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 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.

Prices of common stocks continued to decline in recent weeks, apparently reflecting as well as contributing to some increase in uncertainty about business prospects. At the time of this meeting average prices of common stocks had fallen about 6 per cent from their mid-May high.

Reports at this meeting suggested that the current pace of the business advance was likely to be maintained over the near term. It was noted that consumer spending would be bolstered in coming months by prospective reductions in Federal excise taxes and increases in social security payments. The decline in sales of new automobiles, to which much of the recent slowdown was attributable, apparently had halted, sales of domestic cars in May, at an annual rate of 8.1 million units, were little changed from April although well below the exceptionally high poststrike rate of 9.3 million units recorded in the first quarter. The numbers of consumers planning to buy cars and other durable goods remained large, according to a Census Bureau survey taken in April, and sales of nondurable goods in May were high and rising.

As to business spending, the May Commerce–SEC survey of plans for fixed investment outlays failed to support the step-up implied by a recent private survey. However, it did confirm the indications of the February official survey that capital expenditures would rise by about 12 per cent in 1965 and would advance more rapidly in the second half of the year than in the first two quarters. The evidence available on business inventories in the second quarter suggested that accumulation was continuing close to the high first-quarter rate and that steel users were adding further to their stocks of that metal.

Average wholesale prices were estimated to have increased about 1 per cent since the end of March. The rise was due mainly to sharply higher prices of foodstuffs as a result of reduced supplies and to a continued upward drift in prices of nonferrous metals and machinery. Higher food prices also contributed to the advance of the consumer price index in April

to a level 1.4 per cent above a year earlier. Further increases in food prices, particularly for meats, were in prospect, but their effects on the consumer index were expected to be offset in part by reductions in excise taxes.

Bank credit expanded at an annual rate of 8 per cent in May, about the same as in April and considerably below the first-quarter rate of over 12 per cent. Growth in time and savings deposits slackened slightly further, and the money supply declined to the January level. The reduction in the money supply was associated with a large increase in Treasury deposits at commercial banks after mid-April, when tax payments were greater than usual. Net borrowed reserves of member banks averaged about $160 million in May and the first 2 weeks of June, compared with an April average of about $130 million.

Despite continued firmness in money market conditions, rates on 3-month Treasury bills declined to about 3.80 per cent in early June from the levels near 3.90 per cent that had prevailed through most of May. In part, the bill rate decline reflected a change in market expectations following a reduction, on June 3, in the discount rate of the Bank of England from 7 to 6 per cent. In addition, continued investor demands for Treasury bills may have been augmented by funds awaiting placement in the capital markets and by shifts in preferences away from common stocks. Meanwhile, supplies of short-term Treasury securities available to the public had been reduced, and were expected to be further reduced, by sizable debt repayments by the Treasury and by Federal Reserve purchases in supplying bank reserves.

In markets for longer-term securities, average yields on new corporate bonds rose about 10 basis points to their highest levels since early 1962 in the face of relatively heavy flotations. Yields on State and local bonds, the markets for which also were somewhat congested, advanced about the same amount to a new 1965 high, but Treasury note and bond yields changed little.

Preliminary data for U.S. international payments in May and early June showed a continued small surplus, reflecting the administration's balance of payments program and further progress in clearing merchandise trade shipments held up by the earlier dock strike. Present indications were that a surplus would be recorded for the second quarter as a whole, in contrast with the large first-quarter deficit, now estimated to have been at a seasonally adjusted annual rate of $2.8 billion. Abroad, the combined external payments of major continental European countries moved from surplus to near-balance in March and April, and Japan's international payments concurrently shifted from surplus to deficit. There had been no marked improvement as yet in Britain's external position, and sterling continued under intermittent pressure in foreign exchange markets.

The Committee agreed that no change should be made in policy at this time. Considerations underlying this decision included the prevailing uncertainties in business and financial markets, the more moderate recent rates of expansion in economic activity and of growth in bank credit, and the maintenance of improvement in the U.S. balance of payments.

Although the Committee's conclusion was unanimous, in their initial expressions of views some members leaned toward a slightly firmer policy or noted that they found the choice between no change and slight firming to be close. These members, along with certain others, were concerned about the implications of upward price movements, both for the domestic economy and for the longer-run position of the U.S. balance of payments. They were not convinced that the pace of bank credit growth, although lower recently than earlier, had fallen to an appropriate level, and they noted the lack of evidence that the more basic forces were working toward improvement in the nation's international payments.

Some members thought, however, that recent and prospective price pressures were not of a character to call for further monetary restraint, and that the possibility of declines in rates of resource utilization later in the year warranted close watching by the Committee. The lack of growth in the money supply thus far in 1965 was noted, and the view was expressed that a firmer policy at this juncture would not make the recent balance of payments improvement more lasting.

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 continuing expansion of the domestic economy, although at a somewhat slower pace than in the first quarter, and maintenance of earlier 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 4 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, Bryan, Daane, Ellis, Galusha, Maisel, Mitchell, Robertson, Scanlon, and Shephardson. Votes against this action: None.

July 13, 1965

Authority to effect transactions in System Account.

The economic advance continued in June, according to reports at this meeting. Employment rose moderately and the unemployment rate—at 4.7 per cent—was little changed from the 4.6 per cent recorded in May. Tentative estimates suggested that both industrial production and retail sales maintained, or possibly bettered, their record May levels. Unit sales of new domestic automobiles rose sharply to an annual rate of 8.8 million units, perhaps partly as a result of purchases that had been postponed earlier because of uncertainty about excise taxes.