or, viewed the other way, the discount on the forward dollar rose to nearly 4 per cent. At that exaggerated level it tended to reinforce expectations of a further revaluation of the mark.

The limited availability of forward cover, even at such expensive rates, diverted commercial hedging demands into foreign purchases of spot marks to cover future mark contracts and German borrowing of dollars, both in New York and in the Euro-dollar market, as a hedge against dollar receivables. The resultant shift of the leads and lags in commercial payments against the dollar and in favor of the mark created a potentially dangerous situation. This situation became the subject of conversations on Friday, March 10, 1961, among officials of the German Federal Bank, Federal Reserve Bank of New York, and United States Treasury. There emerged the decision to undertake on the following Monday, March 13, forward sales of marks in the New York market by the New York Federal Reserve Bank as agent of the United States Treasury, with the dual objective of providing an ample supply of forward marks as an alternative to anticipatory purchases of spot marks by foreigners and dollar borrowing by Germans and, in the process, of driving down the forward premium on the mark as closely as possible to the 1 per cent level.

These forward sales of marks by the United States Treasury were undertaken under a "parallel" arrangement, generously suggested by the German Federal Bank, which agreed to supply the United States Treasury with marks (should they be needed) at the time the contracts matured, at the same rate as that at which the marks had been sold by the United States Treasury. In effect, the United States Treasury's forward commitments were entirely protected against any risk of loss. Forward operations undertaken under this arrangement were later supplemented by forward sales by the United States Treasury on the basis of \$100 million equivalent of German marks obtained by the United States under the \$587 million German debt repayment in April 1961.

Table 1 illustrates the scope and pattern of the Treasury's forward mark operations. From March 13 to the end of the month, the Treasury forcefully resisted the speculative inflow to Germany by selling over \$118 million equivalent of marks for delivery in three months. Market demand for forward marks then gradually declined, perhaps partly owing to the reassuring effect of official operations on so sizable a scale. But by mid-June the outstanding forward mark commitments of the United States Treasury had risen to \$340 million.

As the first of the forward contracts began to mature, the tide turned and the spot dollar rate gradually rose off the floor to which it had been pinned for many months. The improvement in the spot dollar rate was attributable in part to a market demand for dollars required to pay the United States Treasury for the forward mark purchases previously contracted for. Coordinated

Table 1
TREASURY FORWARD OPERATIONS IN GERMAN MARKS
MARCH 13-DECEMBER 13, 1961

Dollar equivalent, in millions

| Month | Future commitments (beginning of month) | New sales (during month) | Maturing contracts not renewed (during month) | Future commitments (end of month) | Premium on three-month forward mark (per cent per annum, end of month) |
|----------------------|---|--------------------------|---|-----------------------------------|--|
| March (13-31)..... | | 118.7 | | 118.7 | 1.47 |
| April..... | 118.7 | 104.4 | | 223.1 | 1.59 |
| May..... | 223.1 | 78.4 | | 301.5 | 1.39 |
| June..... | 301.5 | 52.8 | -86.5 | 267.8 | 2.21 |
| July..... | 267.8 | 32.9 | -98.1 | 202.6 | 1.45 |
| August..... | 202.6 | 12.7 | -89.3 | 126.0 | 1.02 |
| September..... | 126.0 | .3 | -76.6 | 49.7 | .88 |
| October..... | 49.7 | | -35.5 | 14.2 | .76 |
| November..... | 14.2 | | -14.0 | .2 | .80 |
| December (1-13)..... | .2 | | -.2 | | 1.00 |

intervention by the German Federal Bank and the United States Treasury in the spot mark market also helped to strengthen the dollar rate.

With the crisis of confidence more or less weathered, it seemed desirable to allow the forward premium on the mark to rise somewhat, thereby increasing the cost of forward cover and further dampening commercial hedging demand. As a consequence, the Treasury's outstanding balance of the forward mark commitments declined rapidly after mid-June as the daily rate of new sales fell far below maturing contracts. In September, in a market also strongly influenced by the Berlin crisis, forward sales were discontinued entirely as a normal flow of forward marks from private sources reappeared. By early December the Treasury's forward mark commitments had been fully liquidated.

By thus offsetting a large-scale flow of speculative funds that proved to be reversible within nine months, the United States Treasury operations in forward marks clearly helped both the United States and Germany. The short-term capital outflow from the United States was held down, and the United States payments deficit thereby reduced, while the German Federal Bank could restrain its dollar accumulations from becoming too large and also prevent the German money market from being flooded with a heavy volume of liquid funds. More generally, the forward mark operation apparently calmed a badly shaken exchange market, which needed time and the assurance of inter-governmental cooperation to recover confidence.

As previously mentioned, the United States Treasury had acquired, in April 1961, \$100 million in marks as part of a German Government debt payment totaling \$587 million. While about half of this mark balance was used to settle forward contracts maturing in the fall of 1961, the remainder was converted into dollars in September to make final payment to the United States lending agencies concerned.

The experience with the forward mark operation had proved sufficiently encouraging, however, to suggest that the United States Treasury might usefully acquire moderate amounts of spot marks when that currency temporarily weakened late in 1961. These mark acquisitions by the United States Treasury reached a total of approximately \$55 million equivalent and have been employed in several operations during the first half of 1962 to support the dollar rate during periods of temporary pressure. These operations have not only proved useful in producing the desired firming of the dollar rate but have also proved reversible. Later strengthening of the dollar rate has permitted replenishment of earlier drafts on the Treasury's mark balances.

Operations in Swiss francs. The second major exchange operation initiated by the United States Treasury during 1961 was in forward Swiss francs. The March 1961 revaluations of the German mark and Dutch guilder resulted in a burst of speculation on a similar revaluation of the Swiss franc and a heavy flow of short-term speculative funds to Switzerland. This influx created a serious problem of excessive liquidity on the Swiss money market while also raising the dollar exchange reserves of the Swiss National Bank far above traditional levels.

These dollar acquisitions by the Swiss National Bank could have been converted immediately into gold by purchases from the United States Treasury. But in the interests of international financial cooperation, the Swiss National Bank refrained from effecting such conversions in order to loan back to the Bank of England a large proportion of the dollar inflow to Switzerland.

There was in near prospect, however, the likelihood of a massive British Government drawing from the IMF which would result in a liquidation of the short-term credits received by the Bank of England from the Swiss National Bank and other European central banks. Accordingly, the Swiss National Bank seemed likely to convert large amounts of surplus dollar holdings into gold unless some means could be found to stimulate an outflow of private funds from Switzerland.

The basic obstacle to such an outflow of private funds from Switzerland came from the lingering fears and hopes of many private individuals that the Swiss franc would somehow or other provide a safer haven than other currencies against a wide range of political, military, and financial risks. But it had become quite clear to both Swiss and United States central bank officials that the "hot" money inflow into Switzerland was disguising a significant deterioration in the basic balance of payments of Switzerland and that, when some recovery of confidence in currency parities reappeared, a cessation of this hot money inflow would result in a strengthening of the dollar against the Swiss franc and in drains on the gold and dollar reserves of the Swiss National Bank. Thus, the piling-up of hot money in Swiss commercial banks was essentially a temporary, reversible phenomenon that might properly be dealt with by compensatory action by the two central banks concerned.

