RECORD OF POLICY ACTIONS
FEDERAL OPEN MARKET COMMITTEE

The record of policy actions of the Federal Open Market Committee is presented in the ANNUAL REPORT of the Board of Governors pursuant to the requirements of Section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each such action, and that it shall include in its ANNUAL REPORT to the Congress a full account of such actions.

In the pages that follow, there are entries with respect to the policy actions taken at the meetings of the Federal Open Market Committee held during the calendar year 1965, including the votes on the policy decisions made at those meetings as well as a résumé of the basis for the decisions, as reflected by the minutes of the Committee.

It will be noted from the record of policy actions that in some cases the decisions were by unanimous vote, and that in other cases dissents were recorded. The fact that a decision in favor of a general policy was by a large majority, or even that it was by unanimous vote, does not necessarily mean that all members of the Committee were equally agreed as to the reasons for the particular decision or as to the precise operations in the open market that were called for to implement the general policy.

The policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. Both the Manager of the System Open Market Account and the Special Manager of the Account for foreign currency operations attend the meetings of the Committee. In the area of domestic open market activities the Bank operates under two separate policy directives from the Open Market Committee—a continuing authority directive and a current economic policy directive. At the beginning of the calendar year the continuing authority directive in effect was as follows:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent current economic policy directive adopted at a meeting of the Committee:

(a) To buy or sell United States 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 United States Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $1.5 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) To buy or sell prime bankers' acceptances of the kinds designated in the Regulation of the Federal Open Market Committee in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed $125 million or 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York;

(c) To buy United States Government securities with maturities of 24 months or less at the time of purchase, and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, from nonbank dealers for the account of the Federal Reserve

Bank of New York under agreements for repurchase of such securities or acceptances in 15 calendar days or less, at rates not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower; provided that in the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to purchase directly from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the rate charged on such certificates shall be a rate ¼ of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed $500 million.

This directive was amended on two occasions during the year, as noted in the entries for March 2 and December 14.

The current economic policy directive was changed frequently during the year, as shown in the respective policy record entries. The current economic policy directive that was in effect at the beginning of 1965 instructed the Federal Reserve Bank of New York as follows:

In light of the economic and financial developments reviewed at this meeting, it remains the Federal Open Market Committee's current policy to facilitate continued expansion of the economy by accommodating moderate growth in the reserve base, bank credit, and the money supply, while seeking to avoid the emergence of inflationary pressures and to strengthen the international position of the dollar.

To implement this policy, and recognizing that international uncertainties and year-end seasonal pressures continue to require a larger than usual degree of flexibility in operations, System open market operations shall be conducted with a view to maintaining about the same conditions in the money market as currently prevail.

In the foreign currency area, the Federal Reserve Bank of New York operates under (1) an authorization regarding open market transactions in foreign currencies, (2) a statement of guidelines for System foreign currency operations, and (3) a continuing authority directive on System foreign currency operations.

The authorization regarding open market transactions in foreign currencies in effect at the beginning of and throughout the year read as follows:

AUTHORIZATION REGARDING OPEN MARKET TRANSACTIONS IN FOREIGN CURRENCIES

Pursuant to Section 12A of the Federal Reserve Act and in accordance with Section 214.5 of Regulation N (as amended) of the Board of Governors of the Federal Reserve System, the Federal Open Market Committee takes the following action governing open market operations incident to the opening and maintenance by the Federal Reserve Bank of New York (hereafter sometimes referred to as the New York Bank) of accounts with foreign central banks.

I. Role of Federal Reserve Bank of New York

The New York Bank shall execute all transactions pursuant to this authorization (hereafter sometimes referred to as transactions in foreign currencies) for the System Open Market Account, as defined in the Regulation of the Federal Open Market Committee.

II. Basic Purposes of Operations

The basic purposes of System operations in and holdings of foreign currencies are:

(1) To help safeguard the value of the dollar in international exchange markets;

(2) To aid in making the existing system of international payments more efficient and in avoiding disorderly conditions in exchange markets;

(3) To further monetary cooperation with central banks of other countries maintaining convertible currencies, with the International Monetary Fund, and with other international payments institutions;

(4) Together with these banks and institutions, to help moderate temporary imbalances in international payments that may adversely affect monetary reserve positions; and

(5) In the long run, to make possible growth in the liquid assets available to international money markets in accordance with the needs of an expanding world economy.

III. Specific Aims of Operations

Within the basic purposes set forth in Section II, the transactions shall be conducted with a view to the following specific aims:

(1) To offset or compensate, when appropriate, the effects on U.S. gold reserves or dollar liabilities of disequilibrating fluctuations in the international flow of payments to or from the United States, and especially those that are deemed to reflect temporary forces or transitional market unsettlement;

(2) To temper and smooth out abrupt changes in spot exchange rates and moderate forward premiums and discounts judged to be disequilibrating;

(3) To supplement international exchange arrangements such as those made through the International Monetary Fund; and

(4) In the long run, to provide a means whereby reciprocal holdings of foreign currencies may contribute to meeting needs for international liquidity as required in terms of an expanding world economy.

IV. Arrangements with Foreign Central Banks

In making operating arrangements with foreign central banks on System holdings of foreign currencies, the New York Bank shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee.

The Bank shall instruct foreign central banks regarding the investment of such holdings in excess of minimum working balances in accordance with Section 14(e) of the Federal Reserve Act.

The Bank shall consult with foreign central banks on coordination of exchange operations.

Any agreements or understandings concerning the administration of the accounts maintained by the New York Bank with the central banks designated by the Board of Governors under Section 214.5 of Regulation N (as amended) are to be referred for review and approval to the Committee, subject to the provision of Section VIII, paragraph 1, below.

V. Authorized Currencies

The New York Bank is authorized to conduct transactions for System Account in such currencies and within the limits that the Federal Open Market Committee may from time to time specify.

VI. Methods of Acquiring and Selling Foreign Currencies

The New York Bank is authorized to purchase and sell foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the Stabilization Fund of the Secretary of the Treasury established by Section 10 of the Gold Reserve Act of 1934 and with foreign monetary authorities.

Unless the Bank is otherwise authorized, all transactions shall be at prevailing market rates.

VII. Participation of Federal Reserve Banks

All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G (1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

VIII. Administrative Procedures

The Federal Open Market Committee authorizes a Subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board of Governors (or in the absence of the Chairman or of the Vice Chairman of the Board of Governors the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate) to give instructions to the Special Manager, within the guidelines issued by the Committee, in cases in which it is necessary to reach a decision on operations before the Committee can be consulted.

All actions authorized under the preceding paragraph shall be promptly reported to the Committee.

The Committee authorizes the Chairman, and in his absence the Vice Chairman of the Committee, and in the absence of both, the Vice Chairman of the Board of Governors:

(1) With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

(2) To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities;

(3) From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Problems.

IX. Special Manager of the System Open Market Account

A Special Manager of the Open Market Account for foreign currency operations shall be selected in accordance with the established procedures of the Federal Open Market Committee for the selection of the Manager of the System Open Market Account.

The Special Manager shall direct that all transactions in foreign currencies and the amounts of all holdings in each authorized foreign currency be reported daily to designated staff officials of the Committee, and shall regularly consult with the designated staff officials of the Committee on current tendencies in the flow of international payments and on current developments in foreign exchange markets.

The Special Manager and the designated staff officials of the Committee shall arrange for the prompt transmittal to the Committee of all statistical and other information relating to the transactions in and the amounts of holdings of foreign currencies for review by the Committee as to conformity with its instructions.

The Special Manager shall include in his reports to the Committee a statement of bank balances and investments payable in foreign currencies, a statement of net profit or loss on transactions to date, and a summary of outstanding unmatured contracts in foreign currencies.

X. Transmittal of Information to Treasury Department

The staff officials of the Federal Open Market Committee shall transmit all pertinent information on System foreign currency transactions to designated officials of the Treasury Department.

XI. Amendment of Authorization

The Federal Open Market Committee may at any time amend or rescind this authorization.

The guidelines for System foreign currency operations in effect at the beginning of the year were as follows:

Guidelines for System Foreign Currency Operations

1. Holdings of Foreign Currencies

Until otherwise authorized, the System will limit its holdings of foreign currencies to that amount necessary to enable its operations to exert a market influence. Holdings of larger amounts will be authorized only when the U.S. balance of international payments attains a sufficient surplus to permit the ready accumulation of holdings of major convertible currencies.

