

FEDERAL RESERVE BANK OF NEW YORK



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Treasury and Federal Reserve Foreign Exchange Operations*

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As of the end of August 1962 the Federal Reserve had negotiated reciprocal currency agreements with seven foreign central banks and the Bank for International Settlements amounting to a total of \$700 million. Since then the network has been extended to include the Bank of Italy, the Austrian National Bank, and the Bank of Sweden. The agreements with the central banks of Sweden and Austria both provide for a \$50 million reciprocal credit facility. The arrangement with the Bank of Italy, initially fixed at \$50 million, has since been raised to \$150 million. During this period the agreement with the German Federal Bank was also increased from \$50 million to \$150 million and the agreement with the Bank of France from \$50 million to \$100 million. As of early March, therefore, the "swap" network had been enlarged to cover ten foreign central banks, plus the BIS, and involved a total amount of \$1,100 million. The amounts and dates of these swap arrangements are shown in Table I.

These swap agreements do not, in themselves, constitute outstanding indebtedness. Rather, they are mutual credit facilities on a stand-by basis. Actual utilization of such swap lines takes the form of drawings, which in general are made only in response to specific short-term needs. When the Federal Reserve initiates a drawing under a swap, it acquires a convertible currency that can provide temporary resources for exchange market operations. In what has been a more typical use, it can purchase from a central bank dollars in excess of those that the bank would ordinarily hold, in effect absorbing or mopping up these dollars

for the period of the swap. Such an operation leaves the total dollar holdings of the foreign country unaffected, but it substitutes dollars sold forward to the Federal Reserve for dollars held "outright"—i.e., without such exchange cover. Therefore, Federal Reserve use of swap facilities can provide a temporary alternative to an enlargement of outright dollar holdings of foreign central banks beyond the point at which conversion into gold would become likely.

Total drawings on the swap arrangements can be and in fact have been initiated not only by the Federal Reserve but also by other central banks. They have exceeded \$600 million since their inception in March 1962. As of the end of February 1963, the net debtor position of the Federal Reserve in all swap agreements combined amounted to considerably less than \$100 million.

The first line of defense against speculation provided by this strengthened swap network has been reinforced by negotiation of a series of Treasury issues of special certificates and bonds denominated in the currencies of the European central banks and treasuries to which they have been issued. Lira bonds taken up by the Bank of Italy now amount to \$200 million equivalent. Mark bonds placed with the German Federal Bank amount to an-

Table I
FEDERAL RESERVE RECIPROCAL CURRENCY AGREEMENTS

Other party to agreement	Amount (in millions of dollars)	Date (of original agreement)	Term (in months)
Bank of France*	100	1962: March 1	3
Bank of England	50	May 31	3
Netherlands Bank	50	June 13	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‡	150	August 2	3
Bank of Italy§	150	October 18	3
Austrian National Bank	50	October 25	3
Bank of Sweden	50	1963: January 17	3
Total for all banks	1,100		

* Increased from \$50 million to \$100 million on March 4, 1963.

† In Swiss francs.

‡ Increased from \$50 million to \$150 million on January 17, 1963.

§ Increased from \$50 million to \$150 million on December 6, 1962.

* This second 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 and Special Manager, System Open Market Account. It covers the period September 1962-February 1963. A report covering operations during March 1961-August 1962 appeared in the September 1962 Federal Reserve *Bulletin* and the October 1962 *Monthly Review*.

other \$200 million, while Swiss franc bonds and certificates acquired by the Swiss National Bank and the Swiss Confederation amount to \$129 million. The precise purpose of each issue has varied somewhat from country to country, but one common characteristic is that these issues provide the foreign countries concerned with an advantageous investment medium for past or present balance-of-payments surpluses.

Such balance-of-payments surpluses, it is important to note, need not necessarily reflect a foreign country's surplus with the United States. Instead, they may represent a surplus in its over-all balance-of-payments accounts with the world as a whole. Nevertheless, because of the role of the dollar as an international reserve currency, such surpluses tend to increase the dollar reserves of the surplus country and hence, if these reserves exceed that country's traditional or legal limits, may create a problem for the United States as banker for the international financial system.

Although the principal surplus countries have already taken a number of actions to neutralize or offset the influx of dollars, especially through debt prepayments and operations in forward markets with their commercial banking systems, the recent introduction by the United States of foreign currency certificates and bonds can be an important further aid in the financing of such international payments imbalances. Issue of foreign currency certificates and bonds by the United States provides this country with an additional source of international liquidity which may be particularly useful during periods of United States balance-of-payments deficits. In addition, insofar as the proceeds of foreign currency borrowing are used by the Treasury to acquire dollars, these dollars may be used to meet fiscal needs which could otherwise require domestic borrowing. The surplus country abroad simultaneously acquires an equivalent source of potential liquidity in the event of a shift from surplus to deficit in its own payments accounts. It is possible that the United States Treasury may undertake similar certificate and bond operations in other European currencies and thereby create in due course a second line of defense behind the swap network. The following account of Federal Reserve and Treasury operations in individual currencies shows the gradual development of these inter-related techniques.

BELGIAN FRANCS

All operations in Belgian francs have been handled by the Federal Reserve on the basis of the \$50 million swap arranged on June 20, 1962 between the Federal Reserve Bank of New York and the National Bank of Belgium. In contrast to all the other swap arrangements, which have

Table II
FEDERAL RESERVE OPERATIONS IN BELGIAN FRANCS
In millions of dollar equivalent

Date	Disbursements	Repurchases	Closing balances (including interest earnings)
June 20, 1962			50.0
August 7, 1962			39.5
September 17-21, 1962	10.5	10.5	50.0
October 11, 1962	10.0		40.0
November 19, 1962	10.0		30.0
December 19, 1962		5.0	35.0
December 28, 1962- January 4, 1963		14.4	50.0
January 31, 1963	5.0		45.0
February 11, 1963		5.0	50.0

now been placed upon a stand-by basis until drawings are initiated by either party, the Federal Reserve swap with the National Bank of Belgium remains fully drawn, as it has been from the beginning. It thereby provides the National Bank of Belgium with a supplementary dollar balance of \$50 million and the Federal Reserve with an equivalent balance of 2,487 million Belgian francs.

