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Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System

COVERING OPERATIONS FOR THE YEAR

1963

Period	Description	Purpose
January-mid-May	Reduced System holdings of U.S. Government securities and then increased them in line with seasonal and moderate growth needs of the economy. Total holdings rose about $470 million on balance, owing mainly to net purchases of issues maturing in more than 1 year. Member bank borrowing rose slightly to a level of about $150 million in the first half of May.	To offset seasonal downward pressures on short-term interest rates early in the period and to provide for growth in bank credit and the money supply at a rate consistent with minimizing capital outflows in accordance with the policy of slightly reduced reserve availability adopted at the December 18, 1962, meeting of the Federal Open Market Committee.
Mid-May-late-July	Reduced the degree of reserve availability slightly further. System holdings of U.S. Government securities increased nearly $1.2 billion, about one-fifth representing net purchases of issues maturing in more than 1 year. Member bank borrowing increased further, averaging $275 million over the period.	To achieve a slightly greater degree of firmness in the money market in order to minimize the outflow of capital while continuing to provide reserves for moderate monetary and credit growth.
Mid-July	Raised the discount rate from 3 to 3½ per cent. Raised maximum interest rates payable by member banks on time deposits (other than savings) and certificates of deposit with maturities of 90 days to 6 months from 2½ to 4 per cent and with maturities of 6 months to 1 year from 3½ to 4 per cent.	To help reduce short-term capital outflows by firming U.S. short-term money market rates and permitting member banks to compete more effectively for foreign and domestic funds.
Late-July-December	Reduced a little further the degree of reserve availability. System holdings of U.S. Government securities increased about $1.1 billion, of which more than one-half represented purchases of securities with maturities of more than 1 year. Member bank borrowing averaged about $325 million over the period.	To attain slightly more firmness in the money market, in the context of a higher discount rate, with a view to minimizing the outflow of funds abroad while offsetting seasonal reserve drains and providing for growth needs of the domestic economy.
November	Raised margin requirements on loans for purchasing or carrying listed securities from 50 to 70 per cent of market value of securities. Also increased retention requirements on proceeds of sales from undermargined accounts from 50 to 70 per cent.	To help prevent excessive use of stock market credit, which had increased sharply since July 1962, when margin requirements were lowered from 70 to 50 per cent.

of monetary ease, a somewhat larger number concluded that the domestic economy had already strengthened sufficiently to permit a move to slightly less ease in order to place greater emphasis on this country's balance of payments problem.

The majority decision, therefore, was to move toward a position of slightly less ease beginning about the middle of May, when current Treasury financing operations would be out of the way; and the Committee's directive was modified to reflect this change in policy and to be more descriptive of the current situation. Accordingly, the following directive was issued to the Federal Reserve Bank of New York:

It is the Committee's current policy to accommodate moderate growth in bank credit, while putting increased emphasis on money market conditions that would contribute to an improvement in the capital account of the U.S. balance of payments. This policy takes into consideration the continuing adverse balance of payments position and its cumulative effects and the improved domestic business outlook, as well as the increases in bank credit, money supply, and the reserve base in recent months. At the same time, however, it recognizes the continuing underutilization of resources.

To implement this policy, System open market operations following the conclusion of the Treasury refunding operation shall be conducted with a view to achieving a slightly greater degree of firmness in the money market than has prevailed in recent weeks, while accommodating moderate reserve expansion.

Votes for this action: Messrs. Martin, Hayes, Balderston, Irons, King, and Shepardson. Votes against this action: Messrs. Bopp, Clay, Mitchell, Robertson, and Scanlon.

May 28, 1963

1. Authority to effect transactions in System Account.

Domestic economic activity in April had generally advanced further, with advances widespread among principal industrial sectors. While information for May was quite incomplete, available data indicated that expansion in activity had continued. Although higher prices were posted for certain products, prices remained little changed on the average.

Industrial production in April rose by almost 2 percentage points to a new high, with about one-third of the total rise accounted for by higher steel production. The April index, at 122, was 4 per cent above a year earlier. Housing starts also advanced in April. Nonfarm employment continued to rise, with manufacturing accounting for much of the increase. Rapid growth in the labor force, however, left the unemployment rate about unchanged despite the gain in employment.

Retail sales in April and early May appeared to have changed little. Sales by automobile dealers maintained a high level, and recent surveys of consumer buying intentions for autos, other durable goods, and houses suggested that spending plans were continuing to show strength. New orders, sales, and unfilled orders received by producers of durable goods rose appreciably in April. Although much of the rise reflected heavy buying of steel, new orders rose moderately in nearly all industries, including machinery.