Foreign currency holdings above a certain minimum shall be invested as far as practicable in conformity with Section 14(e) of the Federal Reserve Act.

2. Exchange Transactions

System exchange transactions shall be geared to pressures of payments flows so as to cushion or moderate disequilibrating movements of funds and their destabilizing effects on U.S. and foreign official reserves and on exchange markets.

In general, these transactions shall be geared to pressures connected with movements that are expected to be reversed in the foreseeable future; when expressly authorized by the Federal Open Market Committee, they may also be geared on a short-term basis to pressures connected with other movements.

Subject to express authorization of the Committee, the Federal Reserve Bank of New York may enter into reciprocal arrangements with foreign central banks on exchange transactions ("swap" arrangements), which arrangements may be wholly or in part on a standby basis.

Drawings made by either party under a reciprocal arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

The New York Bank shall, as a usual practice, purchase and sell authorized currencies at prevailing market rates without trying to establish rates that appear to be out of line with underlying market forces.

If market offers to sell or buy intensify as System holdings increase or decline, this shall be regarded as a clear signal for a review of the System's evaluation of international payments flows. This review might suggest a temporary change in System holdings of a particular convertible currency and possibly direct exchange transactions with the foreign central bank involved to be able to accommodate a larger demand or supply.

Starting operations at a time when the United States is not experiencing a net inflow of any eligible foreign currency may require that initial System holdings (apart from sums that might be acquired from the Stabilization Fund) be purchased directly from foreign central banks.

It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions in order that System transactions do not conflict with those being undertaken by foreign monetary authorities.

3. Transactions in Spot Exchange

The guiding principle for transactions in spot exchange shall be that, in general, market movements in exchange rates, within the limits established in the International Monetary Fund Agreement or by central bank practices, index affirmatively the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public.

Temporary or transitional fluctuations in payments flows may be cushioned or moderated whenever they occasion market anxieties, or undesirable speculative activity in foreign exchange transactions, or excessive leads and lags in international payments.

Special factors making for exchange market instabilities include (i) responses to short-run increases in international political tension, (ii) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, or (iii) market rumors of a character likely to stimulate speculative transactions.

Whenever exchange market instability threatens to produce disorderly conditions, System transactions are appropriate if the Special Manager, in consultation with the Federal Open Market Committee, or in an emergency with the members of the Committee designated for that purpose, reaches a judgment that they may help to re-establish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified, curtailed, or eventually discontinued pending a reassessment by the Committee of supply and demand forces.

4. Transactions in Forward Exchange

Occasion to engage in forward transactions will arise mainly when forward premiums or discounts are inconsistent with interest rate differentials and are giving rise to a disequilibrating movement of short-term funds, or when it is deemed appropriate to supplement existing market facilities for forward cover as a means of encouraging the retention or accumulation of dollar holdings abroad.

Proposals of the Special Manager to initiate forward operations shall be submitted to the Committee for advance approval.

For such operations, the New York Bank may, where authorized, take over from the Stabilization Fund outstanding contracts for forward sales or purchases of authorized currencies.

The New York Bank may also, where authorized, purchase currencies through forward transactions for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements.

The New York Bank may further, where authorized, purchase and sell currencies through forward as well as spot transactions for the purpose of settling commitments denominated in one currency by means of utilizing the Bank's holdings of another currency.

5. Exchange Rates

Insofar as practicable, the New York Bank shall purchase a currency through spot transactions at or below its par value, and should lower the rate at which it is prepared to purchase a currency as its holdings of that currency approach the established maximum.

The Bank shall also, where practicable, sell a currency through spot transactions at rates at or above its par value, and should raise the rate at which it is prepared to sell a currency as its holdings of that currency approach zero.

Spot transactions at rates other than those set forth in the preceding paragraphs shall be specially authorized by the members of the Committee designated in Section VIII of the Authorization for Open Market Transactions in Foreign Currencies.

Revisions were made in these guidelines at the meetings of March 2, March 23, and November 23, as noted in the entries for those dates.

The continuing authority directive with respect to foreign currency operations in effect at the beginning of the year was as follows:

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines for System Foreign Currency Operations reaffirmed by the Federal Open Market Committee on March 3, 1964, as amended October 20, 1964; provided that the aggregate amount of foreign currencies held under reciprocal currency arrangements shall not exceed $2.35 billion equivalent at any one time, and provided further that the aggregate amount of foreign currencies held as a result of outright purchases shall not exceed $150 million equivalent at any one time:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs
Belgian francs
Canadian dollars
Austrian schillings
Swedish kronor
Japanese yen

The Federal Reserve Bank of New York is also authorized and directed to operate in any or all of the foregoing currencies in accordance with the Guidelines and up to a combined total of $200 million equivalent, by means of:

(a) purchases through forward transactions, for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements;

(b) purchases and sales through forward as well as spot transactions, for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies;

(c) purchases through spot transactions and concurrent sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations; and

(d) sales through forward transactions, for the purpose of influencing interest arbitrage flows of funds and of minimizing speculative disturbances.

The Federal Reserve Bank of New York is also authorized and directed to make purchases through spot transactions, including purchases from the U.S. Stabilization Fund, and concurrent sales through forward transactions to the U.S. Stabilization Fund, of any of the foregoing currencies in which the U.S. Treasury has outstanding indebtedness, in accordance with the Guidelines and up to a total of $100 million equivalent. Purchases may be at rates above par, and both purchases and sales are to be made at the same rates.

This directive was amended on five occasions during the year, as noted in the entries.

January 12, 1965

1. Authority to effect transactions in System Account.

As 1964 ended, according to reports at this meeting, domestic business activity was recovering vigorously from the effects of the automobile industry strikes in October and November. Industrial production was estimated to have risen to a new record level in December, about 7½ per cent above a year earlier. Automobiles were being produced in exceptionally large volume, and industry schedules called for high output rates to be maintained in the first quarter of 1965. Steel production also was expected to continue large, at least for a time; consumption of steel was high, and users were attempting to accumulate stocks as a precaution against a possible strike in the spring. Manufacturers' inventories, which had risen slowly earlier in the year, increased rapidly in October and November and probably also in December. Retail sales rose sharply in December and may have exceeded the high reached in the summer of 1964.

Estimates of various statistics for the fourth quarter as a whole reflected the effects of the work stoppages in the automobile industry. Gross national product, according to preliminary indications, rose much less than earlier in the year despite the substantial increase in the rate of inventory investment. Industrial production averaged only slightly higher than in the third quarter, and the increase in consumer spending was the smallest for any quarter in the current business expansion, which now had continued for nearly 4 years.

Nonfarm employment reached a new record high in December and the unemployment rate edged down to 4.9 per cent. In manufacturing, the rise during 1964 in compensation per employee—including fringe benefits, which continued to increase more rapidly than money wages—was on the average close to the administration's guideposts, and unit labor costs remained relatively stable. It was noted that the outcome of the contract negotiations in the steel industry would provide a major test of whether labor costs would continue stable.

Recent price movements did not suggest any significant change in the price situation, although some businessmen reportedly were expecting an inflationary price drift partly because of the nature of the steel industry settlement they anticipated. The industrial commodity price index, which had increased by four-tenths of 1 per cent in October, rose only two-tenths of a per cent further in November and one-tenth of a per cent in December, and average consumer prices in November continued 1.2 per cent above the year-earlier level.

For the year as a whole bank credit had expanded by about 8 per cent, the same as in 1963, and the money supply had increased by 4 per cent compared with 3.8 per cent in the prior year. Bank credit continued to expand in December, but by an amount considerably below the large increase in November as banks sold Treasury securities acquired late in the preceding month and security loans rose less than usually. Growth in the money supply also slowed in December, but time and savings deposits expanded at a rate slightly higher than their 12.6 per cent rise in the year as a whole. A large increase in non-borrowed reserves in December facilitated continued expansion in bank credit and deposits as member bank borrowings declined from the average levels prevailing before the late-November increase in the discount rate.

