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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.

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 winter, but in July a modest rise appeared likely. Consumer prices increased in June, with higher food prices the major factor, and industrial prices in wholesale markets firmed.

Despite the generally favorable tone of the statistics, more crosscurrents and uncertainties in the economy were apparent than earlier, with some questioning of the continuation of the current rate of expansion. The persistent balance of payments deficit contributed to the uncertainties, and programs designed to deal with it had been announced by the President in mid-July.

The recent action increasing the Federal Reserve discount rate to 3½ per cent had been widely anticipated, particularly following reports of a further deterioration in the balance of payments in the second quarter. Yields on U.S. Government securities rose during the first half of July, with Treasury bills showing the greatest response. The 3-month bill rate rose about ¼ of 1 percentage point to 3¼ per cent, and intermediate- and long-term bond yields increased somewhat. After the discount rate announcement yields receded slightly, but on the shortest maturities yields subsequently moved back to about the 3¼ per cent level. Federal funds rates, after oscillating sharply during the period when differing Reserve Bank discount rates were in existence, moved up into a 3¼ to 3½ per cent range. Corporate and municipal bond yields were not affected significantly.

Credit at weekly reporting member banks declined much more than usual in the first 3 weeks of July following an exceptionally large increase in June, both months being affected by the earlier timing of Treasury financing operations this year. Required reserves against private deposits rose more than seasonally in the 4 weeks ended July 24. Free reserves averaged somewhat less than in the preceding 4 weeks, while both excess reserves and borrowings were larger.

The seasonally adjusted money supply increased sharply in the first half of July, following a somewhat smaller rise in June. Time and savings deposits at commercial banks increased in the first half of July at about the second-quarter rate; the mid-

month increase to 4 per cent in the maximum permissible rate of interest payable on time deposits with maturities between 90 days and 1 year was followed by a sharp rise in time deposits at weekly reporting member banks.

The U.S. balance of payments deficit proved to have increased sharply in June and for the second quarter. Excluding net receipts from special Government transactions, the seasonally adjusted deficit for the quarter was expected to come to about $1.25 billion, considerably larger than the deficit for the first quarter. The increase was traceable to an enlarged capital outflow, especially of short- and medium-term bank credit.

In the week and a half after the increase in the discount rate and the announcement of a proposed interest equalization tax on American purchases of foreign securities, the U.S. dollar strengthened against the Canadian dollar and very slightly against sterling, but showed little or no general improvement against other currencies.

The discussion at this meeting showed that the range of views as to the appropriate policy to be followed for the next 3 weeks was relatively narrow. To a considerable extent, the differences of opinion reflected varying judgments as to whether open market operations should focus more on the levels of short-term rates or on target levels for the availability of bank reserves. Judgments also differed on whether short-term rates should preferably remain about where they were for the period immediately ahead, or whether they should be encouraged to move up slightly further, in the context of a higher discount rate, to clarify to the market the present posture of System policy. It developed that a majority of the Committee favored attaining a slightly greater degree of firmness in the money market, while continuing to provide for moderate expansion in bank reserves, and the following current policy directive therefore 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.

To implement this policy in the context of a higher discount rate, System open market operations shall be conducted with a view to attaining a slightly greater degree of firmness in the money market, while accommodating moderate expansion in aggregate bank reserves.

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

2. Amendment of continuing authority directive.

The Account Manager suggested that under present conditions the continuing authority directive to the Federal Reserve Bank of New York, which had been amended on June 18, 1963, to raise from $1 billion to $1.5 billion the limit on net changes in the System Open Market Account in the period between Committee meetings, might appropriately be changed to restore the former figure of $1 billion. Accordingly, the Committee amended Section 1(a) of that directive by inserting "$1 billion" and deleting "$1.5 billion."

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

August 20, 1963

Authority to effect transactions in System Account.

According to preliminary figures on industrial production, retail trade, employment, new orders, and private construction, the domestic economy demonstrated somewhat more vigor in July than had been generally anticipated. The industrial pro-

duction index rose nearly 1 percentage point, to 126.5 per cent of the 1957-59 average, from a June figure that had been revised upward, and the gains were widespread among industries and market groupings.

The labor market also showed some improvement as nonagricultural employment rose further, factory hours of work were maintained at high levels, and the rate of unemployment declined slightly. The number of major labor market areas classified in substantial labor surplus categories had been reduced to the smallest total since mid-1960. Retail trade, which had been on a plateau for some time, showed evidence of advancing in both June and July, with sales in July more than 2 per cent above the May level. According to a recent survey, consumer buying plans also had strengthened. Industrial prices remained relatively stable on average, while stock market prices had risen to the year's high and were close to the record high of December 1961.

The impact of the mid-July increase in the Reserve Bank discount rate, other monetary actions, and the President's program to deal with the deficit in the balance of payments had now been reflected more substantially in the financial sector. Treasury short-term bill rates had risen somewhat further and were about one-third of a percentage point above the 3 per cent level prevailing at the beginning of July. Other money market rates had also risen, and Federal funds recently had been trading quite consistently at 3½ per cent. In longer-term markets yields on Treasury bonds remained practically unchanged at about 4 per cent for most issues, while yields on new issues of corporate and municipal bonds had declined several basis points. Although the volume of corporate and municipal financing continued to be light, dealers had nevertheless encountered some sluggishness in investor demand.

Bank credit, seasonally adjusted, declined substantially in July following a large rise in June, but the average expansion for the 2 months was about the same as that for earlier months