FIFTY SECOND

Annual Report

OF THE

BOARD OF GOVERNORS

OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1965

Period	*Action*	*Purpose*
January	Reduced System holdings of U.S. Government securities by about \$500 million. Member bank borrowings averaged \$300 million.	To absorb seasonal reflow of bank reserves while maintaining about the same firmness in the money market as had prevailed in earlier weeks.
February	Introduced a program, at the request of the President and in cooperation with the Treasury, under which financial institutions were asked to limit voluntarily their expansion of foreign loans and investments.	To reduce the outflow of private capital and thus improve the U.S. balance of payments and strengthen the international position of the dollar.
February-March	Limited the increase in System holdings of U.S. Government securities to about \$1.0 billion, nearly one-fifth of which were securities maturing in over 1 year. Member bank borrowings rose to an average of nearly \$500 million in late March.	To move toward firmer conditions in the money market, while offsetting a \$600 million gold outflow, and to encourage more moderate growth in the reserve base, bank credit, and the money supply—in an effort to reinforce the voluntary foreign credit restraint program and avoid the emergence of inflationary pressures.
April-November	Limited the increase in System holdings of U.S. Government securities to about \$2.4 billion, nearly one-third of which were securities maturing in over 1 year. Member bank borrowings averaged \$500 million.	To offset a drain on bank reserves from market factors—as outflows of \$2.5 billion in currency and \$700 million in gold were only partly offset by reserves supplied from other technical factors—while attempting to maintain firm conditions in the money market in a period of rising credit demands and shifting expectations and at the same time accommodating no more than moderate growth in bank reserves, bank credit, and money.
Early December	(1) Raised the discount rate from 4 to 4½ per cent and (2) raised maximum interest rates payable by member banks on time deposits (other than savings deposits) from 4 to 5½ per cent for maturities of 30-89 days and from 4½ to 5½ per cent for longer maturities.	(1) To moderate additional bank reliance on short-term borrowings from the Federal Reserve to meet intensifying loan demand and (2) to enable banks to attract and retain time deposits of businesses and individuals and thus to assure an adequate flow of funds.
December	Increased System holdings of U.S. Government securities by about \$1.1 billion, one-fifth of which represented securities acquired under repurchase agreements. Member bank borrowings averaged about \$450 million.	To moderate adjustments in money and credit markets following the December discount rate increase and to offset part of the seasonal drain on bank reserves.

The Committee also amended the continuing authority directive for foreign currency transactions to increase, from $2.35 billion to $2.65 billion, the dollar limit specified in the first paragraph on the aggregate amount of foreign currencies held under reciprocal currency arrangements. It had been the Committee's practice to set this limit at the sum of the amounts currently specified by the Committee for all individually authorized reciprocal currency arrangements, which represented the maximum of System covered holdings of foreign currencies under these arrangements in the remote possibility that they might all simultaneously be fully drawn on. This revision reflected authorization earlier in the present meeting to increase the sizes of the reciprocal currency arrangements with the Bank of Italy from $250 million to $450 million, and with the Bank of Japan from $150 million to $250 million.

Votes for this action: Messrs. Martin, Hayes, Balderston, Bryan, Daane, Ellis, Mitchell, Robertson, Scanlon, Shepardson, and Clay. Votes against this action: None.

April 13, 1965

Authority to effect transactions in System Account.

Reports at this meeting indicated that the business expansion was vigorous and broadly based. Nonfarm employment advanced in March to a level more than 2 million higher than a year earlier, and the unemployment rate dropped to 4.7 per cent, the lowest figure in more than 7 years. Industrial production also rose to a new high, with gains widespread among materials and finished products. Tentative weekly data suggested that retail sales had declined moderately in March after allowance for usual seasonal influences, as consumer purchases of automobiles and other durables rose less than seasonally. Retail sales figures

for January and February had been revised upward, however, and first-quarter sales were at a record level.

Output in the steel and automobile industries continued at extraordinarily high rates. Although auto production currently exceeded consumer purchases, it was expected to remain large at least for a few more months as dealers increased inventories. The prospects for steel depended on the outcome of current wage negotiations, since users were continuing to accumulate stocks against the possibility of a strike. The present labor contract in the steel industry was scheduled to expire on May 1.