New security financing by corporations and State and local governments in the preceding weeks had been moderate, and the calendar through June indicated that offerings would be fairly light in the corporate area, although more substantial for State and local issues. Retail distributions of new issues were reported as slow, however, and dealers' inventories quite large. Bond yields declined somewhat through mid-May but moved up thereafter, while downward pressure on mortgage rates continued. Common stock prices held at a level a little below the late 1961 peak, and the volume of stock market credit reached a new high.

Treasury bill rates were steady in early May but moved higher after midmonth, partly in response to a somewhat lower margin of free reserves available to member banks; the 3-month rate advanced from about 2.90 per cent to 2.97 per cent. Treasury bond yields fluctuated in a narrow range after early May, with substantial purchases of coupon issues by the Treasury for its investment accounts a steadying factor.

The seasonally adjusted money supply rose moderately further in the first half of May to a level 2.4 per cent above a year earlier. In the April-early May period time deposits at commercial banks increased considerably less rapidly than earlier in 1963.

Reflecting, in part, action of the System Account pursuant to the directive issued at the preceding Committee meeting, free reserves moved lower after mid-May. Borrowings from the Federal Reserve Banks rose to an average of $281 million in the week ending May 22, up from an average of $134 million during the preceding 3 weeks.

The balance of payments deficit for April, while somewhat smaller than had been indicated by the earlier preliminary figures, was substantial. Moreover, tentative and fragmentary figures for the first 3 weeks of May indicated continued sizable net transfers to foreigners, and foreign borrowing in U.S. markets continued on a large scale. In these circumstances the dollar remained weak against the major continental European currencies. Trading on the London gold market was quite active, although the price changed little.

Discussion at this meeting centered on reviewing economic and market developments in the light of the slight shift in monetary policy toward less ease that had been adopted at the May 7 meeting of the Committee. This review found quite general agreement that a moderate further strengthening of domestic economic activity had occurred. Business sentiment, although perhaps a bit more cautious than earlier, apparently remained optimistic. The performance of the economy, however, was still below capabilities, with unemployment persisting at unsatisfactory levels and with other indications of continuing inadequate resource utilization. The balance of payments problem continued to be serious, and the position of the dollar in foreign exchange markets had weakened.

Most members of the Committee felt that the lessened credit

ease accomplished since the preceding meeting was constructive and that the existing market tone and degree of reserve availability should be continued for the next 3 weeks. Some members, in fact, would have been inclined, if anything, to favor action to lessen credit ease further. Others, however, continued to question the desirability of the restraint already imposed, although only one member urged a return at this time to the degree of ease prevailing at the time of the previous meeting.

The case for maintaining the current position, or for moving toward a lesser degree of ease, reflected particularly the gravity of the U.S. international financial position and some indication of a deterioration of lending and investing standards at home. The case for a greater degree of ease reflected a desire to provide further stimulus to the domestic economy, along with doubt as to the effectiveness of modest changes in monetary policy for dealing with the balance of payments problem. One member held that a policy of less ease was neither a necessary nor desirable means of improving the quality of credit under present conditions of low resource utilization. It was clear from the entire discussion, however, that a large majority felt that policy should not be changed again at this time, one way or the other.

The consensus therefore was to maintain, but not intensify, the slightly lesser degree of ease established pursuant to the May 7 policy action. It was felt that the effects of that change were not yet fully apparent and that additional time for market adjustments was desirable, especially in the light of the uncertainties stemming from legislative consideration of the debt ceiling. Accordingly, the following directive was issued to the Federal Reserve Bank of New York:

It is the Committee's current policy to accommodate moderate growth in bank credit, while putting increased emphasis on money market conditions that would contribute to an improvement in the capital account of the U.S. balance of payments. This policy takes into consideration the continuing adverse balance of payments position and its cumulative effects and the improved domestic business outlook, as well as the increases in bank credit, money supply, and the reserve base in recent months. At the same time, however, it recognizes the continuing underutilization of resources.

To implement this policy, System open market operations shall be conducted with a view to continuing the degree of firmness in the money market that has prevailed recently, while accommodating moderate reserve expansion.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Clay, Irons, King, Mills, Scanlon, and Shepardson. Vote against this action: Mr. Mitchell.

2. Authority to purchase and sell foreign currencies.

The guidelines for System foreign currency operations, as reaffirmed on March 5, 1963, were amended as follows:

In Section 2, the following new paragraph was inserted after paragraph 3:

Drawings made by either party under a reciprocal arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

In Section 4, the following two new paragraphs were added:

The New York Bank may also, where authorized, purchase currencies through forward transactions for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements.

The New York Bank may further, where authorized, purchase and sell currencies through forward as well as spot transactions for the purpose of settling commitments denominated in one currency by means of utilizing the Bank's holdings of another currency.