With a continuing ebb and flow of dollar payments between Belgium and the rest of the world, the Federal Reserve has made periodic disbursements of Belgian francs to absorb temporary surpluses of dollars on the books of the National Bank of Belgium, and then quickly reversed these operations as Belgian demands for dollars enabled the Federal Reserve to replenish its Belgian franc balance. Table II above illustrates the reversible flows of funds which have been cushioned by such Federal Reserve exchange operations.

In its turn, the National Bank of Belgium has also used the swap facility. On January 16, 1963, the National Bank disbursed \$5 million of its dollar balance acquired under the swap—which it replenished by January 31—and on February 21, it again made net use of the swap, this time in the amount of \$10 million. Thus, between August 1962 and mid-February 1963, payments swings in the Belgian dollar position of more than \$90 million were smoothly and quietly financed through the swap facility, thereby dispensing with gold payments in an equivalent amount. Such routine employment of mutual credit facilities has represented a noteworthy economy in the use of gold.

NETHERLANDS GUILDERS

As noted in the previous report, a substantial influx of funds into the Netherlands developed in the late spring and early summer of 1962 in response to various factors—a large stock offering by a Dutch corporation, a tighten-

ing of the Amsterdam money market, and, perhaps most important of all, the uncertainties created by the sharp decline in prices on the New York and foreign stock markets late in May. Part of this inflow seemed likely to prove reversible in due course; moreover, there were also in early prospect sizable dollar outpayments by the Netherlands for various special purposes. To bridge the gap, the Federal Reserve drew between June 14 and July 26 the entire \$50 million in guilders available under the swap arrangement negotiated with the Netherlands Bank on June 13 and used these guilder funds to absorb surplus dollars on the books of the Netherlands Bank. These swap operations by the Federal Reserve were supplemented in late July by a resumption of Treasury forward operations in guilders, which reached a total of \$36 million equivalent of forward sales contracts outstanding by the end of August. The Treasury also executed a \$50 million swap with the Netherlands Bank on July 26, of which \$15 million was immediately drawn and disbursed. These System and Treasury operations enabled the Netherlands Bank to avoid purchasing roughly \$100 million of gold from the United States during a period of considerable nervousness in the exchange markets.

By mid-August 1962 the tide had already begun to turn. With an easing of the Amsterdam money market, Netherlands repayments of dollar bank loans and a striking recovery of confidence in the dollar following President Kennedy's Telstar broadcast, the dollar strengthened against the guilder. The Federal Reserve was thereby enabled to accumulate guilders against its liability under the swap drawing. By September 17 the Federal Reserve had paid off the entire \$50 million drawn under the swap, which then reverted to a stand-by basis. A continuation of these exchange market conditions throughout September, most of October, and November also enabled the United States Treasury to accumulate sufficient guilders to pay off its swap drawing prior to maturity and to liquidate at maturity the three-month forward guilder contracts entered into during July and August. When early in October the Netherlands guilder rate rose somewhat, owing to a renewed tightening of conditions in the Amsterdam money market, however, the Treasury sold a small amount of spot guilders to moderate the rise. The Federal Reserve also drew \$10 million of guilders under its swap arrangement to prepare for possible additional operations. No occasion arose to use this guilder drawing, however, and it was liquidated early in 1963. With the exception of this episode and of a brief flurry of speculation during the Cuban crisis, requiring only minimal intervention by the Federal Reserve in the spot market, the dollar-guilder market has remained relatively well balanced during the past six months.

CANADIAN DOLLARS

In June 1962 the Federal Reserve and the Bank of Canada concluded a \$250 million swap agreement which was immediately and fully drawn upon as part of a billion dollar program of international financial cooperation designed to reinforce the Canadian Government's efforts to defend Canada's newly established par value against a speculative onslaught. Announcement of financial assistance on this massive scale, coupled with a Canadian Government announcement of fiscal and other measures to reduce Canada's payments deficit, immediately broke the speculative wave. In succeeding days, the United States Stabilization Fund made market purchases of Canadian dollars in small amounts.

As the liquidation of short positions in Canadian dollars got under way and the historically heavy flow of United States capital funds to Canada resumed, Canadian official reserves registered heavy gains from month to month. After renewing the Federal Reserve swap for an additional three months on September 26, the Bank of Canada took advantage of the continuing return flow of funds to liquidate the swap in three steps: \$125 million on October 31, \$50 million on November 30, and the remaining \$75 million at the December 26 maturity. The swap then reverted to a stand-by facility which may be immediately drawn upon by either party in case of need. The speed and effectiveness of international financial cooperation in repelling the 1962 attack on the Canadian dollar has had a useful chastening effect on speculative activity in exchange markets throughout the world.

AUSTRIAN SCHILLINGS

With the Austrian balance of payments in strong surplus, the reserves of the Austrian National Bank rose by \$211 million during the first nine months of 1962. On October 25 the Federal Reserve entered into a \$50 million swap with the Austrian National Bank and shortly thereafter drew and utilized the full proceeds of the swap to absorb \$50 million of surplus dollars on the books of the Austrian National Bank. During the three months' term of the swap drawing, the Austrian balance of payments remained in surplus, and no reversal of the flow of funds appeared in immediate prospect. Accordingly, at maturity on January 24, 1963, the swap drawing was entirely repaid and was placed on a stand-by basis. Meanwhile, the swap had provided the Austrian National Bank with a satisfactory alternative to immediate purchases of gold. Although no opportunity arose for the customary swing operation, one useful result has been that Austrian

gold purchases have been stretched out over a longer period than would otherwise have been the case.