Money market conditions continued firm in late December and early January, a season in which they normally ease, partly as a result of a sharp shift of reserves to country banks and heavy dealer financing needs associated in part with the Treasury's advance refunding operation, announced on December 30. The refunding was accorded a highly favorable reception by investors, and yields on long-term U.S. Government bonds, which had moved up earlier in part because of market discussion of a possible major financing operation, changed little after its announcement. These yields currently were at about the levels that had prevailed at the beginning of 1964 and again shortly after the November discount rate action. Despite the firmness in the money market, the 3-month Treasury bill rate declined from 3.85 per cent in mid-December to 3.77 per cent on the day preceding this meeting, mainly as a result of the refunding and usual seasonal demands for bills.

The deficit in the U.S. balance of payments was estimated to have increased sharply in the fourth quarter, largely because of a marked increase in capital outflows through foreign security issues in the United States and lending by U.S. banks abroad. Indeed, outflows of private capital were at record or near-record levels throughout the year. Short-term capital outflows were heavy in the first half but diminished later as outflows on long-term bank loans and foreign security issues rose. The deficit for the full year, which seemed likely to exceed $2.5 billion, was below the 1963 deficit of $3.3 billion as a result of a marked expansion in net receipts from transactions in goods and services, including income from foreign investment.

Foreign exchange markets had continued in an unsettled state in recent weeks. Sterling was under intermittent pressure, and the demand for gold on the London market was heavy at times. Among the factors contributing to the market unsettlement were uncertainties on the part of participants about the outlook for sterling and press reports that France would increase its gold purchases from the United States substantially.

The Committee decided that a change in policy was precluded at this time by the Treasury's advance refunding, the settlement date for which was January 19. The members agreed that the problems of the U.S. balance of payments and the international position of the dollar had become increasingly serious recently. Some members indicated that if a Treasury financing had not been in process they would have favored reducing the availability of bank credit somewhat as a means of contributing to a solution of these problems. In their judgment such an action would not adversely affect the domestic economy; and it was noted that, if specific measures also were adopted to curtail the volume of bank lending abroad, the availability of credit to domestic borrowers could be affected less than total supply. Other members indicated that they favored no change in policy at present, even apart from the Treasury financing, on the grounds that under current domestic circumstances it was preferable to use selective measures for dealing with the international financial problems.

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

In light of the economic and financial developments reviewed at this meeting, and taking the current Treasury refunding into account, it remains the Federal Open Market Committee's current policy to facilitate continued expansion of the economy by accommodating moderate growth in the reserve base, bank credit, and the money supply, while seeking to avoid the emergence of inflationary pressures and to strengthen the international position of the dollar, particularly in view of the current unsettlement in financial markets abroad.

To implement this policy, and recognizing that international uncertainties and shifting seasonal pressures require a larger than usual degree of flexibility in operations, 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, Hayes, Balderston, Daane, Hickman, Mitchell, Robertson, Shepardson, Shuford, Swan, and Wayne. Votes against this action: None.

2. Authority to purchase and sell foreign currencies.

On recommendation of the Special Manager of the System Open Market Account, the Committee amended the second paragraph of its continuing authority directive for System foreign currency operations to increase the combined dollar limit on forward transactions of the several authorized types by $75 million to $275 million. With this amendment, the paragraph read as follows:

The Federal Reserve Bank of New York is also authorized and directed to operate in any or all of the foregoing currencies in accordance with the Guidelines and up to a combined total of $275 million equivalent, by means of:

(a) purchases through forward transactions, for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements;

(b) purchases and sales through forward as well as spot transactions, for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies;

(c) purchases through spot transactions and concurrent sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations; and

(d) sales through forward transactions, for the purpose of influencing interest arbitrage flows of funds and of minimizing speculative disturbances.

Votes for this action: Messrs. Martin, Hayes, Balderston, Hickman, Mitchell, Robertson, Shepardson, Shuford, Swan, and Wayne. Votes against this action: None.

This amendment was made after the Special Manager indicated that a substantial part of the $200 million authorized earlier for forward transactions currently was committed and that he might have occasion to engage in further useful operations of these types in the near future.

February 2, 1965

Authority to effect transactions in System Account.

Information presented at this meeting indicated that domestic business activity was continuing to expand, while the U.S. international payments position had worsened in late 1964.

Employment increased substantially in December, although the unemployment rate was little changed. Industrial production and retail sales reached new record levels in December, and it appeared that both were rising somewhat further in early January. New orders for durable goods increased in December despite a decline in defense orders. Upward pressures on some commodity prices were evident, but improvement in supplies had reduced pressure in markets for certain nonferrous metals, where the largest price advances had occurred in 1964. At the end of January average prices of common stocks were at record highs.

Much of the support for recent advanced levels of industrial activity was contributed by increased inventory accumulation; for the fourth quarter as a whole business inventories rose at a rate twice that earlier in the year. Record sales of automobiles were limiting replenishment of dealer stocks depleted during the strike period, but steel users were continuing to increase stocks in anticipation of a possible spring strike in that industry. Inventories of other goods also were expanding, including consumer durable goods other than automobiles.

The administration's budget message, recently transmitted to the Congress, suggested that fiscal policy would be more stimulative in the second half of the calendar year 1965 than in the first half. The projected patterns of expenditures and receipts implied a larger-than-usual swing in the cash budget from a first-half surplus to a second-half deficit. The additional fiscal stimulus expected after midyear stemmed mainly from proposed increases in social security benefit payments and grants to State and local governments and reductions in excise taxes.

The money supply, which had risen more slowly in December than earlier, increased substantially in early January but was estimated to have declined later in the month. Commercial bank time and savings deposits were expanding unusually sharply, suggesting that banks were competing successfully for savings flows under the new higher ceilings established under Regulation Q. A marked strengthening in business loans at city banks in early January was related in part to inventory accumulation and may also have reflected increased foreign lending. Free reserves at member banks averaged about $90 million in January, compared with a December average of about $130 million.

Some hesitancy had developed recently in security markets as a result of growing investor concern over possible implications of balance of payments developments for monetary policy. Since mid-January the 3-month Treasury bill rate had risen about 10 basis points to a level of 3.88 per cent. In the latter part of January yields on long-term Treasury issues also advanced somewhat as dealers continued to distribute securities acquired in the January advance refunding. Subscription books were open on the day preceding this meeting for the Treasury's regular February refunding, which involved a cash sale of a

21-month note to refinance the $2.2 billion of securities maturing at midmonth that remained outstanding.

The U.S. balance of payments deficit in 1964 was now estimated at $3 billion, well above earlier expectations. Half of the 1964 deficit was incurred in the fourth quarter alone; loans to foreigners by domestic banks rose sharply, and a large volume of foreign security issues was sold in the United States. Outflows of short-term bank loans and liquid funds were particularly heavy in December, although fragmentary data suggested that some of these flows were reversed in January. It was expected that an administration message on special measures to deal with the balance of payments problem would be transmitted to the Congress shortly.

The Committee decided to modify its policy at this time by moving gradually toward slightly firmer money market conditions. In view of the moderate size of the Treasury's current financing and the relatively short maturity of the security to be issued, the Committee agreed that as strict an adherence to an "even keel" policy as was usual during Treasury operations was not required at present. Because of this financing, however, and because distribution of the securities issued in the January advance refunding was still in process, it was decided that the policy change should be implemented cautiously. The objectives sought included some reduction in growth rates of bank credit and the money supply and moderately higher short-term interest rates, all of which would require moderately lower reserve availability.

This action was taken primarily because of the persistence of the deficit in the U.S. balance of payments and the recent sharp increase in capital outflows, and it was hoped that it would buttress the administration's expected program of special measures to strengthen the international position of the dollar. The Committee concluded that the action would not have injurious domestic effects in light of the strength of the economy. Some members thought that a slight reduction in monetary ease also was appropriate on domestic grounds in view of the latent inflationary pressures they saw, and some expressed the view that it would tend to sustain the current expansion by helping to avoid speculative excesses.

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

In light of the economic and financial developments reviewed at this meeting, including the generally strong and continuing expansion of the domestic economy and the continuing adverse position of our international balance of payments, it remains the Federal Open Market Committee's current policy to accommodate growth in the reserve base, bank credit, and the money supply but at a more moderate pace than in recent months. This policy seeks to avoid the emergence of inflationary pressures and to support other measures that may be taken to strengthen the international position of the dollar.

To implement this policy, while taking into account Treasury financing, System open market operations over the next 4 weeks shall be conducted with a view to moving toward slightly firmer conditions in the money market than have prevailed in recent weeks.