After extensive discussions among officials of the United States Treasury, the New York Federal Reserve Bank, and the Swiss National Bank, it appeared that a useful start could be made in offsetting such temporary inflows of hot money by providing adequate incentives to the re-export of private investment funds from Switzerland on a hedged, or covered, basis. Partly because of speculative fears or hopes of a revaluation of the Swiss franc, the premium

on the forward Swiss franc had risen to roughly $1\frac{7}{8}$ per cent, at which level it was prohibitively costly to cover short-term placements in New York, London, or other financial markets abroad.

Consequently, in July 1961 the United States Treasury agreed to supply through the agency of the Swiss National Bank forward Swiss francs to the market at rates sufficiently attractive to induce the Swiss commercial banks and other short-term investors to move funds into the dollar market. These forward operations were begun in a limited, experimental fashion on the basis of relatively small Swiss franc balances previously acquired by the United States Treasury.

With the emergence of the Berlin crisis in August 1961, however, the problem was complicated by a renewed flow of hot money to Switzerland, and the Treasury accordingly enlarged the scope of its forward operations. To provide a broader base for such operations, the Swiss National Bank agreed to provide a sizable line of credit in Swiss francs to the United States Treasury which could be drawn upon by issuance of three-month certificates of indebtedness carrying a rate of $1\frac{1}{4}$ per cent and denominated in Swiss francs. As the Treasury's forward commitments rose rapidly, it availed itself of its drawing rights to the extent of 200 million Swiss francs (\$46 million equivalent) in October 1961. By the end of November the Treasury's forward sales had reached \$152.5 million equivalent, which meant a roughly corresponding reduction in the dollar reserves of the Swiss National Bank and in Swiss gold purchases from the United States Treasury.

During December the Treasury's forward commitments declined somewhat (\$15 million of maturing contracts were paid off by the Treasury rather than renewed). This happened largely because Swiss commercial banks wanted to increase their franc assets for year-end window dressing. New contracts of \$9 million equivalent were undertaken at the end of January 1962. And in January and February all contracts were rolled over at maturity, so that by the end of February the Treasury's outstanding forward franc market commitments amounted to \$146.5 million equivalent.

In February 1962 the Swiss franc began to weaken, as had been expected with Switzerland's large current-account deficit and the tapering-off of the short-term capital inflow. In these circumstances, the Swiss National Bank had to supply dollars to the market and, by the end of May, the New York Federal Reserve Bank as agent of the United States Treasury had sold \$139 million to the Swiss National Bank.

If the United States Treasury had elected to meet these dollar requirements of the Swiss National Bank by accepting Swiss francs in payment, the resultant increase in the Treasury's franc balances would have been adequate to

liquidate nearly all of the forward Swiss franc market contracts outstanding. But a rapid liquidation of these forward contracts would have tended to recreate too much liquidity on the Swiss money market. Accordingly, the Swiss National Bank suggested that the United States Treasury might accept gold rather than Swiss francs in payment of part of the Swiss dollar requirements. Swiss gold sales to the United States Treasury amounted to \$74 million. The remaining \$65 million required by the Swiss were paid for in Swiss francs.

The Swiss franc balances were gradually used to liquidate \$55 million of maturing forward contracts, which by the end of May 1962 were less than \$91.5 million equivalent outstanding. The \$46 million certificates of indebtedness issued to the Swiss National Bank in the autumn of 1961 were also fully liquidated, as the Treasury found its forward position could be sustained on a smaller cash reserve. In effect, the program of forward sales of Swiss francs, initiated by the United States Treasury in July 1961, proved to be a self-liquidating operation, as the swing developing in the Swiss payments position would have permitted nearly complete liquidation of the forward operation within a matter of ten months. And the forward operations helped both the United States and Switzerland by damping United States gold losses from speculative money movements while relieving the Swiss market of too much liquidity.

Unfortunately the pendulum began to swing back. During the latter part of May 1962, capital funds again flowed to Switzerland in response to speculation caused by the Canadian devaluation and by the subsequent sharp decline of the New York stock market. But meanwhile the financial resources and market techniques available to the United States Government had been strongly reinforced by the entrance of the Federal Reserve System into the foreign exchange field. As subsequently outlined, a coordinated program involving the United States Treasury, the Federal Reserve System, and the Swiss National Bank succeeded in minimizing the impact of potentially dangerous speculative pressures.

Operations in Netherlands guilders. After the revaluation of the Netherlands guilder on March 7, 1961, the premium on the three-month forward guilder rose to well over 2 per cent and remained there until the end of April. The premium encouraged a further inflow of short-term funds into the Netherlands and deterred any covered outflow.

In this context, early in May the United States and Netherlands authorities discussed whether the United States should intervene in the forward guilder market to reduce the guilder premium to levels more consistent with interest

rates on dollar and guilder investments. These discussions between the United States and Netherlands authorities produced their first tangible results in July, when the Netherlands Bank, whose dollar reserves were to be depleted by a large British IMF guilder drawing (for conversion into dollars) in August, agreed to sell spot guilders to the United States and to provide for United States investment of these guilders in Dutch Treasury bills. It was agreed that it would be useful for the Treasury to acquire modest guilder balances for possible use in exchange operations in the future. Accordingly, the Netherlands Bank sold \$15 million equivalent of guilders to the United States Treasury during September.

As expectations of another revaluation of the guilder withered away, the forward guilder premium declined to more normal levels. But toward the end of 1961, rumors questioning the stability of exchange parities and the beginning of continental commercial bank repatriations of funds for year-end window-dressing operations induced a renewed rise in both spot and forward guilder rates. By December 20 the premium on the three-month forward guilder was again over 2 per cent (though moving erratically) and was clearly out of line with comparative interest rates.

Although the premium declined somewhat after the turn of the year, the United States Treasury concluded that it might usefully test the market by a small offering of forward guilders which might succeed in nudging the rate down to a more normal level. After further negotiations it was agreed that the Netherlands Bank would sell forward guilders in the market for the Treasury's account.

The sales were first made in January 1962 and reached \$20.8 million equivalent by early February. As the availability of forward cover stimulated Netherlands investment demand for short-term placements in New York and other financial markets, the spot guilder rate weakened to about par and, in the process, enabled the United States Treasury to acquire more spot guilders from the Netherlands Bank against dollars.

The forward operations were terminated on February 13 as the Netherlands money market had become less liquid, and the United States Treasury later liquidated each contract at maturity. The remaining guilder balances of the United States Treasury were used to intervene occasionally in the market to slow down a strong rise of the guilder spot rate during the spring months as a result of a tightening of liquidity in the Netherlands financial market. Also a sizable foreign exchange inflow was expected as a result of the Philips Lamp stock issue.

Operations in Italian lire. A continuing surplus in Italy's balance of payments has made the Italian lira one of the

strongest continental currencies. From mid-April 1961 until the present the lira has usually remained at its upper limit against the dollar.

In these circumstances, in late 1961 discussions began on the possibility of United States Treasury operations in the lira market. In January 1962 it was agreed that the Treasury would take over a substantial block of forward lire contracts from the Italian foreign exchange office and that the Bank of Italy would simultaneously extend to the Treasury a \$150 million line of credit in lire to support such spot as well as forward operations in lire as might appear desirable.