ITALIAN LIRE

For most of 1962 Italy remained in a strong balance-of-payments position and would have registered another large official reserve gain in the absence of cooperative action with the United States, involving Italian debt prepayments, United States borrowing operations, and coordinated official action on the exchange markets. The United States and Italian Governments approached this problem in a spirit of mutual cooperation and understanding, with no expectation on either side that the problem could be quickly solved. On the other hand, it was mutually recognized that exchange and related operations designed to minimize the growth in Italian exchange reserves could provide a highly important breathing space during which natural corrective forces, plus policy measures, might gradually take effect.

Even if Federal Reserve swap facilities had been available at the beginning of 1962, it is highly doubtful that this central bank technique to deal with reversible flows would have been utilized at that time. The device actually chosen was that of issuance to the Bank of Italy by the United States Treasury of three-month certificates denominated in lire under a \$150 million line of credit extended by the Bank of Italy. Under this line of credit, the United States Treasury issued a \$25 million lira certificate on January 26, another \$50 million certificate on March 9, and a \$75 million certificate on August 7. The lira proceeds of these issues were only sparingly disbursed in exchange operations during the first half of the year. But, as the Italian balance of payments moved into seasonally heavy surplus during the summer months, the Treasury absorbed the bulk of the inflow by drawing upon the lira balances acquired through the certificate issues. The Italian Government made a highly effective contribution to this program of restraining the rise in Italian official reserves by an advance payment of \$178 million of debt owed to the United States Government.

By the end of October, with the exception of a brief speculative flurry occasioned by the Cuban crisis, the flow of funds to Italy had tapered off to minimal proportions but there was still no early prospect of outflows sufficiently large to enable the United States Treasury to liquidate its lira certificate obligations. Although roll-overs of the three-month lira certificates would have been entirely feasible, it seemed appropriate to acknowledge forthrightly the likelihood that this indebtedness would have to remain outstanding for some time by shifting from short- to

medium-term financing. Accordingly, in October, the Treasury began a program of refunding the \$150 million of maturing lira certificates, which had been rolled over several times at their respective maturities, into fifteen-month lira bonds. These lira bond issues were increased to \$200 million in November in order to offset a sudden increase in Italian official reserves indirectly resulting from institutional reforms in the Italian short-term money market.

While thus taking direct action to cope with the growth of Italian official reserves, the United States Treasury also undertook to share the forward contract commitments undertaken by the Bank of Italy with Italian commercial banks. These forward exchange contracts also provide the Bank of Italy with an important instrument for regulating commercial bank liquidity. Both total contracts outstanding and the share held by the United States Treasury varied considerably over the course of the year. In view of the dual purpose such forward operations may serve, it is possible that these contracts might be permitted to run somewhat beyond the restoration of equilibrium in the Italian balance of payments.

It would have been inappropriate to use essentially short-term Federal Reserve swap facilities to deal with the basic surplus position of Italy during most of 1962. Nevertheless, in anticipation of circumstances in which such Federal Reserve operations might become desirable, the Federal Reserve entered into a \$50 million swap arrangement with the Bank of Italy on October 18 and, on December 6, the arrangement was increased to \$150 million. At the year end, a sizable flow of dollars to Italy developed, mainly as a result of year-end commercial bank window-dressing, which was expected to reverse itself early in the new year. This essentially temporary flow of funds was largely absorbed on December 28 by a Federal Reserve drawing of \$50 million under the swap. The anticipated reflow did occur, and the drawing was repaid on January 21, 1963.

SWISS FRANCS

As noted in the previous report, the Treasury's outstanding market commitments in forward Swiss francs amounted to \$146.5 million equivalent at the end of February 1962. As the Swiss balance of payments moved into deficit during succeeding months, the Swiss National Bank purchased a total of \$139 million from the Federal Reserve Bank of New York as agent of the United States Treasury. If the United States Treasury had elected to meet these dollar requirements of the Swiss National Bank by accepting Swiss francs in payment, the increase in the

Treasury's franc balances would have been adequate to liquidate nearly all of its outstanding market contracts in forward Swiss francs. But, in order to avoid recreating suddenly too much liquidity on the Swiss money market, the Swiss sold gold to the United States Treasury in payment for \$74 million of the dollars needed by the Swiss National Bank and paid for the remaining \$65 million in Swiss francs. The United States Treasury used these Swiss franc balances to liquidate \$55 million of maturing forward contracts. By the end of May 1962, contracts outstanding had been reduced to \$91.5 million equivalent.

In late May 1962, although Switzerland's balance of payments on current account remained in heavy deficit, the flow of funds again shifted heavily in favor of Switzerland as a result of speculation caused by the Canadian devaluation and the precipitous decline in the New York and other stock markets. As a consequence, the Swiss National Bank had to buy dollars in the amount of about \$270 million between May 30 and July 23. This development not only raised the possibility of equivalent purchases of United States gold by the Swiss National Bank, but also excited speculative pressures on the exchange markets. To deal with this troublesome situation, the Federal Reserve in mid-July negotiated stand-by swap arrangements of \$100 million each with the Swiss National Bank and the BIS.

Under these swap arrangements, the Federal Reserve drew a total of \$110 million in Swiss francs which were immediately employed to absorb an equivalent amount of dollars on the books of the Swiss National Bank. Reinforcing this operation, the United States Treasury increased its forward contracts outstanding from \$90 million at the end of June to a peak of \$139 million by August 6. These exchange operations enabled the Swiss National Bank to limit its purchases of gold from the United States to no more than \$50 million during a period of widespread anxiety in the exchange markets. More generally, these operations provided further proof of the ability and determination of the United States and Swiss financial authorities to defend their currency parities against exchange market speculation. By August, partly due to President Kennedy's Telstar statements, the speculative fever had subsided and the Federal Reserve was able to initiate purchases of Swiss francs. Of \$40 million equivalent purchased by October 15, \$25 million was used to pay off—in advance—drawings under the swap with the BIS. These repayments reduced drawings of the Federal Reserve in Swiss francs to \$85 million as of October 24.