Some sensitive commodity prices, particularly of nonferrous metals and products, recently had begun to advance again, but average industrial prices had been essentially stable thus far in 1965 following a rise of three-fourths of 1 per cent during the preceding autumn. The consumer price index was unchanged in February at a level 1.2 per cent above a year earlier.

The demand for business loans at commercial banks continued unusually strong in March, and bank credit rose at an even faster rate than in the first 2 months of the year. At the same time the earlier rapid expansion in time and savings deposits slackened markedly, while the money supply increased by the amount it had declined in February. In the first quarter as a whole, bank credit expanded at a 13 per cent annual rate, compared with about 7 per cent in the fourth quarter of 1964; time and savings deposits and the money supply combined advanced at a rate of about 9 per cent, little changed from the preceding quarter.

Net borrowed reserves of member banks averaged about $130 million in the last week of March and the first week of April, compared with an average of $30 million earlier in March. The tone of the money market was somewhat firmer, with Federal funds frequently trading at rates about the 4 per cent discount rate. However, yields on Treasury securities and corporate and municipal bonds had shown little net change since the preceding meeting of the Committee. Bond markets exhibited some hesitancy in the early part of the interval as a result of continued concern over the position of sterling, evidences of strength in the domestic economy, and attempts to appraise the prospects for monetary policy. The market atmosphere improved subsequently, however, following budget proposals by the British Government and a reduction in the discount rate of the Bank of France. An announcement of the terms on which the Treasury would refund securities maturing on May 15, of which $4.1 billion were held by the public, was expected near the end of April.

Tentative estimates of the U.S. balance of payments in the first quarter suggested that the deficit was at a seasonally adjusted annual rate of roughly $2.5 billion, somewhat below the $3.1 billion deficit of 1964 and well below the fourth-quarter deficit of $6.0 billion, annual rate. There were encouraging additional indications that net outflows of U.S. private capital had diminished sharply after announcement of the administration's balance of payments program in the middle of the quarter. It was still too early to determine, however, how substantial and enduring an improvement was being achieved under the program.

The Committee concluded that no change should be made in its policy at this time, and that open market operations over the next 4 weeks should be conducted with a view to maintaining the firmer money market conditions that had prevailed recently. While this decision took into account the forthcoming Treasury financing operation, in the judgment of most members such a policy was appropriate in the light of current domestic and international conditions. At the same time, a considerable degree of concern was expressed about the acceleration in the rate of bank credit expansion of recent months; and some members indicated that they would welcome a slightly higher level of domestic short-term interest rates if market forces worked in that direction.

The following current economic policy directive was issued to the Federal Reserve Bank of New York:

The economic and financial developments reviewed at this meeting indicate a generally strong further expansion of the domestic economy and the continuing need to improve our international balance of payments, as highlighted by heavy gold outflows in recent months. In this situation, it is the Federal Open Market Committee's current policy to reinforce the voluntary restraint program to strengthen the international position of the dollar, and to avoid the emergence of inflationary pressures, while accommodating moderate growth in the reserve base, bank credit, and the money supply.

To implement this policy, while taking into account the forthcoming Treasury financing, System open market operations over the next 4 weeks shall be conducted with a view to maintaining the firmer conditions in the money market that have recently prevailed.

Votes for this action: Messrs. Martin, Balderston, Bryan, Daane, Ellis, Mitchell, Robertson, Scanlon, Shepardson, Clay, and Treiber. Votes against this action: None.

May 11, 1965

Authority to effect transactions in System Account.

The business situation remained strong and, while some information for April suggested that the pace of the advance had moderated from the very high first-quarter rate, prospects for further expansion in coming months were strengthened by two recent developments. First, an interim labor agreement reached in the steel industry postponed the possibility of a strike at least until September 1 and offered an opportunity for a more orderly adjustment of steel production to final consumption rates. Secondly, businesses apparently had increased their anticipated capital expenditures in 1965 from levels reported earlier in the year. According to a private survey taken in March and early April, outlays on new plant and equipment in 1965 would be 15 per cent larger than in 1964. This compared with an expected