Votes for this action: Messrs. Martin, Hayes, Balderston, Daane, Hickman, Mills, Shepardson, Shuford, Swan, and Wayne. Votes against this action: Messrs. Mitchell and Robertson.

Messrs. Mitchell and Robertson dissented from this action because they believed that additional monetary restraint was not warranted either by present domestic conditions or by the balance of payments situation. They noted that the present high levels of demand for steel and automobiles were likely to be only temporary, and that any expansive effects of the Federal fiscal program would not be felt until the second half of the year. As to the balance of payments, they thought that—in view of the large differentials existing between interest rates in the United States and abroad—a policy change large enough to reduce capital outflows significantly would have severe deflationary effects on the economy. For this reason, Mr. Robertson felt that the appropriate remedy for the international payments problem lay elsewhere than in the area of monetary policy, and Mr. Mitchell thought it lay in specific measures to remove the disequilibrating effect of international interest rate differentials. Mr. Robertson added that in his judgment Treasury financing operations and the recent weakness in security markets also argued for keeping policy on a steady course at present.

March 2, 1965

1. Authority to effect transactions in System Account.

Economic activity was continuing to advance after four consecutive years of expansion. In January, steel and automobile production remained at high levels, and output gains in a broad variety of other industries carried total industrial production to a new peak. Retail sales continued strong in January and early February; sales of new domestic cars were at a record annual rate of 9.7 million units in the first month of the year. Although stock-sales ratios remained low, rough estimates suggested that the rate of inventory accumulation continued high in early 1965 after turning up sharply in the closing months of 1964. Much of the accumulation still was related to strikes—both the possible strike in steel and the earlier strike in automobiles—but stocks of other commodities apparently also were growing rapidly. Labor markets were strong in January: nonfarm employment increased further; the average manufacturing workweek was extended to the longest period since World War II; and the unemployment rate declined to 4.8 per cent from 5 per cent in December.

Average industrial commodity prices, which had risen six-tenths of 1 per cent in the fourth quarter of 1964, edged up one-tenth of a per cent in January. Weekly estimates through mid-February suggested no further change, and the average remained within the broad range of recent years.

Growth in commercial bank credit accelerated in January and early February, and banks reduced their holdings of Government securities to help accommodate record demands for business loans. Part of the exceptional rise in business loan volume reflected various temporary factors, but part was due to the general strength of business activity. Time and savings deposits at commercial banks continued to expand rapidly in response to the higher interest rates now being paid on such deposits. The money supply rose at a reduced rate in both December and January and declined in the first half of February. Recent money supply performance no doubt was affected by some transfers of funds from demand into time and savings deposits and, in early February, by a larger than usual rise in U.S. Government deposits. Member bank borrowings rose in February, and free reserves were estimated to have averaged about $30 million compared with a revised figure of $114 million in January.

Yields on U.S. Government securities had advanced recently, partly as a result of the somewhat reduced level of reserve availability and of market interpretations of that development as reflecting a mild shift in monetary policy. Rates on 3-month Treasury bills rose about 10 basis points in February to about the 4 per cent discount rate, and Government bond yields also increased slightly. Average prices of common stocks declined in early February but more recently returned to levels near their earlier highs.

In a message to the Congress on February 10, the President had set forth a program to improve the nation's balance of payments position. Steps subsequently were taken by the Federal Reserve System and the Department of Commerce, in cooperation with the Treasury Department, to implement the part of the program that called for voluntary efforts by banks, other financial institutions, and nonfinancial businesses to restrain foreign lending and investment. In January and early February, prior

to the Presidential message, the U.S. payments deficit had continued large, according to tentative data. Long-term bank loans to foreigners were particularly heavy, perhaps partly because of expectations that the interest equalization tax soon would be extended to such loans.

In the Committee's discussion of prospective business conditions, it was noted that the current high output rates for steel and automobiles probably were unsustainable—declines appeared likely in steel if and when the threat of a strike was removed and in automobiles after previous strike losses were made up—and that downturns in those industries might check the rate of over-all expansion. On the other hand, some members thought that the widespread nature of recent production gains suggested sufficient underlying strength in the economy to cushion the expected readjustments in steel and autos, and that prospects for sustained growth now appeared brighter than earlier.

The Committee concluded that over the next 3 weeks, while the President's balance of payments program was getting underway, it would be appropriate to maintain the slightly firmer money market conditions that had been achieved under the policy adopted at the meeting a month earlier. Some members, although not advocating a policy change at present, expressed concern about the recent high rate of growth in bank credit and indicated that a somewhat more restrictive policy might be necessary in coming months to achieve a reduction in that rate.

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

In light of the economic and financial developments reviewed at this meeting, including the generally strong and continuing expansion of the domestic economy and the continuing adverse position of our international balance of payments, it remains the Federal Open Market Committee's current policy to accommodate growth in the reserve base, bank credit, and the money supply but at a more moderate pace than in recent months. This policy seeks to support fully the national program to strengthen the international position of the dollar, and to avoid the emergence of inflationary pressures.

To implement this policy, System open market operations over the next 3 weeks shall be conducted with a view to maintaining the slightly firmer conditions in the money market that have prevailed in recent weeks.

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

Messrs. Balderston, Ellis, and Shepardson dissented from this action because they favored a further slight firming of money market conditions. Mr. Balderston noted that bank credit had expanded at a considerably higher rate than GNP throughout the current business expansion. This, in his judgment, had added to the volume of funds seeking investment abroad and might have created potentially inflationary pools of liquidity. Messrs. Ellis and Shepardson observed that if the program to restrain foreign lending by U.S. banks was effective, more funds presumably would be available for domestic loans, thus adding to what they considered to be an undesirably high rate of domestic bank lending. Mr. Ellis thought that a firmer monetary policy might result, beneficially, in the deferral of some current domestic demands and indicated that he also favored such a policy for balance of payments reasons.

2. Amendment of continuing authority directive.

The Committee amended Section 1(c) of the continuing authority directive to the Federal Reserve Bank of New York relating to transactions in U.S. Government securities and bankers' acceptances to remove the maturity limitation on Government securities that might be held under repurchase agreements with nonbank dealers during Treasury refunding operations. The directive previously in effect, as set forth in the preface to this record of Federal Open Market Committee policy actions for 1965, limited Government securities acquired under repurchase agreements to those having maturities of 24 months or less at the time of purchase. The new directive authorized repurchase agreements involving Government securities of any maturity during any period beginning the day after the Treasury had announced a refunding operation and ending on the settlement date for the exchange. As amended, Section 1(c) of the continuing authority directive read as follows:

To buy U.S. Government securities with maturities as indicated below, and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, from nonbank dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or acceptances in 15 calendar days or less, at rates not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower; provided that in the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market. U.S. Government securities bought under the provisions of this section shall have maturities of 24 months or less at the time of purchase, except that, during any period beginning with the day after the Treasury has announced a refunding operation and ending on the day designated as the settlement date for the exchange, the U.S. Government securities bought may be of any maturity.

Except for the change resulting from this amendment the directive was renewed in its existing form.

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

Under the provisions of the previous directive it had been the practice of the Account Management to terminate any repurchase agreements against "rights" (securities eligible for exchange in a Treasury refunding) when the dealer by whom they were to be repurchased entered a subscription to exchange the rights in question for new securities offered by the Treasury with maturities of 24 months or more. During some Treasury refundings such terminations had proved to be inconvenient from the point of view of efficient market operations. Accordingly, the Committee decided to amend the directive so that they would no longer be required.

3. Authority to purchase and sell foreign currencies.

The Committee approved a number of revisions in the guidelines for System foreign currency operations, the purposes of which were (1) to delete passages relating to the original launching of operations in foreign currencies in 1962 and passages that had been found by experience to be unnecessarily detailed; (2) to consolidate certain provisions that had been incorporated into the guidelines at different times into a form that lent itself more readily to operational requirements; and (3) to clarify the language at a number of points. The guidelines previously in effect are shown in the preface to this record of policy actions. As amended, the guidelines read as follows:

1. Holdings of Foreign Currencies

Until otherwise authorized, the System will limit its holdings of foreign currencies to that amount necessary to enable its operations to exert a market influence. Holdings of larger amounts will be authorized only when the U.S. balance of international payments attains a sufficient surplus to permit the ready accumulation of holdings of major convertible currencies.

Foreign currency holdings shall be invested as far as practicable in conformity with Section 14(e) of the Federal Reserve Act.