The Treasury made the first drawing on this line of credit on January 26, 1962, when it issued a three-month certificate of indebtedness for the equivalent of \$25 million in lire. It made a second drawing of \$50 million in March, and a third drawing of \$75 million in August.

Both spot and forward operations by the United States Treasury in lire are continuing and have lessened the accumulation of dollar reserves during the recent seasonal inflows to Italy.

BEGINNING OF FEDERAL RESERVE OPERATIONS

While the exchange operations undertaken by the Treasury with the limited resources of its Stabilization Fund had yielded encouraging results, Federal Reserve officials—with the full concurrence of the Treasury—considered whether it might not also be desirable to reactivate Federal Reserve exchange operations. After many months study, the Federal Open Market Committee on February 13, 1962, authorized open market transactions in foreign currencies.¹

Currencies involved. Under this authorization, the Special Manager of the Open Market Account for foreign currency operations received Committee approval to inaugurate operations by purchasing from the Stabilization Fund at market rates the following foreign currencies in order to open accounts with the central banks responsible for these currencies and develop procedures for future operations (Table 2).

Table 2
FEDERAL RESERVE PURCHASES OF FOREIGN CURRENCIES
FROM THE UNITED STATES TREASURY

| Currency | Dollar equivalent (in millions) |
|----------------------------|------------------------------------|
| German marks | 32.0 |
| Swiss francs | .5 |
| Netherlands guilders | .5 |
| Italian lire | .5 |

¹ The text of the authorization appears in the Appendix, pp. 139-40.

Accounts had previously been opened, and maintained for some years with more or less nominal balances, with the central banks of Canada, Great Britain, and France.

With the authorization of the Committee, the Special Manager proceeded to negotiate a series of reciprocal credit, or swap, facilities with seven foreign central banks and with the Bank for International Settlements. The amounts and dates of these swap arrangements are shown in Table 3.

Table 3

FEDERAL RESERVE RECIPROCAL CURRENCY AGREEMENTS, 1962

| Other party to agreement | Amount (in millions of dollars) | Date (of original agreement) | Term (in months) |
|--|---------------------------------------|------------------------------------|---------------------|
| Bank of France | 50 | March 1 | 3 |
| Bank of England | 50 | May 31 | 3 |
| Netherlands Bank | 50 | June 14 | 3 |
| National Bank of Belgium | 50 | June 20 | 6 |
| Bank of Canada | 250 | June 26* | 3 |
| Bank for International Settlements† | 100 | July 16 | 3 |
| Swiss National Bank | 100 | July 16 | 3 |
| German Federal Bank | 50 | August 2 | 3 |
| Total for all banks | 700 | | |

* Announced on Sunday, June 25.

† In Swiss francs.

Mechanics of swap arrangements. The details of the swap arrangements varied somewhat from agreement to agreement, reflecting differing institutional arrangements and operational procedures among the central banks. However, certain general principles ran throughout all of the agreements. They may be summarized as follows.

1. A swap constitutes a reciprocal credit facility under which a central bank agrees to exchange on request its own currency for the currency of the other party up to a maximum amount over a limited period of time, such as three months or six months.

2. If such a stand-by swap between the Federal Reserve and the Bank of England, for example, were to be drawn upon by the Federal Reserve, the Federal Reserve would credit the dollar account of the Bank of England with \$50 million at a rate of, say, \$2.80 to the pound, while obtaining in exchange a credit on the books of the Bank of England of about £18 million. Both parties would agree to reverse the transaction on a specified date, say, within three months, at the same rate of exchange, thus providing each with forward cover against the remote risk of a devaluation of either currency.

3. The foreign currency obtained by each party as a result of such cross credits to each other's accounts would, unless disbursed in exchange operations, be invested in a

time deposit or other investment instrument, earning an identical rate of interest of, say, 2 per cent and subject to call on two days' notice.

4. After consultation with the other, each party would be free to draw upon the foreign currency acquired under the swap to conduct spot transactions or meet forward exchange obligations.

5. Each swap arrangement is renewable upon agreement of both parties.

Use of swaps. Use of these various swap arrangements has followed a varied pattern. The \$250 million swap with the Bank of Canada was immediately drawn upon through a cross-crediting of Canadian and United States dollars as part of a Canadian stabilization program. The Canadian Government also received financial assistance from the IMF, the Export-Import Bank, and the Bank of England.

In the swaps with the Bank of France, the Bank of England, and the National Bank of Belgium, in amounts of \$50 million each, the stand-by facility was immediately drawn upon by the Federal Reserve in order to test communications, investment procedures, and other operational arrangements. In both the French and British swaps, no occasion has arisen for either party to use the proceeds of the swap in exchange operations. Consequently, after one renewal on June 1, the swap with the Bank of France was liquidated in advance of maturity on August 2 and placed on a stand-by basis. The swap with the Bank of England, which matured on August 30, was similarly placed on a stand-by basis.

The swaps of \$100 million each with the Swiss National Bank and the Bank for International Settlements were negotiated as stand-by facilities but with anticipation of an early necessity for their use to mop up a speculative flow of hot money to Switzerland in June and early July of 1962. Similarly, a stand-by swap with the Netherlands Bank has been actively utilized to mop up temporary flows of funds to the Netherlands. Finally, the \$50 million swap with the German Federal Bank was negotiated as a stand-by facility and no drawings have been affected to date.

Swiss francs. As previously noted, the stand-by swap arrangements of \$100 million each negotiated in mid-July by the Federal Reserve with the Swiss National Bank and the Bank for International Settlements anticipated an early drawing on these swaps to mop up surplus dollars taken in by the Swiss National Bank. Under these swap arrangements, the Federal Reserve drew, during July and August, \$60 million of Swiss francs under its swap arrangement with the Bank for International Settlements and \$50 million equivalent in Swiss francs under the swap

with the Swiss National Bank. The total proceeds of \$110 million in Swiss francs were immediately employed to buy back an equivalent amount of dollars on the books of the Swiss National Bank.

During the same period, the United States Treasury enlarged somewhat its forward operations in Swiss francs and thereby absorbed an additional amount of dollars held by the Swiss National Bank. As a result of these operations, the dollar holdings of the Swiss National Bank were substantially reduced, and the Bank purchased no more than \$50 million of gold from the United States during a period of intense speculation following the June decline in the New York and other stock exchanges.

Federal Reserve drawings under the Swiss franc swaps also indirectly served to absorb excess liquidity on the Swiss money market since the Swiss francs supplied under the swap by the Bank for International Settlements came from deposits of Swiss commercial banks. The Swiss National Bank similarly absorbed Swiss francs from the market by various forward operations involving investments by Swiss commercial banks in United States Treasury bills on a covered basis. Subsequently, the speculative fever subsided, the dollar strengthened significantly against the Swiss franc, and the Federal Reserve has already begun to acquire Swiss franc balances in anticipation of an eventual liquidation of the drawing under these two swaps.