This period of gradual liquidation of Federal Reserve drawings on the swaps with the BIS and the Swiss National

Bank was abruptly ended by the Cuban crisis. On October 23, the day after President Kennedy's announcement of the quarantine of Cuba, another heavy inflow of funds into Switzerland developed and was only partially offset by Federal Reserve sales in the market of \$8.6 million in Swiss francs. Additional small sales were undertaken during the next few days. Although the inflow subsided almost as quickly as it had begun, the Swiss National Bank had meanwhile again acquired surplus dollars, this time roughly \$50 million. These surplus dollars were absorbed by combined Federal Reserve-Treasury operations. The Federal Reserve drew an additional \$20 million under the BIS swap and purchased dollars from the Swiss National Bank. (Total Federal Reserve drawings of Swiss francs on the BIS thus rose to \$55 million, while \$50 million remained due under the swap drawing from the Swiss National Bank in July.) The remaining \$30 million of surplus dollars on the books of the Swiss National Bank was sold by it to Swiss commercial banks on a spot basis with cover provided through forward purchases of these dollars by the United States Treasury.

These Treasury forward contracts posed certain problems. In view of the approaching year-end window-dressing period for the Swiss commercial banks, it seemed advisable to shorten the usual ninety-day term of such contracts to no more than two months. As these contracts moved toward maturity and with no reversal in the flow of funds appearing, consideration was given to using part of United States outright holdings of German marks to acquire Swiss francs. While there was, of course, no obstacle to United States market sales of these German marks for Swiss francs, such sales might well have resulted in a parallel transfer of dollars from German to Swiss hands. As a result, the entire operation might have become self-defeating. To escape at least temporarily this potentially perverse consequence of the use of the dollar as an international currency, a three-month swap between the United States Treasury and the BIS of German marks for Swiss francs was devised, and this enabled the Treasury to liquidate at maturity the \$30 million of one- to two-month Swiss franc forward contracts falling due in December.

In the period since the Cuban crisis, the Federal Reserve has acquired modest amounts of Swiss francs, and those only recently. This delay was mainly a result of the seasonal reflux of funds to Switzerland for window-dressing purposes during the closing months of the year. Accordingly, the Federal Reserve swap drawings on the BIS and the Swiss National Bank have been rolled over at maturity with a continuing expectation by all parties concerned that the current-account deficit of Switzerland will in time bring

about a reversal of the flow of funds, thereby permitting liquidation of the swap drawings.

On the other hand, considerable progress has been made in reducing Treasury forward contracts outstanding by a partial funding of these obligations. This was accomplished through a new device, i.e., the issue by the United States Treasury of medium-term obligations denominated in Swiss francs. After inauguration of the Treasury's forward operations in July 1961, a substantial proportion of these forward contracts had been acquired through the market by the Swiss Confederation which for several years has been running sizable budget surpluses and understandably has been desirous of investing savings thereby drawn from the Swiss public in earning assets, such as United States Treasury bills on a covered basis. Since the Swiss Confederation's investment plans reached well beyond the three-month range, repeated roll-overs of the three-month forward contracts with the United States Treasury to facilitate such investment were recognized by both sides as an unnecessary complication. The decision was accordingly reached to provide a more direct investment outlet for the Swiss Confederation in the form of Swiss franc bonds. This method of investment enabled the Confederation to avoid recourse to the exchange markets and lessened the risks that its investment operations would become confused by the public with other Treasury and Federal Reserve exchange operations.

On October 18, 1962, therefore, the United States Treasury issued \$23 million equivalent of fifteen-month bonds denominated in Swiss francs and carrying a rate of interest roughly midway between United States and Swiss market rates. The proceeds of this bond issue, plus a draft upon the Treasury's cash balance in Swiss francs, were immediately used to pay off \$25 million of maturing forward contracts held by the Swiss Confederation. On November 8, a second issue of Swiss franc bonds, this time in the amount of \$28 million for a sixteen-month maturity, was undertaken. Again the proceeds were used immediately to liquidate \$31 million of forward contracts held by the Swiss Confederation. Still a third issue of Swiss franc bonds, this time for \$30 million, with a sixteen-month maturity, was placed with the Swiss Confederation on January 24, 1963, and the proceeds were used to pay off an equivalent amount of forward contracts held by the Confederation. As a result of these successive bond issues, which might of course be enlarged to provide an investment outlet for further budget surpluses of the Confederation, the outstanding Swiss franc forward contracts placed by the United States Treasury in the market were reduced to no more than \$53 million. This reduction provides leeway for additional operations in the forward mar-

ket to cope with speculative pressure or other adverse developments.

The United States Treasury also undertook a somewhat related operation in October 1962 by issuing five- and eight-month certificates to the Swiss National Bank to absorb \$48 million equivalent of commercial bank funds which had been sterilized by the Swiss authorities in order to restrain inflationary pressure on the Swiss market. By mobilizing such idle funds, the United States Treasury substantially reinforced its Swiss franc balances available either for intervention in the exchanges or for conversion into gold at a fixed price. (The announcement of this certificate issue, as well as the first issue of Swiss franc bonds, occurred at the very beginning of the Cuban crisis and seems to have had a useful stabilizing effect on the exchange markets at a highly critical moment.) In the future, it is possible that both the United States Treasury and the Swiss National Bank may find it desirable to enlarge the issue of such certificates so as to draw into effective international use further amounts of the Swiss commercial bank funds sterilized at the Swiss National Bank.

GERMAN MARKS

In the case of Germany, the flow of funds to Europe during June 1962 after the widespread stock market declines was reinforced by a tightening of the German money market in connection with a tax payment date. With the exchange markets already nervous because of the Canadian dollar crisis and the stock price declines, a sharp rise in the German mark rate might have aggravated market uncertainties, especially against the background of very weak dollar rates in other exchange markets. Consequently, in a program of market intervention fully coordinated with German Federal Bank operations and designed to moderate the increase in the mark rate, the Federal Reserve sold a sizable amount of marks in New York between June 20 and July 11.