2. Exchange Transactions

System exchange transactions shall be geared to pressures of payments flows so as to cushion or moderate disequilibrating movements of funds and their destabilizing effects on U.S. and foreign official reserves and on exchange markets.

In general, these transactions shall be geared to pressures connected with movements that are expected to be reversed in the foreseeable future; when expressly authorized by the Federal Open Market Committee, they may also be geared on a short-term basis to pressures connected with other movements.

Subject to express authorization of the Committee, the Federal Reserve Bank of New York may enter into reciprocal arrangements with foreign central banks on exchange transactions ("swap" arrangements), which arrangements may be wholly or in part on a standby basis.

Drawings made by either party under a reciprocal arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

The New York Bank shall, as a usual practice, purchase and sell authorized currencies at prevailing market rates without trying to establish rates that appear to be out of line with underlying market forces.

If market offers to sell or buy intensify as System holdings increase or decline, this shall be regarded as a clear signal for a review of the System's evaluation of international payments flows.

It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions in order that System transactions do not conflict with those being undertaken by foreign monetary authorities.

3. Transactions in Spot Exchange

The guiding principle for transactions in spot exchange shall be that, in general, market movements in exchange rates, within the limits established in the International Monetary Fund Agreement or by central bank practices, index affirmatively the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public.

Temporary or transitional fluctuations in payments flows may be cushioned or moderated whenever they occasion market anxieties, or undesirable speculative activity in foreign exchange transactions, or excessive leads and lags in international payments.

Special factors making for exchange market instabilities include (i) responses to short-run increases in international political tension, (ii) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, or (iii) market rumors of a character likely to stimulate speculative transactions.

Whenever exchange market instability threatens to produce disorderly conditions, System transactions are appropriate if the Special Manager, in consultation with the Federal Open Market Committee, or in an emergency with the members of the Committee designated for that purpose, reaches a judgment that they may help to re-establish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified, curtailed, or eventually discontinued pending a reassessment by the Committee of supply and demand forces.

Insofar as is practicable, the New York Bank shall purchase a currency through spot transactions at or below its par value, and sell a currency through spot transactions at rates at or above its par value.

Spot transactions at rates other than those set forth in the preceding paragraph shall be specially authorized by the Committee or by the members of the Committee designated in Section VIII of the Authorization for Open Market Transactions in Foreign Currencies, except that purchases of exchange to meet System commitments may be executed without special authorization at rates above par when necessary.

4. Transactions in Forward Exchange

Transactions in forward exchange, either outright or in conjunction with spot transactions, may prove desirable:

(1) When forward premiums or discounts are inconsistent with interest rate differentials and are giving rise to disequilibrating movements of short-term funds;

(2) When it is deemed appropriate to supplement existing market supplies of forward cover, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders;

(3) To allow greater flexibility in covering System commitments, including those under swap arrangements;

(4) To facilitate the use of holdings of one currency for the settlement of commitments denominated in other currencies.

Forward sales of authorized currencies to the U.S. Stabilization Fund out of existing System holdings or in conjunction with spot purchases of such currencies may also prove desirable in order to allow greater flexibility in covering commitments of the U.S. Treasury.

In all other cases, proposals of the Special Manager to initiate forward operations shall be submitted to the Committee for advance approval.

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

4. *Review of continuing authorizations.*

This being the first meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1965, and their assumption of duties, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. The actions taken with respect to the continuing authority directive for domestic open market operations and the guidelines for System foreign currency operations have been described in the preceding portions of the entry for this date.

The Committee reaffirmed its authorization regarding open market transactions in foreign currencies and its continuing authority directive on foreign currency operations, in the form in which they were outstanding at the beginning of the year 1965, as set forth in the preface to this record of policy actions.

Votes for these actions: Messrs. Martin, Hayes, Balderston, Bryan, Daane, Ellis, Mitchell, Scanlon, Shepardson, and Clay. Votes against these actions: None.

March 23, 1965

1. *Authority to effect transactions in System Account.*

The domestic business situation continued strong, according to reports at this meeting. Industrial production, retail sales, and nonfarm employment all rose to new record levels in February, although the unemployment rate returned to 5.0 per cent after dipping to 4.8 per cent in January. Weekly estimates suggested that average industrial commodity prices remained stable from mid-January through early March at a level less than 1 per cent above that prevailing in the first 9 months of 1964.

The near-term outlook appeared generally favorable despite uncertainties related to labor negotiations in the steel industry and to apparently unsustainable rates of activity in steel and automobiles. As to the latter, it seemed doubtful that sales of new cars would maintain the exceptionally high rate set in the first 2 months of 1965, which was about one-fifth above the year-earlier level. On the other hand, a survey by the U.S. Department of Commerce and the Securities and Exchange Commission of business plans for plant and equipment expenditures, taken in February, implied that capital outlays would grow throughout 1965, and for the year as a whole would average about 12 per cent above their 1964 level.

Bank credit expanded at an annual rate of about 11½ per cent in the first 2 months of the year, considerably above the 8 per cent rise in 1964, and time and savings deposits continued to increase rapidly. In addition to meeting strong loan demands, banks added to their holdings of municipal issues, while substantially reducing their holdings of Treasury bills. Credit growth continued rapid in early March, according to data for city banks, but the rate of increase in time and savings deposits moderated. The money supply, which had declined in February, advanced sharply in the first half of March. Aggregate borrowings of member banks from the Reserve Banks were greater than their excess reserves in the first 3 weeks of March, with net borrowed reserves averaging about $40 million; in February excess reserves had exceeded borrowings by about $30 million.

Interest rates on most money market instruments continued firm or rose in recent weeks against the background of seasonally heavy liquidity needs associated with the March corporate dividend and tax dates, but the 3-month Treasury bill yield had declined about 5 basis points since early March to 3.92 per cent. The disparate behavior of bill yields apparently partly

reflected temporary investments in bills of corporate funds being repatriated under the administration's program calling for voluntary efforts to restrain foreign lending and investment; any concomitant liquidation of dollar assets by foreign holders may have involved a broader variety of instruments. Treasury bond yields also declined, and yields on corporate and municipal bonds, which had advanced from late January to early March, stabilized at about the levels prevailing in the autumn of 1964.

The Treasury's gold stock declined by $825 million in the first 11 weeks of 1965, after decreasing by only $125 million in all of 1964. Although little firm statistical information was available as yet on the impact of the administration's balance of payments program, announced February 10, incomplete weekly figures suggested a surplus in the over-all U.S. payments balance in the most recent 4 weeks, following substantial deficits in the preceding 6 weeks. Outflows on long-term bank loans to borrowers in developed countries apparently dropped abruptly after mid-February from their high rate earlier in the year. Consistent with this development and also with larger than seasonal withdrawals of U.S. corporate funds from the Euro-dollar market, interest rates advanced in that market, and the dollar strengthened in markets for foreign exchange.

The Committee decided that a further slight firming of money market conditions was desirable at this time. The object, in part, was to reinforce the program of voluntary efforts to restrain foreign lending and investment, but the action also was considered appropriate in view of the strength of the domestic economy and the potential threat to general price stability that might be posed by a continuation of recent high rates of bank credit expansion. Other reasons cited by some members for a slight firming in policy were the recent decline in Treasury bill rates—considered undesirable on balance of payments grounds—and the fact that repatriation of funds formerly invested abroad added to the availability of credit to domestic borrowers.

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, System open market operations over the next 3 weeks shall be conducted with a view to attaining slightly firmer conditions in the money market.

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

Messrs. Mitchell, Robertson, and Clay dissented from this action on both domestic and balance of payments grounds. In their judgment the likely pace of the advance in business activity did not call for a firmer policy, particularly in view of the declines expected before long in the steel and automobile industries. In connection with the balance of payments, Messrs. Robertson and Clay felt that the recently launched administration program also provided grounds for not changing policy at this time. None of the dissenting members thought a change in policy was called for by the recent decline in Treasury bill rates relative to other money market rates. Mr. Robertson did not consider international bill rate differentials to be a good measure of rate incentives to capital flows; moreover, there appeared to be a reflux of short-term funds, rather than an outflow, at present. In Mr. Mitchell's judgment, higher Euro-dollar interest rates could give foreign central banks a desirable incentive to dispose of some of their dollar holdings to their own nationals

to relieve pressures in that market, and it would be a mistake to offset any such tendency by higher U.S. interest rates.

