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.

in the near future on the ground that recent rates of expansion in bank credit were excessive, particularly in view of the inflationary pressures they believed were latent in the economy.

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 some improvement in our international balance of payments, but with gold outflows continuing. In this situation, it remains 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.
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> To implement this policy, while taking into account the current Treasury financing, System open market operations over the next 2 weeks shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks.

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

May 25, 1965

Authority to effect transactions in System Account.

Earlier indications that expansion in domestic economic activity had slowed in April from its advanced first-quarter pace were confirmed by reports at this meeting. As preliminary estimates had suggested, the rise in industrial production was small and retail sales edged down further; and in addition to the lack of advance in nonagricultural employment reported earlier, the average length of the workweek in manufacturing was reduced. There were a number of favorable factors in the outlook, including the recent results of a private survey suggesting a step-up in business plans for capital spending, other evidences of continuing business optimism, and administration proposals for reductions in excise taxes. It appeared, however, that GNP would increase by considerably less in the second quarter than in the first, when an unusually large rise of $14 billion (seasonally adjusted annual rate) had been recorded under the combined stimuli of recovery from earlier automobile strikes and anticipations of a possible steel strike.

According to weekly data, average prices of industrial commodities advanced slightly further in May to a level fractionally higher than the 1960 peak and 1 per cent above a year earlier, mainly as a result of increases in metals and machinery. The total wholesale price index had risen somewhat more in the past year—1.5 per cent—as prices of meats and fruits and vegetables also moved up.

Data for city banks indicated that loan demand remained strong in the first part of May, but total bank credit was expanding at the slower rate evident in April as banks reduced security holdings. The money supply, which increased rapidly in March and April, dropped sharply in the first half of May as Treasury deposits rose substantially, and time deposits continued to grow at the reduced rate of the previous 2 months.

Although net borrowed reserves of member banks averaged about $155 million in the first 3 weeks of May, somewhat higher than the April average of about $130 million, conditions in money markets were little changed. Rates on 3-month Treasury bills fluctuated in a narrow range near 3.90 per cent. Yields on Treasury notes and bonds also continued generally stable, although they were under some upward pressure stemming in part from the slow progress by Government securities dealers in distributing issues acquired in the recent Treasury refunding. Corporate bond yields moved to new highs for the year—reflecting the heavy volume of public offerings in May—and prices of common stocks eased somewhat from the record level reached at midmonth.

More detailed data on U.S. balance of payments developments in March and April confirmed previous estimates of surpluses in those months, and tentative figures suggested that the nation's international payments were roughly in balance in early May. The improvement that had occurred appeared to reflect largely the initial success of the voluntary foreign credit restraint program and the aftereffects of the dock strike rather than basic adjustments of longer-run consequence. Additional gold sales by the Treasury to foreign monetary authorities were reported.

The Committee concluded that no change in current money market conditions was required at this time on either domestic or international grounds, although a minority favored a shift toward firmer conditions on one or both bases. While the members differed somewhat in their assessments of the prospects for domestic business activity and prices, it was generally agreed that the recent slowing in the pace of the expansion was not surprising in view of the special factors making for extremely rapid growth earlier. A number of members—including some who favored no change in policy at present—thought that the economic outlook remained highly favorable, but others were less certain about prospects. With respect to prices, some members thought that upward pressures might pose a serious problem. The view also was expressed, however, that recent price increases had been moderate in size and limited in scope, particularly when the unusual strength of demand pressures in the first quarter was considered. The reduction in the growth rate of bank credit in April and early May and the recent decline in the money supply were noted by some members as reasons for not seeking firmer money market conditions, as was the possibility that such conditions might lead to a significant rise in longer-term interest rates under present circumstances.

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, although at a somewhat slower pace, and some improvement in our international balance of payments, but with gold outflows continuing.

In this situation, it remains 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, System open market operations over the next 3 weeks shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks.

Votes for this action: Messrs Martin, Bryan, Daane, Galusha, Maisel, Mitchell, Robertson, and Scanlon. Votes against this action: Messrs. Hayes, Balderston, Ellis, and Shepardson.

Mr. Balderston dissented from this action because he believed that the progress being made in effecting improvement in the U.S. balance of payments would be undermined unless it was supported by some reduction in domestic credit availability. Mr. Hayes shared this view, and also felt that the domestic business and price outlook now permitted and might even require a somewhat firmer policy. Mr. Ellis, who described the Committee's actions on February 2 and March 23 as "cautious probing toward modest credit restraint," thought that a continuation of such probing would be desirable on both domestic and international grounds. Mr. Shepardson concurred in these judgments.

June 15, 1965

Authority to effect transactions in System Account.

Domestic economic activity expanded in May but, as in April, the advance was slower than earlier in the year. Industrial production and total employment rose moderately and, with the labor force little changed, the unemployment rate dropped to 4.6 per cent from 4.9 per cent in the previous month. Retail sales, which were now indicated by revised data to have increased in April, rose further in May to a level slightly above the February peak.