On August 2, the Federal Reserve and the German Federal Bank concluded a \$50 million swap agreement, thus giving the System access to additional marks on a stand-by basis. The upward pressure on the mark eased, however, as was to be expected in view of Germany's fairly well-balanced payments position. Thus, when renewed tension over the Berlin situation pushed the German mark rate slightly below par at the end of August, the Federal Reserve was able to rebuild its balances and the United States Treasury also acquired a small amount of additional marks.

The market for German marks remained quiet during the rest of 1962, except for a brief period in early Decem-

ber when repatriation of funds by German banks for year-end statement purposes and to meet a tax payment date temporarily forced the rate up. In these circumstances the Federal Reserve again intervened on a small scale. By early February 1963 the rate had again receded, and the Federal Reserve was able to rebuild its holdings.

Although German payments swings have recently been relatively small, past experience with very large flows of funds between Germany and other financial centers suggested the desirability of increasing the size of the swap facility between the Federal Reserve and the German Federal Bank. Consequently on January 17, 1963 this first line of defense was reinforced by expanding it to \$150 million, on the usual stand-by basis.

In January and February 1963, the Treasury extended the scope of its foreign currency borrowing operations in marks by issuing four medium-term bonds denominated in marks to the German Federal Bank. These bonds, which had maturities of up to two years and totaled \$200 million equivalent, provided the German Federal Bank with a mark investment medium for some of the excess exchange reserves it had accumulated while Germany had very substantial surpluses in its international payments.

FRENCH FRANCS, POUNDS STERLING, AND SWEDISH KRONOR

No Federal Reserve drawings and disbursements remain outstanding under the swaps with the Bank of France, the Bank of England, or the Bank of Sweden.

CONCLUDING COMMENT

During the past two years—a period of recurrent pressure on both the dollar and sterling—the international financial system has demonstrated a high degree of flexibility and resilience in absorbing the successive shocks of the mark and guilder revaluations, the Berlin crisis, the attack on the Canadian dollar, world-wide stock market declines, and finally the Cuban crisis. These emergency situations were dealt with quickly, and perhaps with increasing effectiveness, by cooperative action by the major central banks and treasuries on both sides of the Atlantic and by the International Monetary Fund. The London gold market arrangements, central bank forward operations, provision of central bank credit facilities either

on the “Basle” *ad hoc* basis or through more formalized stand-by swap facilities, United States acquisition of foreign exchange and intervention in the exchange markets, massive Fund credits to the United Kingdom and Canada, and, most recently, United States Treasury issuance of certificates and bonds denominated in foreign currencies—all these have proved their usefulness in offsetting and restraining speculation at times of severe pressures. Those who might be tempted to speculate against any major currency are now confronted with the prospect of coordinated defensive action by central banks, treasuries, and the IMF, which are capable of mobilizing impressive resources in support of any currency under attack.

No central bank or treasury official concerned with these defensive arrangements has any illusions that such devices provide any substitute for policy action to correct basic imbalances in the payments accounts of the countries involved. But it is equally recognized that such defenses against speculation can and do provide a margin of time during which appropriate policy solutions can be developed and carried out in an orderly manner.

ANNUAL REPORT — 1962

The Federal Reserve Bank of New York has just published its forty-eighth *Annual Report*, which reviews the economic and financial developments of 1962. The *Report* examines in detail the problems faced by monetary policy as it sought to encourage a more rapid rate of domestic economic growth and, at the same time, to protect the international position of the dollar. Considerable attention is devoted to the effort to maintain stability in international exchange markets through Federal Reserve and Treasury foreign exchange operations. Looking toward the future, the *Report* discusses the need for tax reduction and the urgent requirement for specific additional measures to correct the continuing large deficit in the United States balance of payments. Copies of the *Annual Report* are available, upon request, from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York 45, N. Y.

The Business Situation

As is frequently the case, economic activity got off to a relatively slow start in the new year. In January, industrial production, payroll employment, and retail sales were virtually unchanged, while housing starts dropped sharply. The lackluster performance was at least in part, however, attributable to unusually severe weather and to several major strikes. The more encouraging developments in January—a rise in new orders for durable goods following two months of decline and continued strength in consumer buying intentions—were registered in indicators that normally are not particularly sensitive to weather conditions. For February, fragmentary data suggest some rise in steel ingot production, a continued high level of automobile assemblies, and little change in retail sales.

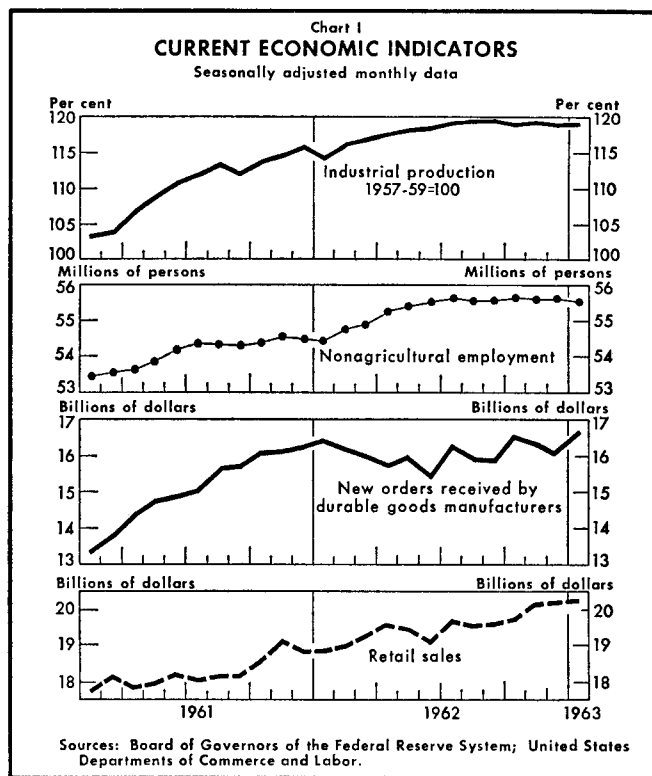
The prospects for tax reduction continue to dominate most appraisals of the over-all economic outlook. Although the Administration has continued to emphasize that it is not predicting an economic downturn for 1963 or even for 1964, the President noted in a recent speech he was “willing to venture” that without a tax cut the country would “in the not-too-far-distant future be struck by its fifth post-war recession”. For this reason he indicated that he considers “the important thing” is to get a tax bill this year that would provide for a tax reduction of at least \$10 billion over the next three years, even if this meant substantial modifications in the tax proposals he submitted to the Congress in January.