2. Authority to purchase and sell foreign currencies.

On March 2, 1965, the Committee had approved a number of revisions in the guidelines for System foreign currency operations. At this meeting the Committee approved further revisions, affecting the first and second paragraphs of Section 4 of the guidelines, for the purpose of language clarification. The revisions in both paragraphs involved replacing the words, "may prove desirable" with the words, "may be undertaken." As amended, Section 4 of the guidelines read as follows:

> 4. Transactions in Forward Exchange
>
> Transactions in forward exchange, either outright or in conjunction with spot transaction, may be undertaken:
>
> (1) When forward premiums or discounts are inconsistent with interest rate differentials and are giving rise to disequilibrating movements of short-term funds;
>
> (2) When it is deemed appropriate to supplement existing market supplies of forward cover, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders;
>
> (3) To allow greater flexibility in covering System commitments, including those under swap arrangements;
>
> (4) To facilitate the use of holdings of one currency for the settlement of commitments denominated in other currencies.
>
> Forward sales of authorized currencies to the U.S. Stabilization Fund out of existing System holdings or in conjunction with spot purchases of such currencies also may be undertaken in order to allow greater flexibility in covering commitments of the U.S. Treasury.
>
> In all other cases, proposals of the Special Manager to initiate forward operations shall be submitted to the Committee for advance approval.

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

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 rise of 12 per cent indicated in the Commerce–SEC survey, employing somewhat different methods, that had been conducted in February.

Industrial production evidently increased less in April than in other recent months; output gains in a variety of industries were partly offset by a reduction of 5 per cent in automobile assemblies from their record March level. Nonagricultural employment was about unchanged, and the seasonally adjusted unemployment rate rose to 4.9 per cent from 4.7 per cent in March because of a larger than usual increase in teenagers seeking work. Retail sales, which had declined 2 per cent in March from the February peak, eased slightly further in April, according to preliminary data, but remained high.

Recent information confirmed that businesses had continued to accumulate inventories at a rapid rate in the first quarter. Most of the rise was at distributors, particularly wholesalers and retail automobile dealers. Manufacturers' stocks, which had increased by a large amount in the fourth quarter, subsequently rose only moderately although steel stockpiling continued at a substantial pace.

Average industrial prices edged up in April as further advances occurred in some sensitive commodity prices. The consumer price index increased slightly in March but continued 1.2 per cent above its level a year earlier. Common stock prices reached a record high in early May.

Some of the temporary factors that earlier had stimulated business loan demand at commercial banks abated in April, and bank credit expansion moderated from the near-record first-quarter rate to about the average rate of 1964. Loan demand remained vigorous, however, and a further sharp increase in business loans occurred at city banks in early May. The money supply rose at a 5.3 per cent annual rate in April, as it had in March, but growth in time and savings deposits slackened further.

Average net borrowed reserves of member banks increased to about $130 million in April from $50 million in the preceding month, and money market conditions remained generally firm. Bond yields moved up slightly or held close to earlier highs, and the tone in corporate and municipal bond markets was generally cautious in the face of large May calendars of public offerings. However, yields on 3-month Treasury bills declined several basis points recently, to 3.88 per cent, under pressure of strong demands, including demands from sellers of "rights" in the Treasury's May refunding, and substantial official purchases. In the refunding, holders of maturing issues were offered a choice of a 15-month, 4 per cent note (priced to yield about 4.12 per cent) or a 9 year, 4¼ per cent bond (priced to yield about 4.22 per cent) with settlement scheduled for May 17. The refunding was well received by the market and public subscriptions to the 4¼ per cent bonds were somewhat larger than most market participants had expected.

Surpluses were recorded in U.S. international payments in March and April, according to early indications, in contrast to large deficits in the first 2 months of the year. The improvement reflected a significant decline in outflows on domestic bank loans to foreigners and a substantial reflux of U.S. liquid funds from abroad, as well as a sharp rise in exports resulting from the end of an earlier longshoremen's strike. Further sales of gold by the Treasury to foreign monetary authorities brought the total reduction in the U.S. gold stock thus far in 1965 to nearly $1 billion.

The Committee agreed that in view of the current Treasury financing it was appropriate to maintain an "even keel" in money markets for the next 2 weeks. Recent signs of moderation in the pace of the business advance and in bank loan demand also were offered as reasons for continuing policy unchanged. On the other hand, several members indicated that they thought it would be desirable to consider seeking somewhat firmer money market conditions and slower growth in member 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.
>
> 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.

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.

Prices of common stocks, which had declined further in late June to a level about 10 per cent below their mid-May peak, subsequently recovered about half of that loss. The continued strength in retail sales, and the fact that no important reappraisals of business plans for fixed capital expenditures had been reported, suggested that the earlier stock market decline had had little effect on spending.

Although the rate of business inventory accumulation decreased in May, according to preliminary data, automobile dealers added further to their relatively large inventories of new cars, and stocks of steel continued to rise rapidly. There was some evidence suggesting that growth in aggregate inventories thus far in 1965 might have been greater than indicated by official figures.

The consumer and wholesale price indexes advanced in May, to levels 1.7 and 2.0 per cent, respectively, above a year earlier, and average wholesale prices rose further in June. Higher prices for foods continued to account for most of the increases. However, wholesale prices of industrial commodities were estimated to have risen by about three-fourths of 1 per cent in the first half of the year, following a rise of a similar amount in the fourth quarter of 1964.

Bank credit expanded substantially more in June than in April or May, as strong underlying demands for loans were augmented by various temporary factors, including heavy borrowing for corporate tax and dividend payments at midmonth. The money supply also increased sharply in June, bringing the annual rate of growth for the first half of 1965 to about 2.5 per cent, and time deposit expansion accelerated from its reduced May pace. Net borrowed reserves of member banks averaged about $180 million in June and the first week of July, as compared with an average of $160 million in May.

Money market conditions remained generally firm in recent weeks. On most days the effective rate on Federal funds was

4⅛ per cent, and a few transactions in such funds reportedly were executed at one-fourth of a percentage point above the 4 per cent discount rate. Yields on 3-month Treasury bills continued to drift down in the latter part of June, but subsequently they rose about 10 basis points to levels above 3.85 per cent. The rise in bill rates was attributable in part to light investor demand and higher borrowing costs to dealers. Also important, however, was the fact that the Federal Reserve met the substantial reserve needs of the period mainly by purchases of longer-term Treasury securities, acquisitions of bills in direct transactions with foreign accounts, and other means, rather than—as many traders had expected—by sizable purchases of Treasury bills in the market.

In long-term security markets yields on new corporate bonds receded slightly from their mid-June peaks but were still about one-quarter of a percentage point above their levels early in the year; State and local bond yields continued under upward pressure; and yields on Treasury notes and bonds showed little net change. It was expected that late in July the Treasury would announce the terms on which securities maturing in mid-August would be refunded. About $3.2 billion of these securities were held by the public.

Tentative estimates indicated a surplus in U.S. international payments in the second quarter of about $200 million, seasonally adjusted. Much of the marked improvement from the large deficit of the first quarter reflected the initial impact of the administration's balance of payments program, particularly on bank credit flows; in contrast to the large first-quarter outflows of bank credit, there were inflows in the form of net repayments in April and May. Also, the trade surplus increased in the second quarter, because delays in shipments caused by the earlier dock strike were greater for exports than for imports.

It did not appear likely that all of the second-quarter improvement in the payments balance would be sustained, and the reappearance in the second half of 1965 of at least a moderate deficit seemed probable. By the end of May aggregate foreign loans of U.S. banks were below the target levels established under the voluntary foreign credit restraint program, thus leaving room for a resumption of net outflows later in the year. Also, recent trends in U.S. merchandise trade, while partly obscured by distortions due to the dock strike, suggested that the gain in U.S. exports from 1964 to 1965 would not be large and might well be substantially less than the rise in imports, with a consequent reduction in the trade surplus.

In the course of the discussion some members of the Committee characterized the domestic business outlook as strong and expressed concern about recent and prospective price developments, the renewed rapid increase in bank credit, and the longer-term outlook for the balance of payments. These considerations, they thought, offered some grounds for seeking a firmer tone in the money market. At the same time certain of these members, as well as others, doubted that a modest policy change would have significantly useful effects under prevailing conditions, and they felt that a larger change was undesirable partly because of the expected Treasury financing. Also, some members noted that an overt change in money market conditions might require an increase in the Federal Reserve discount rate, a step they did not favor at present. However, the view also was expressed that a discount rate increase would be appropriate if bank credit continued to expand at a rapid pace, and that a modest firming of policy now would provide a better basis for such action later.