The effect of the amendment to Section 2 was to recognize, within the context of a specific application, the principle embodied in the guidelines that the use of foreign currency credit facilities available under reciprocal currency arrangements should be geared to market swings that were expected to prove reversible in the relatively near future. Indebtedness incurred by the System through drawings under reciprocal arrangements was clearly intended to be of a short-term nature, and in no sense to provide longer-term financing for persistent U.S. balance of payments deficits. However, the guidelines had not heretofore specified precisely the time period implied in the reversible principle underlying such drawings. The amendments to Section 4 were designed to provide flexibility in settling System commitments.

The continuing authority directive to the Federal Reserve Bank of New York on foreign currency operations, which had previously been amended on March 5, 1963, to authorize the purchase of foreign currencies through forward transactions within specified limitations, was further amended at this meeting to authorize the purchase and sale of foreign currencies through forward as well as spot transactions for the purpose of settling commitments denominated in one currency by means of utilizing System holdings of another currency. The directive was also amended to increase from $1.3 billion to $1.75 billion the limit on total holdings of foreign currencies at any one time. At this date reciprocal currency agreements outstanding between the Federal Reserve System and foreign banks aggregated $1.1 billion, and it was anticipated that the reciprocal currency arrangement with the Bank of England would shortly be raised from $50 million to $500 million to enlarge the facilities for dealing with temporary reversible flows of funds between the two countries and further reinforce international liquidity by augmenting the availability of foreign exchange in case of need.

Accordingly, the continuing directive was issued in the following form:

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines on System Foreign Currency Operations reaffirmed by the Federal Open Market Committee on March 5, 1963, as amended May 28, 1963:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs

Belgian francs
Canadian dollars
Austrian schillings
Swedish kronor

The Federal Reserve Bank of New York is also authorized and directed to purchase, in accordance with the Guidelines and for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements, any or all of the foregoing currencies through forward transactions, up to a combined total of $25 million equivalent.

The Federal Reserve Bank of New York is further authorized and directed to purchase and sell, in accordance with the Guidelines and for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies, any or all of the foregoing currencies through forward as well as spot transactions, up to a combined total of $50 million equivalent.

Total foreign currencies held at any one time shall not exceed $1.75 billion.

Votes for these actions: Messrs. Martin, Hayes, Balderston, Bopp, Clay, Irons, King, Mills, Mitchell, Scanlon, and Shepardson. Votes against these actions: None.

June 18, 1963

1. Authority to effect transactions in System Account.

Expansion in domestic activity was reported to have continued in May and early June. The industrial production index advanced again in May, with gains widespread among industries and products. Employment also increased and hours of work at factories lengthened, but the unemployment rate rose as teenagers entered the labor market. Retail sales were unchanged from the level of the preceding 3 months, and commodity prices continued to show only small mixed changes. Stock market prices showed little change on balance.

Business confidence remained strong; a recent survey found the planned rise in outlays for new plant and equipment in 1963 to be practically the same as reported earlier, but with relatively more of the increase anticipated in the second half of the year.

Expectations of higher sales and inventories than had been indicated earlier were also reported. Stockpiling against a possible steel strike appeared about at an end, however, and the steel industry was expected soon to become a contractive influence on the economy, at least temporarily, as production was brought into closer balance with consumption.

In the financial area, market adjustments to the mid-May shift in System policy toward slightly less monetary ease continued moderate. Yields on Treasury securities had risen somewhat, but a Treasury offering of a 4 per cent intermediate-term bond met with an exceptionally strong market reception. Corporate yields on new issues changed little, while yields on municipal securities increased.

In May, seasonally adjusted bank credit rose substantially, offsetting a comparable decline in April. Real estate and consumer loans continued to expand rapidly; the rise in business loans was less sharp. The seasonally adjusted money supply was unchanged in May, in part because of an unusually large increase in Treasury deposits. Time and savings deposits rose more rapidly than in April, but more slowly than earlier in the year. Free reserves of member banks averaged somewhat lower after mid-May than earlier.

The U.S. balance of payments deficit in April and May continued at about the advanced level of the first quarter, with capital outflows remaining a major factor. Gold and foreign exchange markets were generally quiet, although the dollar was relatively weak against most major foreign currencies.

At this meeting of the Committee, attention was focused on the failure of the balance of payments deficit to show improvement; on the role of capital outflows in the continuing large deficits; and on the contribution that monetary policy might make, either alone or in conjunction with other Governmental actions, toward a solution of the problem. The majority view was that market adjustments to the mid-May shift in policy were still in process and that no further change in open market policy