PRODUCTION AND EMPLOYMENT

The Federal Reserve's index of industrial production remained at 119 per cent of the 1957-59 average in January, continuing at the level which has prevailed since June of last year (see Chart I). Relatively little change in production levels was also the characteristic pattern for most major industries, with the only sizable gains being shown by producers of consumer home goods and of electricity and gas. Of course, unusually severe weather probably accounted for much of the advance in the output of electricity and gas. On the other hand, part of the lack of vigor in over-all production was due to unusually cold weather and severe snow storms that blanketed large sections of the country in the latter days of the month and pre-

vented some workers from getting to their jobs. Moreover, there is some evidence that the East and Gulf Coast dock strike, which was not settled until late in January, tended to curtail production in industries that depend on imports for their raw materials.

Weekly production figures for February suggest that new cars are continuing to come off the assembly line at a seasonally adjusted annual rate of about seven million units, close to the level that has prevailed since last July. The industry planned to have a record of slightly more than one million cars in dealers' inventories by the beginning of March, in preparation for the spring sales push. In the steel industry, ingot production continued upward in February and substantial bookings are said to be already in for March. While these orders undoubtedly included some destined for protective inventories being built up in anticipation of a possible steel strike or price rise, the amount



was believed to be relatively small. A more substantial protective build-up does seem in prospect, however, unless labor and management reach a noninflationary settlement in the not-too-far-distant future.

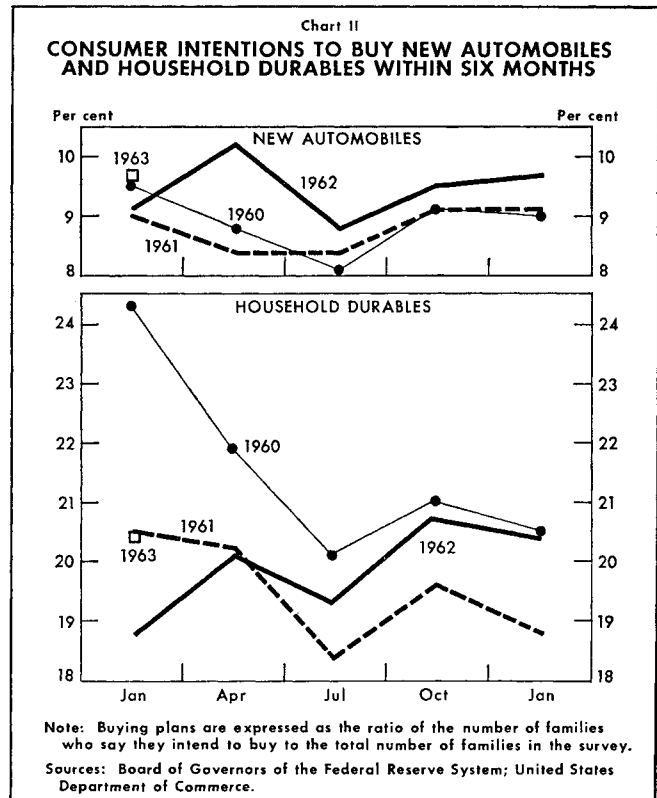
The employment situation in January was also influenced by strikes and inclement weather. Total payroll employment remained virtually unchanged for the eighth consecutive month (see Chart I). Cold weather continued to impede outdoor work in construction and about 70,000 transport workers, according to Labor Department estimates, were out of work as a result of the longshoremen's strike. In manufacturing, employment and average weekly hours edged off slightly, largely reflecting cutbacks in the apparel and automobile industries. A decline in the number of initial claims filed for unemployment compensation in February suggests, however, that adverse factors may not have been so significant in that month.

INDICATORS OF FUTURE DEVELOPMENTS

In contrast to the lack of change shown by measures of current activity, new orders received by durable goods producers rose by 4 per cent in January, following two months of decline (see Chart I). The bulk of the January advance came in the steel industry, but machinery and aircraft industries also reported modest gains. Although no conclusive data are available, there have been scattered reports that some firms are beginning to step up equipment purchases in response to the Treasury Department's revised depreciation schedules and the new investment credit legislation. Whatever the cause, however, orders for machinery and equipment have risen in three of the last five months and, in January, were 3 per cent higher than last June.

Forward-looking indicators of residential construction present a mixed picture but, on balance, imply no weakening from recent high levels. On the one hand, new building permits issued rose markedly in November and December and then held near the high December level in January. In contrast, private housing starts fell sharply in both December and January. Housing starts in January made their worst showing in the northeast and north central regions of the country where weather was particularly bad, whereas in the western region the number of new starts rose substantially. A similar siege of bad weather had curtailed starts at the beginning of 1962, but starts then spurted in the spring as weather conditions improved.

The consumer sector continues to be a major source of strength in the economy. While retail sales showed almost no change in January, they remained above \$20 billion (seasonally adjusted), a level that has been exceeded in



only three months since the series has been in existence (see Chart I). Moreover, this high level was maintained despite a weakening in the latter part of the month that may have been caused by adverse weather. In addition, of course, newspaper strikes in New York City and Cleveland made it difficult for stores in those cities to advertise their post-Christmas sales. Indeed, sales by New York City department stores so far this year have been about 7 per cent below the year-earlier volume in contrast to an increase in the rest of the nation. Partial data for February suggest little change in unit sales of new automobiles as well as in the volume of other retail sales.