Other members—noting the possibility of inventory adjustments later in the year and indications that final demands were not likely to expand as rapidly as productive capacity—were less confident about prospects for the economy. In their judgment neither domestic price and bank credit developments nor the balance of payments situation warranted a firmer policy;

indeed, they believed that the Committee shortly might find it necessary to move in the direction of greater ease. Still other members found little basis in current domestic and international circumstances for either firmer or easier money market conditions.

While their reasons differed, at the conclusion of the discussion all but one member of the Committee agreed that no change should be made in policy at this time. 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 slower pace than in the first quarter. Reflecting the large initial impact of the administration's balance of payments program, there was a surplus in our international payments in the second quarter. In this situation, and with gold outflows continuing, 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, and taking into account the forthcoming Treasury financing, 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, Balderston, Bryan, Daane, Galusha, Maisel, Mitchell, Robertson, Scanlon, Shepardson, and Treiber. Vote against this action: Mr. Ellis.

Mr. Ellis dissented from this action because he favored a further slight step toward less ease similar to the several such actions the Committee had taken during the past 12 months. In his judgment this would help to hold any autumn credit surge within bounds; and, if credit demands should weaken, it would have established a base from which a policy move toward ease would have greater impact.

August 10, 1965

1. Authority to effect transactions in System Account.

Business activity expanded further in July, and the outlook for coming months was affected by a number of developments, including a Presidential announcement on July 28 of a planned enlargement of U.S. military efforts in Viet Nam. The additional defense spending presently planned did not appear large enough in itself to result in excessive levels of aggregate demand or in widespread production bottlenecks, but the volume of expenditures that might ultimately prove necessary was, of course, impossible to foresee. Amendments to the Social Security Act signed into law on July 30 provided, among other things, for increases in benefit payments retroactive to the first of the year, which appeared likely to add to consumer spending. On the other hand, it was expected that production for inventory would abate later in the year from its current rate. In particular, steel output was likely to decline after September 1—when the 4-month interim labor agreement was scheduled to expire—even if a settlement was reached, as users worked off stocks accumulated as a precaution against a strike.

In July the rate of unemployment declined to 4.5 per cent, the lowest monthly rate since October 1957, despite a sharp rise in the labor force. Early indications were that industrial production rose further to a new peak, and retail sales, which had edged down in June, were tentatively estimated to have exceeded their previous high. These July gains followed a second quarter in which, according to preliminary Department of Commerce estimates, GNP rose at a seasonally adjusted annual rate of about $9 billion—less than the unusual first-quarter advance of $14 billion, but more than had been generally expected.

Average wholesale prices of industrial commodities apparently changed little in July. Increases for some basic commodities, related to developments in Viet Nam, proved—with the exception of copper—to be largely temporary. The consumer price index advanced one-half of 1 per cent in June as prices of foods rose further.

At commercial banks business loans continued to grow rapidly in July. Total bank credit probably declined a little during the month, however, as a result of repayments of various kinds of temporary credits that had contributed to the large increase in June and of further reductions in bank holdings of Government securities. Growth in the money supply was less rapid than in June, but time deposits expanded at the highest rate since February. Average net borrowed reserves of member banks, at about $180 million, were unchanged from June.

Securities markets were characterized by a cautious tone in recent weeks as a result of uncertainties relating both to developments in Viet Nam and to continued intermittent pressures on sterling in markets for foreign exchange. Treasury note and bond yields edged up in late July and early August, and the 3-month Treasury bill rate, after declining in the latter part of July, advanced somewhat in early August to levels in the neighborhood of 3.85 per cent. Despite such market weakness, the Treasury's mid-August refunding, which involved slightly more than $3 billion in publicly held maturing securities, was well received.

The U.S. balance of payments continued in surplus in July, according to tentative estimates. Available data for June, however, provided further indications of a deterioration in the trade surplus; exports were about unchanged from the level of the previous autumn but imports were sharply higher.

On July 27 Britain announced further measures designed to improve its external position. There was no substantial abatement of exchange market pressures on sterling, however, partly because of uncertainties arising from published figures indicating further reductions in Britain's international reserves in July. Most recently, publication of British foreign trade figures for July revealed a substantial increase in that country's exports.

Members of the Committee differed somewhat in their assessment of the forces affecting the outlook for the domestic economy. They agreed, however, that no change should be made in policy at this time, particularly in light of the various uncertainties presently existing at home and abroad. The current Treasury financing, although moderate in size and about to be completed, also was advanced as providing some ground for maintaining present policy.

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 that the domestic economy has expanded further, but at a slower pace than early in the year, and that the improvement in our international payments that occurred in the second quarter has been maintained for the time being, although gold outflows have continued and international developments are creating uncertainties in securities and foreign exchange markets. In this situation, it remains the Federal Open Market Committee's current policy 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, while taking into account the Treasury financing about to be completed and the unsettled conditions in securities and foreign exchange markets.

Votes for this action. Messrs. Martin, Balderston, Galusha, Maisel, Mitchell, Robertson, Scanlon, Shephardson, Bopp, Irons, and Treiber. Votes against this action: None.

2. Authority to purchase and sell foreign currencies.

At this meeting the Committee revised its continuing authority directive for transactions in foreign currencies in two respects.

One revision involved a change, from $2.65 billion to $2.8 billion, in the dollar limit specified in the first paragraph of the directive on the aggregate amount of foreign currencies held under reciprocal currency arrangements. As indicated in Section 2 of the entry for March 23, 1965, it had been the Committee's practice to set this limit at the sum of the amounts currently specified by the Committee for all individual authorized reciprocal currency arrangements. Today's revision was made because earlier in the present meeting the Committee had ratified an increase in the size of the reciprocal currency arrangement with the Bank for International Settlements from $150 million to $300 million. The second revision involved the addition of a new final paragraph to the directive authorizing purchases of sterling by the Federal Reserve Bank of New York on a covered or guaranteed basis up to a total of $50 million equivalent, in addition to the foreign currency purchases authorized in preceding paragraphs. This supplementary authorization provided a further potential for cushioning or moderating disequilibrating movements of funds in foreign exchange markets.

Reflecting these revisions, the continuing authority directive for transactions in foreign currencies read as follows:

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines for System Foreign Currency Operations as amended March 23, 1965; provided that the aggregate amount of foreign currencies held under reciprocal currency arrangements shall not exceed $2.8 billion equivalent at any one time, and provided further that the aggregate amount of foreign currencies held as a result of outright purchases shall not exceed $150 million equivalent at any one time:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs

Belgian francs
Canadian dollars
Austrian schillings
Swedish kronor
Japanese yen

The Federal Reserve Bank of New York is also authorized and directed to operate in any or all of the foregoing currencies in accordance with the Guidelines and up to a combined total of $275 million equivalent, by means of:

(a) purchases through forward transactions, for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements;

(b) purchases and sales through forward as well as spot transactions, for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies;

(c) purchases through spot transactions and concurrent sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations; and

(d) sales through forward transactions, for the purpose of influencing interest arbitrage flows of funds and of minimizing speculative disturbances.

The Federal Reserve Bank of New York is also authorized and directed to make purchases through spot transactions, including purchases from the U.S. Stabilization Fund, and concurrent sales through forward transactions to the U.S. Stabilization Fund, of any of the foregoing currencies in which the U.S. Treasury has outstanding indebtedness, in accordance with the Guidelines and up to a total of $100 million equivalent. Purchases may be at rates above par, and both purchases and sales are to be made at the same rates.

The Federal Reserve Bank of New York is also authorized and directed to make purchases of sterling on a covered or guaranteed basis in terms of the dollar up to a total of $50 million equivalent.

Votes for this action: Messrs. Martin, Balderston, Daane, Galusha, Maisel, Mitchell, Robertson, Scanlon, Shepardson, Bopp, Irons, and Treiber. Votes against this action: None.

August 31, 1965

Authority to effect transactions in System Account.