Netherlands guilders and Belgian francs. Similarly, a heavy influx of funds into the Netherlands following the stock market declines in June was absorbed by drawings upon the Federal Reserve swap with the Netherlands Bank, combined with a resumption of Treasury forward operations in Dutch guilders. Sizable foreign payments for certain special purposes by the Netherlands have since reduced the dollar holdings of the Netherlands Bank and thereby enabled the Federal Reserve to completely repay drawings under the swap, which has now reverted to a stand-by facility.

Here, again, United States Government exchange operations have succeeded in dealing with what proved to be a reversible flow of funds and, as a result, the Netherlands Bank refrained entirely from purchases of gold from the United States during this difficult period. Intervention on a small scale in Belgian francs by drafts upon the swap with the National Bank of Belgium has served a similar purpose, with subsequent repurchases of Belgian francs by the Federal Reserve as the dollar strengthened.

Canadian dollars. The \$250 million Federal Reserve swap with the Bank of Canada on June 25, 1962, played an important role in a broad program of international financial cooperation designed to reinforce the Canadian Government's efforts to defend the Canadian dollar. Be-

tween January 1 and June 25, about \$900 million, or 44 per cent of Canada's gold and dollar reserves of \$2,056 million, was swept away by a mounting balance-of-payments deficit which threatened to force the Canadian dollar off its newly established parity. If this had happened, it would have been an extremely serious setback, not only to Canada but to the entire international financial system of fixed parities, and might easily have touched off a world-wide burst of speculation against other currencies, including the United States dollar.

In this atmosphere of emergency, a combined program of \$1,050 million was put together within four days. This included a \$300 million Canadian drawing upon the Fund, a \$250 million swap between the Federal Reserve and the Bank of Canada, a \$100 million credit to the Bank of Canada from the Bank of England, and a \$400 million stand-by credit to the Canadian Government by the Export-Import Bank. Announcement of financial assistance on this massive scale, coupled with a Canadian Government announcement of fiscal and other measures of restraint, immediately broke the speculative wave. Between June 25 and the end of August, Canada recovered more than \$500 million of its earlier reserve losses. Once again, the potentialities of central bank and intergovernmental financial cooperation in defending currency parities against essentially reversible flows of speculative funds was demonstrated.

The great bulk of the exchange operations undertaken by the Federal Reserve for its own account have involved transactions directly with foreign central banks, rather than in the exchange market. The foreign central banks have continued their policy of active direct participation in the market, and their activity has been supplemented from time to time by appropriate Treasury operations. The Federal Reserve has not thus far undertaken any forward operations in the exchange markets for its own account. Spot operations in support of the dollar in the markets have so far been limited to moderate sales of German marks, sometimes accompanied by similar sales of marks by the Treasury. These transactions have proved fully reversible, with both the Federal Reserve and Treasury subsequently replenishing their mark holdings as the dollar strengthened.

COORDINATION OF TREASURY AND FEDERAL RESERVE EXCHANGE OPERATIONS

Treasury and Federal Reserve exchange operations are continuously coordinated by frequent telephone communications each day between Treasury and Federal Reserve officials concerned with market operations. At 2:30 p.m.

each day the Foreign Exchange Trading Desk in the Foreign Department of the Federal Reserve Bank of New York provides a full and detailed report, over a Treasury and Federal Reserve telephone conference circuit, of exchange rates, market conditions, and operations undertaken during the day by both the Federal Reserve and the Treasury Stabilization Fund. The very fact that the Special Manager of the System Account is an officer of the Federal Reserve Bank of New York which also conducts exchange operations on behalf of the Treasury eliminates,

insofar as is humanly possible, any risk of an inadvertent clash of operations by the two agencies and greatly facilitates the task of insuring a coordination of both Federal Reserve and Treasury operations with the foreign central banks concerned.

With both agencies pursuing identical policy objectives and employing a single instrument of operations, it has proved possible during recent months to carry out an effective meshing of Federal Reserve and Treasury operations in several European currencies.

APPENDIX

AUTHORIZATION REGARDING OPEN MARKET TRANSACTIONS IN FOREIGN CURRENCIES

Pursuant to Section 12A of the Federal Reserve Act and in accordance with Section 214.5 of Regulation N (as amended) of the Board of Governors of the Federal Reserve System, the Federal Open Market Committee takes the following action governing open market operations incident to the opening and maintenance by the Federal Reserve Bank of New York (hereafter sometimes referred to as the New York Bank) of accounts with foreign central banks.

I. Role of Federal Reserve Bank of New York

The New York Bank shall execute all transactions pursuant to this authorization (hereafter sometimes referred to as transactions in foreign currencies) for the System Open Market Account, as defined in the Regulation of the Federal Open Market Committee.

II. Basic Purposes of Operations

The basic purposes of System operations in and holdings of foreign currencies are:

- (1) To help safeguard the value of the dollar in international exchange markets;
- (2) To aid in making the existing system of international payments more efficient and in avoiding disorderly conditions in exchange markets;
- (3) To further monetary cooperation with central banks of other countries maintaining convertible currencies, with the International Monetary Fund, and with other international payments institutions;
- (4) Together with these banks and institutions, to help moderate temporary imbalances in international payments that may adversely affect monetary reserve positions; and
- (5) In the long run, to make possible growth in

the liquid assets available to international money markets in accordance with the needs of an expanding world economy.

III. Specific Aims of Operations

Within the basic purposes set forth in Section II, the transactions shall be conducted with a view to the following specific aims:

- (1) To offset or compensate, when appropriate, the effects on U. S. gold reserves or dollar liabilities of those fluctuations in the international flow of payments to or from the United States that are deemed to reflect temporary disequilibrating forces or transitional market unsettlement;
- (2) To temper and smooth out abrupt changes in spot exchange rates and moderate forward premiums and discounts judged to be disequilibrating;
- (3) To supplement international exchange arrangements such as those made through the International Monetary Fund; and
- (4) In the long run, to provide a means whereby reciprocal holdings of foreign currencies may contribute to meeting needs for international liquidity as required in terms of an expanding world economy.

IV. Arrangements with Foreign Central Banks

In making operating arrangements with foreign central banks on System holdings of foreign currencies, the New York Bank shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee.

The Bank shall instruct foreign central banks regarding the investment of such holdings in excess of minimum working balances in accordance with Section 14 (e) of

the Federal Reserve Act.

The Bank shall consult with foreign central banks on coordination of exchange operations.

Any agreements or understandings concerning the administration of the accounts maintained by the New York Bank with the central banks designated by the Board of Governors under Section 214.5 of Regulation N (as amended) are to be referred for review and approval to the Committee, subject to the provision of Section VIII, paragraph (1), below.

V. Authorized Currencies

The New York Bank is authorized to conduct transactions for System Account in such currencies and within the limits that the Federal Open Market Committee may from time to time specify.

VI. Methods of Acquiring and Selling Foreign Currencies

The New York Bank is authorized to purchase and sell foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the Stabilization Fund of the Secretary of the Treasury established by Section 10 of the Gold Reserve Act of 1934 and with foreign monetary authorities.

Unless the Bank is otherwise authorized, all transactions shall be at prevailing market rates.