That consumer spending may continue strong in the months ahead is suggested by the Census Bureau's latest quarterly survey of consumer buying intentions. Plans to buy new automobiles in the next six months were slightly above the levels of a year earlier, while plans to purchase household durables showed significantly greater strength than at the beginning of 1962 (see Chart II). While previous experience is, of course, no certain guide to future performance, it is noteworthy that the high level of buying intentions during 1962 was accompanied by rather sharp increases in total purchases of durable goods in both the first and second halves of the year.

The Money Market in February

A firm tone pervaded the money market in February. Nation-wide reserve availability declined slightly from the float-inflated January level, but the market handled without undue strain the heavy activity associated with large Treasury debt operations. As is usual in such a period, banks in the money centers experienced large basic reserve deficits, but they were able to balance their positions without difficulty through large purchases of Federal funds and some increase in their average borrowings from the Reserve Banks. Federal funds traded at a steady 3 per cent on virtually every day, and the rates posted by the major New York City banks on call loans to Government securities dealers were generally within a $3\frac{1}{8}$ to $3\frac{1}{4}$ per cent range.

The final details of the Treasury's combined "pre-refunding" and "junior" advance refunding, the second step in the three-phase financing plan announced on January 30, were released after the close of business on Wednesday, February 20. (The third step—a long-term bond auction—is planned, subject to market developments, for the first half of April.) The Treasury said that the issues eligible for the pre-refunding would include the $3\frac{1}{2}$ per cent certificate and the $2\frac{1}{2}$ per cent bond maturing in August 1963, the $3\frac{1}{8}$ per cent certificate maturing in November 1963, and the 3 per cent bond maturing in February 1964. Owners of these securities were given the option of exchanging them for a new $3\frac{5}{8}$ per cent note maturing in February 1967, or for additional amounts of the outstanding $3\frac{7}{8}$ per cent bond of November 1971 or of the outstanding 4 per cent bond of February 1980. Based on the prices of the potential pre-refunding "rights" before the announcement, adjusted for the cash payments by the Treasury, yields on the 1967, 1971, and 1980 offerings worked out to about 3.63 to 3.65 per cent, 3.96 to 3.97 per cent, and 4.03 to 4.04 per cent, respectively. The issues eligible for exchange in the junior advance refunding were the $3\frac{1}{2}$ per cent note maturing in November 1965, the $3\frac{5}{8}$ per cent note maturing in February 1966, the 3 per cent bond of August 1966, and the $3\frac{3}{8}$ per cent bond due in November 1966. Holders of these issues were offered the opportunity to exchange them for the $3\frac{7}{8}$ per cent bond of November 1974, which is being reopened to yield from 3.97 to 3.98 per cent after allowing for the cash payments

connected with the exchange, or for the 1980 bond mentioned above. The subscription books were open for all investors from February 25 through February 28, and are to remain open for individual investors through March 8. Settlement for the exchange is scheduled to occur on March 15. The public holds about \$10.6 billion of the issues eligible for the pre-refunding and \$9.7 billion of those eligible for the advance refunding.

Treasury bill rates, after a brief upward adjustment in early February, moved downward on good demand until late in the month when they again edged irregularly higher. In the market for Treasury notes and bonds, interest centered on the exchange refunding of maturing debt early in February and the advance refunding described above. Over the month, prices tended to strengthen in the shorter coupon issues and to soften in the intermediate area where additional issues were expected—and were offered—in the advance refunding. In the market for corporate and tax-exempt bonds, prices moved somewhat lower in the first few days of February, as underwriters sought to attract additional investor interest in new issues. Thereafter, prices edged slightly higher in the corporate sector and steadied in the tax-exempt sector until late in the month when a somewhat easier tone spread from the Government securities market.

BANK RESERVES

Market factors absorbed reserves on balance from the last statement period in January through the last statement period in February. Reserve drains primarily reflected the effects of a routine Treasury interest payment to the Federal Reserve Banks and an expansion of currency in the hands of the public. These effects were only partly offset by a further seasonal decline in required reserves. System open market operations, however, counterbalanced reserves drained by market factors in February. Outright System holdings of Government securities increased on average by \$386 million from the last statement period in January through the last statement week in February, while holdings under repurchase agreements declined by \$104 million. Net System holdings of bankers' acceptances fell by \$17 million. From Wednesday, January 30, through Wednesday, Feb-

**CHANGES IN FACTORS TENDING TO INCREASE OR DECREASE
MEMBER BANK RESERVES, FEBRUARY 1963**

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

Factor	Daily averages—week ended				Net changes
	Feb. 6	Feb. 13	Feb. 20	Feb. 27	
Operating transactions					
Treasury operations*	+ 61	- 65	- 77	+ 94	+ 13
Federal Reserve float	- 257	- 39	+ 383	- 106	- 19
Currency in circulation	- 25	- 158	- 30	+ 65	- 148
Gold and foreign account	+ 14	- 6	+ 25	- 58	- 25
Other deposits, etc.	- 5	+ 11	- 139	- 43	- 176
Total	- 211	- 257	+ 162	- 49	- 355
Direct Federal Reserve credit transactions					
Government securities:					
Direct market purchases or sales	+ 260	+ 212	- 110	+ 24	+ 386
Held under repurchase agreements	+ 157	+ 34	- 284	- 11	- 104
Loans, discounts, and advances:					
Member bank borrowings	+ 124	- 58	- 8	- 28	+ 30
Other	-	- 2	-	+ 30	+ 28
Bankers' acceptances:					
Bought outright	-	-	- 1	- 1	- 2
Under repurchase agreements	- 5	- 10	-	-	- 15
Total	+ 535	+ 175	- 401	+ 13	+ 322
Member bank reserves					
With Federal Reserve Banks	+ 324	- 82	- 239	- 36	- 33
Cash allowed as reserves†	- 251	+ 20	+ 128	+ 48	- 57
Total reserves‡	+ 73	- 62	- 111	+ 10	- 90
Effect of change in required reserves‡	- 47	+ 106	+ 34	+ 48	+ 141
Excess reserves‡	+ 26	+ 44	- 77	+ 58	+ 51
Daily average level of member bank:					
Borrowings from Reserve Banks	223	165	157	129	169‡
Excess reserves‡	457	501	424	482	466‡
Free reserves‡	234	336	267	353	297‡

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 February 27, 1963.

ruary 27, outright System holdings of Government securities maturing in less than one year rose by \$252 million while holdings maturing in more than one year declined by \$60 million.

