FIFTIETH

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.

was appropriate at this time. One minority position was that monetary policy should move a little further toward firmness; this position was based on the view that while the domestic economy continued to strengthen, the balance of payments drain remained serious and could be alleviated somewhat through a higher structure of domestic interest rates, particularly short-term rates. Another minority view, which favored returning to the degree of monetary ease existing before the May decision, was based largely on the feeling that an easier credit posture would encourage the domestic economy to expand more rapidly and that this in turn would help the balance of payments situation.

Although no expectations of a boom in domestic conditions were expressed, neither were there reports from Federal Reserve districts of any significant weakening of business and financial expectations for maintenance of activity at current advanced levels. A majority agreed that, with unemployment persisting at high rates, domestic conditions did not require a further lessening of monetary ease at this time. Further monetary action—possibly dramatic action—might be required soon, however, if the international financial situation did not show signs of betterment.

By majority vote, the current economic policy directive to the New York Reserve Bank was reissued in the same form as approved at the preceding meeting of the Committee.

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

Messrs. Hayes and Balderston dissented because they felt that the Committee should move further in the direction of slightly less ease, while Mr. Mitchell dissented because he favored a return to the greater degree of ease that had existed prior to the policy shift of mid-May.

2. Amendment of continuing authority directive.

In accordance with the recommendation of the Account Manager, Section 1(a) of the continuing authority directive to

the Federal Reserve Bank of New York was amended to raise from $1 billion to $1.5 billion the limit on changes in holdings of securities in the System Open Market Account between meetings of the Committee. With this amendment, Section 1(a) read as follows:

> (a) To buy or sell U.S. Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account (including forward commitments, but not including such special short-term certificates of indebtedness as may be purchased from the Treasury under paragraph 2 hereof) shall not be increased or decreased by more than $1.5 billion during any period between meetings of the Committee.

> Votes for this action: Messrs. Martin, Hayes, Balderston, Bopp, Clay, Irons, Mills, Mitchell, Scanlon, and Shepardson. Votes against this action: None.

July 9, 1963

Authority to effect transactions in System Account.

Economic activity had continued to expand moderately through June, but business sentiment appeared to have become a little less buoyant than earlier, probably reflecting some uncertainty over the timing and magnitude of inventory curtailments following the steel labor settlement. A threatened rail strike also may have been a factor.

GNP was indicated to have increased substantially again in the second quarter. Retail sales in June, however, showed little change at the level prevailing since February. The industrial production index apparently was at least as high in June as in May, as reductions in steel output were offset by gains elsewhere. The construction and housing situation appeared strong.

The labor market strengthened a little. The unemployment rate declined slightly to 5.7 per cent in June from 5.9 per cent in May; young people had entered the labor market in smaller numbers than expected. New and unfilled orders in the machinery industry rose in May, but a survey of capital appropriations by large manufacturers indicated a decline in the first quarter, following 2 quarters of sharp increases. Business inventory accumulation in the second quarter apparently increased less than expected, and Federal Government expenditures were below projected levels.

In the financial area, bank credit expansion in June was exceptionally large, with bank holdings of U.S. Government securities up substantially, including a sizable proportion of the recent $1.9 billion issue of Treasury 7-year bonds. Holdings of other securities also increased further, and loan growth was substantial. The seasonally adjusted money supply rose moderately further in June, and time and savings deposits expanded again, but not so rapidly as in most other months this year. Bank reserve positions were somewhat less easy as member banks obtained more of their reserves by borrowing from Federal Reserve Banks.

The money market had firmed since the preceding meeting of the Committee, with the 3-month bill rate moving up sharply in early July to about 3.20 per cent from around a 3 per cent rate earlier, reflecting widespread market expectations of a change in the Federal Reserve Bank discount rate. Yields on other maturities of U.S. Government securities also moved upward. Yields on corporate bonds continued to show little change, however, while yields on municipals, which had risen sharply from mid-May to mid-June, tended to stabilize.