VII. Participation of Federal Reserve Banks

All Federal Reserve banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G (1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

VIII. Administrative Procedures

The Federal Open Market Committee authorizes a Subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board of Governors (or in the absence of the Chairman or of the Vice Chairman of the Board of Governors the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate) to give instructions to the Special Manager, within the guidelines issued by the Committee, in cases in which it is necessary to reach a decision on operations before the Committee can be consulted.

All actions authorized under the preceding paragraph shall be promptly reported to the Committee.

The Committee authorizes the Chairman, and in his absence the Vice Chairman of the Committee, and in the

absence of both, the Vice Chairman of the Board of Governors:

(1) With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

(2) To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities;

(3) From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Problems.

IX. Special Manager of System Open Market Account

A Special Manager of the Open Market Account for foreign currency operations shall be selected in accordance with the established procedures of the Federal Open Market Committee for the selection of the Manager of the System Open Market Account.

The Special Manager shall direct that all transactions in foreign currencies and the amounts of all holdings in each authorized foreign currency be reported daily to designated staff officials of the Committee, and shall regularly consult with the designated staff officials of the Committee on current tendencies in the flow of international payments and on current developments in foreign exchange markets.

The Special Manager and the designated staff officials of the Committee shall arrange for the prompt transmittal to the Committee of all statistical and other information relating to the transactions in and the amounts of holdings of foreign currencies for review by the Committee as to conformity with its instructions.

The Special Manager shall include in his reports to the Committee a statement of bank balances and investments payable in foreign currencies, a statement of net profit or loss on transactions to date, and a summary of outstanding unmatured contracts in foreign currencies.

X. Transmittal of Information to Treasury Department

The staff officials of the Federal Open Market Committee shall transmit all pertinent information on System foreign currency transactions to designated officials of the Treasury Department.

XI. Amendment of Authorization

The Federal Open Market Committee may at any time amend or rescind this authorization.

The Business Situation

Economic activity continued on a high level in August and September, but there was no conclusive indication of a significant movement one way or the other. Industrial production, payroll employment, and retail sales were little changed in August; however, such slight changes as did occur were downward. In September, scattered and fragmentary production figures suggest that changes were largely seasonal. Department store sales appeared to be on the rise in the early weeks of the month, but automobile sales continued to be limited by the short supply of 1962 models. The economy thus seems to be "marking time".

Indicators of future economic activity give little sign of any substantial change from recent levels. Business and personal incomes, according to the latest available data, have continued to rise moderately or at least to hold near peak rates, thus providing the purchasing power to support the current rate of economic activity. On the other hand, recent gains do not add up to the kind of enlargement of demand which might be expected to spark a general upsurge. Surveys of anticipations and projections with regard to business sales, inventories, and capital outlays suggest that businessmen expect only a moderate improvement over the balance of the year. Recent sales and new order figures accordingly reflect a "wait and see" attitude. On the other hand, there is no evidence of significant weakness developing in the economy.

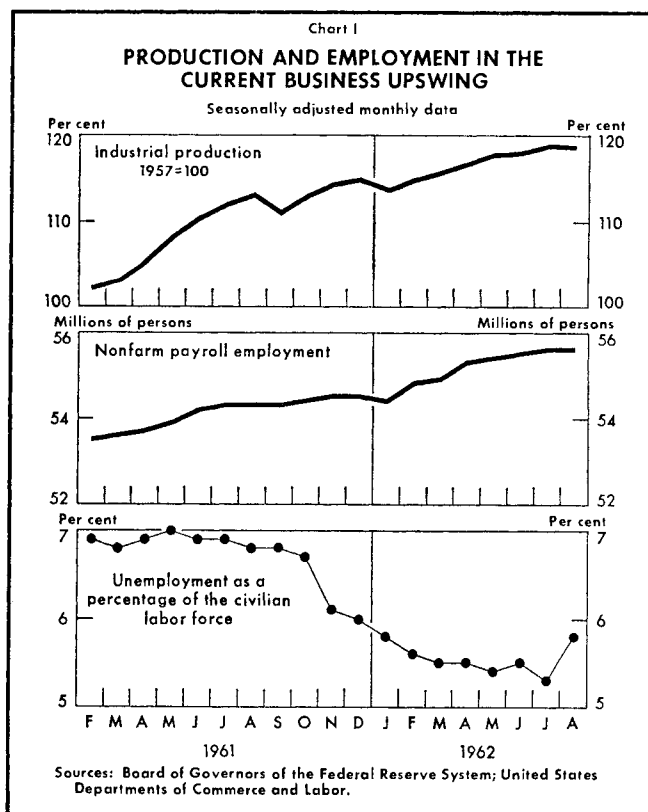
PRODUCTION AND EMPLOYMENT

Industrial production (as measured by the Federal Reserve index) was virtually unchanged in August, after advancing for six consecutive months (see Chart I). There were declines in production by utilities and nondurables manufacturing industries, but these were largely offset by higher output of steel and by small gains in several other durable goods industries, particularly those producing business equipment. In the case of steel, the August gain was the first increase since last February.

For September the weekly indicators of production generally show seasonal increases. Steel inventories continue to be a restraining factor and have so far prevented ingot production from rising much beyond 60 per cent of capacity. For the month as a whole, however, steel output

appears to show a slightly more than seasonal gain over August. In the auto industry, all companies returned to full operation shortly after Labor Day, following the August shutdowns for model change-over. September schedules call for a seasonally adjusted assembly rate equivalent to more than 7 million cars annually, about equal to the August pace.

The employment situation worsened in August as non-farm payroll employment declined for the first time since January. The household survey, in contrast, reported a sharp rise in nonagricultural employment, but also showed a substantial increase in unemployment. Indeed, the unemployment rate (unemployment as a percentage of the labor force) rose to 5.8 per cent (see Chart I). To be sure, these changes were partly traceable to special circum-



stances. This year's model change shutdowns in the automobile industry were more heavily concentrated in August than in former years. Moreover, because of the later-than-usual date of the household survey during the month, a large number of women (possibly school teachers) were this year reported as waiting to begin work within thirty days and thus counted as unemployed. Reports for unemployment insurance claims in early September suggest some decline in unemployment in that month, but this may, of course, merely reflect the fact that the special circumstances which had affected the August statistics were no longer present. It apparently remains true that the rate of unemployment has shown little net change since the beginning of the year, despite the rise in production since that time.