Over the four statement weeks ended February 27, free reserves averaged \$297 million, compared with \$357 million (revised) in the five weeks ended January 30. Average excess reserves fell by \$116 million to \$466 million, while average borrowings from the Federal Reserve Banks declined by \$56 million to \$169 million.

THE GOVERNMENT SECURITIES MARKET

Treasury debt operations, in process and pending, dominated the market for Treasury notes and bonds in February. At the beginning of the month, market attention focused on the Treasury's exchange refunding in which holders of \$9.5 billion of Treasury notes and certificates maturing on February 15 were given the opportunity to convert these securities into new 3¼ per cent certificates

of 1964 or increased amounts of the 3¼ per cent bonds of 1968. Initial market reaction to the terms of the exchange was very favorable. Prices of the rights, the three maturing issues eligible for conversion, moved up as much as ⅞₃₂ in early trading, while prices of both of the securities to be issued were quoted at premium bids of from ⅞₃₂ to 7₃₂ in "when-issued" trading. The success of the refunding, for which the subscription books were open from February 4 through 6, was reflected in the fact that attrition on the \$5.5 billion publicly held portion of the maturing securities amounted to only 4 per cent. Approximately \$6.8 billion of the maturing securities was converted into the 3¼ per cent certificates of 1964, and \$2.5 billion was turned in for the reopened 3¼ per cent bonds of 1968.

Once the books closed on the February refunding, market attention shifted to the forthcoming advance refunding expected in the latter half of February. Prior to the announcement of the terms of the operation on February 20, prices of outstanding issues due through 1966 moved generally upward, reflecting market views that some of these issues would become rights in this refunding and that supplies in this maturity area would accordingly be reduced. Concurrently, prices of issues due later than 1966 generally edged lower, prompted by investor expectations that the refunding would add to the supply of securities, perhaps as far out as 1980. In mid-February, trading activity contracted as the market awaited the precise terms of the offering.

The Treasury revealed on February 19 that it was considering enlarging the scope of its forthcoming financing to include not only a junior advance refunding, as earlier indicated, but also a pre-refunding of issues of Government securities maturing within one year. Complete details (discussed above) were released on the following day. Subsequently, trading was heavy and prices moved fractionally lower, as investors adjusted their positions in the light of the numerous alternatives made available by the refunding and as Government securities dealers absorbed a heavy volume of rights. Over the month as a whole, prices of Treasury notes and bonds due through 1966 ranged from ⅞₃₂ higher to 3₃₂ lower, those in the 1967-72 maturity category were 7₃₂ higher to 21₃₂ lower, and long-term issues were 2₃₂ higher to 1⅞₃₂ lower.

Treasury bill rates moved slightly higher in the first few days of the month. Reinvestment demand arising from switches out of rights to the Treasury's early February exchange refunding was relatively light, and dealers' awards in the first weekly bill auction of the month were fairly large. At the higher yield levels, however, demand expanded, resulting in a decline in seasonally swollen dealer positions. The market was also buoyed by anticipa-

tions that additional demand for bills might result from the February redemption of a large Government agency issue and from the Treasury's advance refunding operation. Against this background, bill rates edged lower from February 6 through 21. In the final auction of the month held on February 25, average issuing rates were 2.870 per cent for the new three-month issue and 2.922 per cent for the six-month bills, in each case 5 basis points below the rates established in the last auction in January. Dealer awards in the auction were large and yields subsequently moved higher, as demand for bills from corporations selling the short-term rights dried up when the prices of the short-term rights declined.

OTHER SECURITIES MARKETS

Prices of seasoned corporate and tax-exempt bonds moved fractionally lower at the beginning of February, but a better tone emerged in both sectors of the market later in the month. The improvement was most pronounced in the corporate sector, which was strengthened by a relatively small supply of new issues and by a light calendar of scheduled flotations. In the tax-exempt sector, on the other hand, the heavy volume of new and forthcoming issues represented a restraining influence. Against this background, prices of corporate bonds edged higher until late in the month when a more hesitant tone appeared in the market, while tax-exempt bonds were generally steady. For the month as a whole, the average yield on Moody's seasoned Aaa-rated corporate bonds declined by 2 basis points to 4.19 per cent, while the average yield on similarly rated tax-exempt bonds rose by 5 basis points

to 3.02 per cent. (These indexes comprise only a limited number of issues and do not always constitute an accurate guide to the tone of the market.)

The total volume of new corporate bonds reaching the market in February amounted to approximately \$275 million, compared with \$345 million in the preceding month and \$490 million in February 1962. One of the two largest new corporate issues marketed during the month was a \$50 million Aaa-rated 4¾ per cent utility company debenture issue maturing in 2003, which reached the market early in February. When reoffered to yield 4.29 per cent, the debentures—which are not redeemable for five years—were well received. However a second \$50 million utility issue floated later in the month, consisting of Aa-rated 4¾ per cent first mortgage bonds maturing in 1998 and reoffered to yield 4.27 per cent, encountered investor resistance. New tax-exempt flotations during the month totaled approximately \$735 million, as against \$890 million in January 1963 and \$1,125 million in February 1962. The Blue List of advertised dealer offerings of tax-exempt securities declined by \$54 million during the month to \$516 million on the final day in February. The largest new tax-exempt offering during the period consisted of a two-part municipal bridge and tunnel authority revenue bond offering. The flotation, which was not rated by Moody's, included \$50 million of 3½ per cent bonds reoffered to yield 3.45 per cent in 1985 and \$50 million of various coupon bonds reoffered to yield from 2.60 per cent in 1970 to 3.20 per cent in 1978 and was well received. Other new corporate and tax-exempt bond issues marketed during the period were accorded mixed receptions.