The balance of payments deficit for the second quarter was estimated to be somewhat above even the high first-quarter rate. The trade surplus in April and May was much larger than in the first quarter, and the volume of foreign securities issued in the U.S. capital market declined from the unusually high first-quarter level. But the effect of these favorable developments on the

payments balance was more than offset by a rise in U.S. bank lending to foreigners and other short-term capital outflows, including unreported transactions. Foreign exchange markets had been moderately active in recent weeks, with some seasonal easing of exchange market pressure on the dollar.

There was extensive discussion at this meeting of the Committee about the proper course of monetary policy in the light of the serious and persistent balance of payments deficit and the urgent need for additional measures to deal with it. At the same time it was recognized that the domestic economy was not expanding at a rate sufficient to bring about full employment soon and that a more rapid rate of growth was highly to be desired.

In considering these problems, special attention was given to reports of additional Governmental measures under consideration to improve the international financial position, and to the role monetary policy might play within the context of a broad corrective effort. It was generally accepted that the large outflow of short-term funds was amenable in some degree to curtailment by a monetary policy directed toward higher short-term interest rates. Judgments differed, however, as to whether short-term rates sufficiently higher to be effective could be brought about without materially affecting the over-all availability of domestic credit or without causing long-term rates to increase somewhat as well. Similarly, there were differences of view as to the likely consequences of higher short-term rates for the domestic economy, which some members felt was not so robust as might appear.

The majority view was that the use of monetary tools was justified in an effort to help improve the balance of payments position. On the question of timing, however, there was some feeling that any further action could properly await additional testing of the strength of the economy and evidence of market reactions to the broader Governmental programs contemplated and yet to be announced. Another view called for prompt action to take advantage of recent widespread market expectations regarding a change in monetary policy, in the belief that this would make for more orderly markets and that everything possible should be done to guard against any possible balance of payments crisis before it became imminent.

Some of the discussion related to the open market policy that might appropriately be followed if early action were taken by the Federal Reserve System to increase the discount rate; several Reserve Bank members of the Committee reported that they intended to recommend to the directors of their respective Banks within the near future that a higher discount rate be established. There was considerable feeling, in such circumstances, that it would be inappropriate for open market operations to permit a sharp decline from existing market rates, which reflected expectations of a discount rate increase, only to have market rates rise again if the discount rate should be increased.

After weighing all of the foregoing considerations, a majority favored conducting open market operations in the next 3 weeks with a view to maintaining the degree of firmness in the money market existing at the time of this meeting. A minority believed that a return to an easier and more stimulative monetary position would be appropriate.

In accordance with the majority view, the following current economic policy 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 high level of domestic business activity, 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.
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> To implement this policy, System open market operations shall be conducted with a view to continuing the present degree of firmness in the money market.

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

Messrs. Mitchell's and Robertson's dissenting votes reflected their view that the Committee should take prompt steps to moderate the money market firming that had occurred in the period since the preceding meeting, and move gradually toward a still easier monetary policy that, along with the tax reduction under consideration by Congress, would be more conducive to an acceleration of domestic economic growth. They recognized fully the gravity of the U.S. balance of payments problem but thought that it should be dealt with by vigorous application of specific remedies, including further efforts to bring about a reduction of existing discriminatory barriers to U.S. exports. They viewed firming money market conditions at this time as continuing the Committee's recent trend toward reducing the incentive for domestic borrowing, and they were concerned that it might induce a backwash of reaction that would worsen rather than help the balance of payments problem over the months immediately ahead.

July 30, 1963

1. Authority to effect transactions in System Account.

The domestic economy had continued to expand at a moderate pace. In the second quarter, GNP was estimated on a preliminary basis at a $579 billion seasonally adjusted annual rate, as compared with $572 billion in the first quarter. Industrial production in June rose further to an index level of 125, despite a decline in steel output.

Housing starts, although off somewhat in June from the advanced May level, were substantially above a year earlier. Nonagricultural employment rose further, average hours of work at factories remained high, and the unemployment rate declined slightly. Retail sales in June were at the level prevailing since