INDICATORS OF FUTURE ACTIVITY

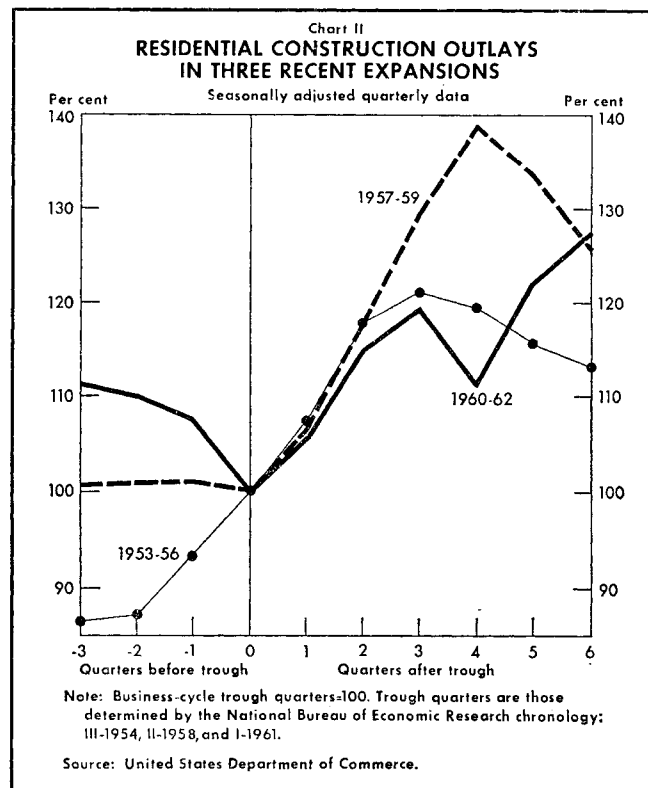
New orders received by manufacturers of durable goods failed to hold their July gains in August, decreasing by 3 per cent, seasonally adjusted. However, compared with the June-July average, total orders in August showed little net change. Most of the fluctuation in orders during the past several months was related to two phenomena, neither of which is necessarily indicative of business sentiment about the future. Government orders for defense purposes lagged in June and then bulged in July, and orders reported by automobile manufacturers rose sharply in July but then fell off markedly in August. (The statistics on new orders received by the automobile industry are based on deliveries of new cars, rather than on actual orders.) Nevertheless, given the fact that steel orders were no longer a drag on total orders—they actually rose in August for the second consecutive month—the over-all order picture shows little exuberance.

One area of business demand that could provide some new strength to orders is spending for inventories, particularly as steel inventories move down closer to desired levels. Although inventory targets may of course be revised on the basis of developments in business sales, manufacturers did expect in August to increase their inventories by \$500-600 million per quarter between the end of June and the end of December, according to a Commerce Department survey. In the second quarter, net inventory purchases by manufacturers had amounted to only \$300 million, reflecting the sharp cutback in steel stocks that had been built up in anticipation of a strike. Even with this somewhat sharper increase, inventories at the year's end are expected to be no higher in relation to sales than they were at midyear.

Spending for new construction, which had fallen off

in July, also showed signs of regaining strength, as total outlays rose in both August and September. Although outlays for commercial and industrial buildings decreased in September for the first time in three months, they still were at the second highest level ever reached, and the August rise in contract awards suggests the possibility of some further increase. In the residential sector, the increase in outlays in September nearly recouped the loss during the previous two months, and the July-August increases in the number of new housing units started may foreshadow some additional rise in expenditures in the months ahead. Such an increase would represent a departure from previous postwar cyclical experience. In the two preceding cycles, residential construction activity had already begun to decline in the fourth or fifth quarter of general business expansion (see Chart II).

In the consumer sector, demand continues to be supported by rising incomes and by the steady advance in consumer credit. The most recent gains in income and consumer credit have, however, been somewhat smaller than those earlier in the year. At the same time, retail sales, after spurting to a new record in July, fell off slightly in August. A major part of the decline came in the automotive group, as relatively low car inventories forestalled any



serious sales push, but department stores sales also were off a bit for the month. Department store sales did apparently again pick up somewhat with the cooler weather in September. It remains to be seen whether this reflects a general improvement in buying intentions. Evidence on consumer sentiment probably will not be conclusive for

several months, and particularly until the 1963 model cars have been available long enough to permit an assessment of the public's reaction to the new styles. In any event, the reception of the new models will have to be quite favorable if car sales are to exceed, by any significant margin, the rapid pace set during the spring and summer months.

The Money Market in September

The money market continued moderately firm during September. Nation-wide reserve availability was about the same as in August, but was concentrated mainly at banks outside New York City. New York City banks experienced some reserve shortages, largely reflecting the continued effects of Treasury refunding operations and a seasonal corporate need for liquidity. Federal funds traded for the most part at $2\frac{3}{4}$ and 3 per cent, with the effective rate at 3 per cent during the first two weeks of the month and mainly at $2\frac{3}{4}$ per cent thereafter. Some temporary firmness developed again in the closing days, however, as float finally declined after remaining near its midmonth peak longer than usual. Rates posted by the major New York City banks on call loans to Government securities dealers were quoted within a 3 to $3\frac{1}{2}$ per cent range throughout the period.

Three Treasury financing announcements were made during the month. On September 5 the Treasury indicated that holders of six of its issues, maturing in February and May of 1963 and bearing coupons ranging from $2\frac{5}{8}$ to 4 per cent, would be given the opportunity to exchange their securities for a new $3\frac{3}{4}$ per cent note maturing August 15, 1967 or a new 4 per cent bond maturing August 15, 1972. The effective offering yields of the new securities, taking into account the various cash payments to be made by the Treasury to subscribers, were from 3.80 to 3.83 per cent on the note and from 4.05 to 4.07 per cent on the bond. This refunding, involving issues considerably closer to maturity than had been the case in previous advance refundings, was intended by the Treasury to reduce the "congested maturity schedules of February and May 1963" as well as "to improve the structure of the outstanding debt". Of the \$26.8 billion of these issues outstanding, \$19.2 billion was publicly held. About 39 per cent, or

\$7.5 billion, of these holdings was exchanged during the subscription period from September 10 through September 12. On September 13 the Treasury announced that a new borrowing technique would be tested by the sale within the next six months of approximately \$250 million of long-term bonds on the basis of competitive bidding by underwriting syndicates. Questions and suggestions from the public will be heard by Treasury officials at a meeting to be held on October 17 at this Bank. Finally, on September 20, the Treasury announced that on September 26 it would auction \$3 billion 170-day tax anticipation bills, dated October 3, 1962 and maturing March 22, 1963. Commercial banks were permitted to make payment through credits to Tax and Loan Accounts.

The market for Treasury notes and bonds displayed a generally firm tone during most of the month and prices tended upward, with occasional interruptions. The various Treasury announcements noted above, although attracting considerable attention, had a comparatively minor price impact. New developments with significant effect on market psychology did not appear until the latter part of the month. At that time, the relatively confident atmosphere which prevailed at the international financial meetings in Washington, the good reception accorded the Treasury's advance refunding, and some fading of optimism concerning business activity all contributed to increased market strength.

The market for Treasury bills was also generally firm in September. Demand was particularly strong just prior to the advance refunding when some investors who did not wish to acquire the new longer term issues sought to capture the relatively attractive premiums at which rights were trading and to reinvest in bills. Corporate offerings associated with the approach of the midmonth tax and

dividend date were relatively moderate and resulted in only small and temporary upward pressures on rates. The corporate and tax-exempt bond markets were quiet during the month, with an underlying firm tone reflecting in part a lower volume of dealer inventories than in recent months and the relatively light calendar of new issues.

MEMBER BANK RESERVES

Operating factors supplied reserves on balance over the month, owing primarily to the effects of a substantially greater than seasonal midmonth increase in float which was unusually slow in falling back to normal month-end levels. System open market operations absorbed a considerable part of these reserves, however, as System Account average outright holdings of Government securities declined by \$679 million from the last statement week in August to the last statement week in September, while average holdings under repurchase agreements remained unchanged. From Wednesday, August 29, to Wednesday,

September 26, System holdings of securities maturing within one year declined by \$1,098 million while holdings maturing in more than one year rose by \$57 million.

Over the four statement weeks ended September 26, free reserves averaged \$406 million, compared with \$403 million in the five weeks ended August 29. Average excess reserves declined by \$30 million to \$490 million, while average borrowings from the Federal Reserve Banks declined by \$33 million to \$84 million.

THE GOVERNMENT SECURITIES MARKET

In the market for Treasury notes and bonds, attention was focused throughout most of the month on current and prospective Treasury financing operations. Although the advance refunding came as a surprise to the market, the offering was favorably received. Prices of rights to the new issues moved up substantially on September 6, the first trading day after the announcement, although the premium relative to bills was subsequently reduced as large supplies were provided by holders not wishing to lengthen their portfolios. At the same time, prices of both the new 3¾ per cent note of 1967 and the new 4 per cent bond of 1972 moved up from their effective issuing price, on when-issued trading, in response to a moderate investment demand. At the end of the subscription period (September 12), prices stood $\frac{3}{8}$ in each case above initial bid quotations of $99\frac{23}{32}$ for the note and $99\frac{17}{32}$ for the bond. The results of the refunding (indicated above) were about in line with the expectations of the more optimistic market observers and were generally regarded as a mark of confidence in the long-term market. Prices of the new issues continued to edge up over the balance of the month and closed at bid quotations of $100\frac{7}{32}$ for the note and $100\frac{5}{32}$ for the bond.

The impact of the refunding on outstanding notes and bonds was relatively moderate. Thus, during the week between the announcement of the refunding and the close of the subscription books, prices of most outstanding issues maturing between 1966 and 1980 declined by only $\frac{4}{32}$ to $\frac{8}{32}$, while prices of other outstanding securities rose by $\frac{2}{32}$ to $1\frac{1}{32}$. Prices of most issues moved generally upward over the remainder of the month, although there were brief reversals on two occasions when plans for new offerings were announced. In the middle of the month, prices of intermediate- and long-term bonds underwent a mild and temporary dip following the Treasury's announcement of plans to sell about \$250 million of long-term bonds through competitive bidding by underwriting syndicates. On September 19, prices of long-term issues declined slightly following the announcement of the American

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

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

| Factor | Daily averages—week ended | | | | Net Changes |
|---|---------------------------|--------------|--------------|--------------|--------------|
| | Sept. 5 | Sept. 12 | Sept. 19 | Sept. 26 | |
| Operating transactions | | | | | |
| Treasury operations* | - 13 | - 27 | - 80 | + 78 | - 42 |
| Federal Reserve float | - 153 | + 266 | + 736 | + 40 | + 889 |
| Currency in circulation | - 96 | - 201 | + 122 | + 163 | - 12 |
| Gold and foreign account | + 3 | - 84 | - 44 | + 4 | - 71 |
| Other deposits, etc. | - 47 | + 49 | + 74 | + 15 | + 91 |
| Total | - 306 | + 52 | + 810 | + 298 | + 854 |
| Direct Federal Reserve credit transactions | | | | | |
| Government securities: | | | | | |
| Direct market purchases or sales | + 245 | + 5 | - 521 | - 408 | - 679 |
| Held under repurchase agreements | + 148 | - 21 | - 127 | - | - |
| Loans, discounts, and advances: | | | | | |
| Member bank borrowings | + 21 | - 17 | - 52 | + 116 | + 68 |
| Other | - 8 | + 1 | - 1 | - | - 8 |
| Bankers' acceptances: | | | | | |
| Bought outright | - | - | - | - | - |
| Under repurchase agreements | - | - | - | - | - |
| Total | + 405 | - 30 | - 702 | - 293 | - 620 |
| Member bank reserves | | | | | |
| With Federal Reserve Banks | + 99 | + 22 | + 108 | + 5 | + 234 |
| Cash allowed as reserves† | - 176 | + 91 | + 100 | + 16 | + 31 |
| Total reserves‡ | - 77 | + 113 | + 208 | + 21 | + 265 |
| Effect of change in required reserves‡ | - 37 | - 6 | - 222 | - 39 | - 304 |
| Excess reserves‡ | - 114 | + 107 | - 14 | - 18 | - 39 |
| Daily average level of member bank: | | | | | |
| Borrowings from Reserve Banks | 94 | 77 | 25 | 141 | 84‡ |
| Excess reserves† | 421 | 528 | 514 | 496 | 490‡ |
| Free reserves† | 327 | 451 | 489 | 355 | 406‡ |

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

* Includes changes in Treasury currency and cash.

† These figures are estimated.

‡ Average for four weeks ended September 26, 1962.

Telephone and Telegraph Company that it would market \$250 million of 34-year debentures on October 23. As with the earlier Treasury announcement, however, the decline was short-lived. Toward the end of the month, price increases accelerated somewhat under the stimulus of the strengthening factors mentioned earlier. Market sentiment may also have been strengthened by a decline in stock prices. Over the month as a whole, prices of Treasury notes and bonds generally ranged from $\frac{7}{32}$ to $\frac{18}{32}$ higher.

After rising somewhat at the beginning of the month, rates on Treasury bills declined sharply on September 6 under the pressure of demand from investors who were switching out of issues involved in the advance refunding announced the day before. This demand soon moderated, however, and rates fluctuated within a narrow range over the next several days. Average issuing rates for the three- and six-month bills in the September 10 auction were 2.789 and 2.911 per cent, respectively, down 5 and 7 basis points from those set at the August 31 auction. Subsequently, rates edged up somewhat as the midmonth tax and dividend date approached. In the September 17 auction the average issuing rate for the three-month bill rose 1 basis point, while the rate for the six-month bill was up 5 basis points as demand for the longer maturity was restrained by the expectation (subsequently confirmed) that a new tax anticipation bill would be offered later in the month. Dealer awards in the September 17 auction were relatively light, particularly for the longer bill. Following that auction, demand again increased. Rates tended downward until the closing days of the month, despite sizable sales of bills by the Federal Reserve System and continuing additions to the outstanding supply of bills by the Treasury. At the final regular auction in the month, average issuing rates were 2.749 per cent and 2.938 per cent for the three- and six-month bills, respectively, 9 and 4 basis points below the rates in the final August auction. Thereafter, rates again rose briefly but, by the end of the period, the new bills were quoted at 1 and 5 basis points, respectively, below their issuing rates. The tax anticipation bills auctioned on September 26 attracted strong bidding interest by banks and were issued at an average rate of about 2.62 per cent.

OTHER SECURITIES MARKETS

Activity in the markets for corporate and tax-exempt securities was generally light during the month. A firm tone prevailed, however, and prices edged higher during most of the month, partly reflecting a reduced volume of dealer inventories and the light calendar of forthcoming issues. The September 19 announcement of the October American Telephone and Telegraph offering noted above resulted in only a temporary lowering of quotations and reduction in activity. Trading became more active in the following few days and prices strengthened, partly in response to the stock market decline. Over the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds fell by 2 basis points to 4.31 per cent, while the average yield on similarly rated tax-exempt issues fell by 3 basis points to 3.00 per cent.

Despite the firm tone in the markets for seasoned issues, new issues received a mixed investor response during the month as underwriters sought in some cases to lead the market by setting relatively full prices. New offerings were generally small, however, and gradual progress was made in distributing unsold dealer balances. Dealers' inventories declined over the first few weeks of the period, but by the end of the month the Blue List of advertised dealer offerings of tax-exempt issues had risen by \$39 million to \$425 million. New tax-exempt securities reaching the market in September amounted to approximately \$395 million, compared with \$537 million in August 1962 and \$651 million in September 1961. The largest new tax-exempt issue was a \$32.8 million Aa-rated multiple purpose municipal bond. Reoffered to yield 1.50 to 3.10 per cent, the bond sold slowly. The total volume of new corporate bonds floated during September amounted to \$155 million, compared with \$438 million in the preceding month and \$119 million a year ago. The largest new issues were two \$50 million offerings, one Aa-rated and one Baa-rated. The former, nonredeemable for five years, was reoffered to yield 4.27 per cent and met with only fair investor response. The latter, also nonredeemable for five years, was reoffered to yield about 4.90 per cent. These bonds were quickly sold and moved to a slight premium in market trading.

Developments in Second District Agriculture

The recent drought has called attention to the farm situation in this region. Although farming is less important in New York, New Jersey, and Connecticut than in other states in the nation—less than 1 per cent of total income in the Second Federal Reserve District derives from agriculture—it remains an important or even dominant form of livelihood in many areas, such as western and central New York and northwestern New Jersey. Moreover, a significant part of the District's industrial activity consists of the processing and distribution of its agricultural commodities.

The major part of the District's farm activity is centered in dairying, which brings in more than half of all receipts from farm marketings. However, the District is also an important producer in a number of other fields, notably poultry, onions, apples, potatoes, and greenhouse and nursery products. On the whole, the trend of recent years seems to have been toward increased specialization in these products.

Nevertheless, the relative importance of agriculture in the District's economy has been declining—indeed, declining more rapidly than in the country as a whole. Because of the high premium on District land for residential and industrial uses, the number of farms and the total land acreage devoted to farming have been shrinking faster than in the nation as a whole.

LONG-TERM TRENDS

Most of the trends which have characterized national agricultural developments in recent decades have operated in the Second District as well, but in varying degree. Thus, the pattern of concentration into larger farming units is reflected in an over-all increase since 1930 of 44 per cent in the average size of District farms as compared with 93 per cent elsewhere. Over this period, the reduction in the number of small- and medium-sized farms (of less than 260 acres) and the growth in that of larger farms of all sizes were even more rapid in the District than nationally. However, there has been little or no development of very large farms such as are important in some grain and cattle producing areas.

Despite the increase in the average size of farms, total

agricultural land in use in the Second District has steadily fallen (it is now 26 per cent below the 1930 level), whereas in the nation as a whole the 1959 acreage was 14 per cent greater than in 1930. This difference in the District pattern is no doubt a reflection of the pressure to convert land to competing uses which has been exerted by the District's high population density and degree of industrialization. In this situation, and in view of the cost-price squeeze often prevailing for their products, many farmers have found it advantageous to sell their property for nonfarm uses in order to benefit from high real estate values. At the same time, the high land prices have curbed the expansion of farm land.

Reflecting these forces, the value of District farm products sold has been declining relative to the national total for at least several decades. The relative decline has been most pronounced in the sale of dairy and poultry products. It has been less marked for receipts from the marketing of crops, but such receipts play a smaller role in this District than in the nation.

It must be emphasized that the decline has been relative rather than absolute. Between 1940 and 1959, District receipts from the sale of dairy products actually rose by 248 per cent and from poultry farming by 141 per cent. While these gains, of course, reflect increases in production and prices, they also reflect gains in productivity. Milk production per cow and egg production per hen have increased 33 per cent since 1940. While the expansion in productivity and cash receipts has been less than occurred nationally, the absolute levels of milk and egg productivity remain higher in the District.

Over the past decade the pattern of changes in total farm income, both nationally and locally, has been erratic and no definite trends are discernible. There was, however, some uptrend in net income per farm in the District and nation, even after allowance is made for increases in farm living costs.¹

¹ Farm income figures for the entire District are not available. The above conclusions are based on data for farm income in New York State, which includes an estimated 87 per cent of District cash receipts from farm marketings and 91 per cent of District farms.

RECENT DEVELOPMENTS

In the past year the District agricultural situation has worsened. Nationally, 1961 realized gross income (before production expenses) and realized net income were well above the year earlier, but in the District realized gross income showed virtually no gain and realized net income declined. Per farm realized net income showed some gain, but less than nationally. Higher farm prices and larger governmental payments, the major sources of the national improvement, also benefited local farmers, but to a lesser extent and not sufficiently to offset the rise in production expenses. District crop receipts, led by improved marketing of apples, onions, wheat, snap beans, and greenhouse and nursery products, showed a somewhat greater gain in 1961 than crop receipts for the United States as a whole. But a decline in receipts from livestock and its products offset most of the improvement in crops.

In 1962, judging from price developments, this trend has apparently continued. Nationally, prices received in 1962 were above 1961 levels in six of the first seven months, but in New York State a sizable decline was registered each month except one. In addition, during the three-month period from May through July, farmers in much of the Second District experienced the second worst drought in the region's 136-year history of weather recording. As a result, some forty of the District's seventy-five counties were designated by the Federal Government as disaster areas, making farmers in these communities eligible for 3 per cent loans for the purchase of hay and feed grains to be used during the winter months and allowing them to graze cattle and harvest hay on more than 90,000 acres previously set aside in the soil bank, feed grain, and wheat stabilization programs.

Dairymen were the group most severely affected. The drought occurred during the months when they harvest their hay, and this year many pastures were seared

and hay cuttings drastically stunted. Large shipments of hay have had to be purchased from the Midwest for the winter months. Despite a 25 per cent reduction in freight tariffs arranged by the Secretary of Agriculture with eastern railroads, the additional expense of hay purchases will result in lower net income for many farmers.

Developments during August and September may have somewhat mitigated these effects. Late summer rains saved much of the District's corn crop, which like hay is used for silage during the winter, and provided the necessary moisture for additional grazing of herds. Furthermore, the reduction of output in response to the drought—which, among other factors, reflects the culling of inferior animals—has resulted in a higher average milk price to dairymen in many area markets. Reportedly, few if any farms have been sold because of the drought, and the swift action taken to obtain large quantities of hay from outside the District has reduced the earlier threat of soaring hay prices.

CONCLUSION

Developments in the District's agriculture have over the postwar period been closely in line with those in the nation as a whole. The number of farms and farm acreage in the District have declined. However, in part because of differences in land use patterns, per acre marketing receipts continued to exceed the national average by a wide margin, while per farm net income roughly paralleled the national level at least through 1960.

In 1961, the picture with respect to both prices received and prices paid became less favorable. Only a small gain was scored in the level of District per farm income as compared with a sizable advance in the national average. In 1962, some decline in District farm income and a further loss of ground relative to the rest of the country seem likely even though the effect of the recent drought may prove less disastrous than had earlier been expected.