Reports at this meeting confirmed earlier estimates that industrial production and retail sales had reached new highs in July. Production gains in both June and July were larger than in most earlier months of the year as a result of further advances in output of business equipment and of materials, including steel; consumer goods output continued to show little change at a level about 5 per cent above a year earlier. Manufacturers' inventories rose considerably in July, following three quarters in which total business inventories had increased at a more rapid rate than earlier in the current business expansion. The unemployment rate, which had declined to 4.5 per cent in July, remained at that level in August.

Business sentiment recently had become more buoyant, as activity continued to expand faster than had been expected and as prospects for further advances were enhanced by expected rises in military outlays in connection with the Viet Nam hostilities. To date, however, developments in Viet Nam did not appear to have given any sharp, direct stimulus to consumer or business spending, and the timing and amount of expected increases in military expenditures remained highly uncertain.

Additional major uncertainties were associated with the situation in the steel industry. Labor negotiations were still in process at the time of this meeting, and the interim agreement, originally scheduled to expire on September 1, had been extended 8 days at the request of the President. It was not clear whether a settlement would be arrived at without a strike, nor what the terms of the settlement would be. Also in doubt were the probable dimensions and timing of the reduction in steel inventories expected to follow the conclusion of a labor agreement; it was possible that the amount of liquidation, while still substantial, would be less than anticipated earlier, particularly if it appeared that military needs for steel would rise rapidly or if the terms of the labor agreement made future increases in steel prices more likely.

Average wholesale prices of industrial commodities, which were stable in July, appeared to have edged up in August, but changes continued selective, without any general response to developments in Viet Nam. The total wholesale price index was estimated to have declined slightly in August as a result of some reductions for foods, which had accounted for most of the rise in the index earlier in the year. The consumer price index rose slightly further in July, despite declines for some products resulting from reductions in excise taxes.

The demand for business loans at banks continued strong and commercial bank credit, which had declined in July, was expanding again in August. Growth of time deposits accelerated from the high July rate, but growth in the money supply moderated further. Average net borrowed reserves of member banks continued to show little change.

The latest information on U.S. international payments indicated that a deficit occurred in August and, contrary to earlier reports, that payments probably were in deficit in July also. Gold outflows continued, but at a lower rate than in the first half of the year. In foreign exchange markets, there had been some improvement recently in attitudes with respect to the outlook for sterling, but the situation remained delicate.

Conditions in domestic money markets generally were steady in recent weeks, although yields on 3-month Treasury bills rose several basis points. Bond markets weakened considerably. Treasury bond yields advanced to their highest levels since the spring of 1964, and yields on new issues of high-grade corporate bonds broke through their June peaks to levels not reached since the summer of 1961. To some extent, the rise in corporate

bond yields stemmed from unseasonally large recent and prospective flotations; and the rise in yields on Treasury bonds reflected the growing attractiveness of corporate yields for institutional investors. Also, dealer holdings of longer-term issues were still sizable, despite recent reductions as a result of official purchases. To a major extent, however, the yield advances reflected a shift in investor expectations regarding the economic outlook and the future course of interest rates. A variety of factors contributed to this shift, including the unexpectedly strong performance of the economy, developments in Viet Nam, uncertainties regarding the probable terms of the steel wage settlement, continued nervousness about the prospects for sterling, and the possibility that a firmer monetary policy might be required for domestic or balance of payments reasons.

The Committee decided that no change should be made in policy at this time, partly because of the various existing uncertainties. Cited in this connection were the uncertainties about the outcome of wage negotiations in the steel industry and about the likely magnitude and duration of the expected subsequent reduction in steel inventories; the lack of reasonably precise information regarding the probable impact of developments in Viet Nam on the economy; the still sensitive position of sterling in foreign exchange markets; and the possibility that, in view of the recent weakening in bond prices, domestic security markets might over-react to any firming of monetary policy, however modest was the intended change.

Some members who agreed that such factors made a policy change inappropriate at present indicated that in the absence of these factors they might have been inclined toward a shift in the direction of firming. Among the grounds for firming mentioned by members in this group were the strength in the business outlook and the prospects for further price advances; the continued rapid growth in business loans at banks; and the recently less favorable balance of payments situation. Other members expressed the view that even apart from the existing uncertainties a firmer policy was not warranted at present. In their judgment a reduction in the rate of over-all inventory accumulation was likely to act as an offset to the economic stimulus of developments in Viet Nam, and they saw little ground at the moment for expecting inflationary pressures to develop in the near future.

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 that the domestic economy has expanded further, but with markets characterized by uncertainties as to possible developments in steel, sterling, and Viet Nam. Our international payments have reverted to deficit in August, and gold outflows have continued, although at a more moderate rate. In this situation, it remains the Federal Open Market Committee's current policy 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 until the next meeting of the Committee shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks, while taking into account unsettled conditions in securities and foreign exchange markets.

Votes for this action: Messrs. Martin, Balderston, Daane, Ellis, Galusha, Maisel, Mitchell, Robertson, Scanlon, Shepardson, and Irons. Vote against this action: Mr. Treiber.

Mr. Treiber dissented because he believed that domestic considerations warranted some restriction in credit availability before inflationary pressures gained momentum, and because in his judgment the need to bring about a fundamental improvement in the international payments of the United States was pressing. While agreeing that, in light of the various existing uncertainties, caution would be required in reducing the degree of credit availability, he felt that moderate action of that kind would not have untoward consequences.

September 8, 1965

Authority to purchase and sell foreign currencies.

At this meeting, which was held by telephone, the Committee amended the final paragraph of the continuing authority directive for foreign currency transactions to increase the dollar limit specified for purchases of sterling by the Federal Reserve Bank of New York on a covered or guaranteed basis in terms of the dollar to $200 million equivalent from $50 million equivalent.

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

For several weeks negotiations had been in process among Britain, the United States, and a number of other countries on a program designed to assist the recovery of sterling, and today's action was taken in connection with that program, on recommendation of the Special Manager of the System Open Market Account. The U.S. Treasury was planning to participate with the Federal Reserve in the package of assistance.

September 28, 1965

Authority to effect transactions in System Account.

Economic activity advanced further against a background of optimistic business sentiment, and most analysts reportedly were now expecting the expansion to continue for some time. Conditions in financial markets had become firmer, and average prices of common stocks had recovered to about their spring highs on heavy trading volume.

Some of the major uncertainties existing at the time of the preceding meeting had since been clarified. The position of sterling in foreign exchange markets improved markedly following announcements by the British Government in the early part of September of further measures to restrain wage and price increases and of new international agreements in support of the pound. Domestically, labor negotiations in the steel industry had been concluded with a settlement that appeared to be about in line with the administration's guideposts.

Industrial production and nonfarm employment rose slightly in August, and the unemployment rate continued at the reduced level of 4.5 per cent reached in July. Retail sales declined by 1 per cent from their high July rate but appeared to be rising again in early September, with automobile sales particularly strong. Average prices of industrial commodities edged up in August but, according to preliminary estimates, had changed little further by mid-September.

Business inventory investment, which had been tending down from the exceptionally high rate reached in the first quarter, was expected to moderate further following the settlement of wage negotiations in the steel industry. Nevertheless, further gains seemed likely in final purchases by businesses as well as by government and consumers. The latest Commerce–SEC survey of business plans for fixed capital outlays indicated that such outlays in 1965 would be about 13.5 per cent above 1964, in contrast to rises of about 12 and 12.5 per cent shown in the February and May surveys, respectively. Moreover, sharply advanced capital appropriations reported by large manufacturing companies in a private survey suggested that the momentum of the expansion in capital spending was likely to

carry forward into 1966. Although the dimensions of the expected increase in Federal expenditures as a result of the hostilities in Viet Nam were still in doubt, Federal spending—for both defense and nondefense purposes—was rising, and spending by State and local governments was continuing to grow. Personal incomes were expected to show an unusually large increase in September because of higher social security benefit payments retroactive to the first of the year and increased military pay rates. According to a Census Bureau survey taken in July, consumers were optimistic about their income prospects, and more of them reported plans to buy new automobiles and houses than a year earlier.

The money supply expanded substantially in September as Treasury deposits were drawn down sharply, but the rate of growth in time and savings deposits fell off somewhat. According to data for city banks, the rate of increase in commercial bank credit, which was high in August as a whole, moderated late in that month and early in September. Among the factors accounting for the more moderate recent growth were the reduction in Treasury deposits, some liquidation of inventory loans by metal-using companies following the steel settlement, slackened growth in bank holdings of municipal and other securities, and cumulating pressures on bank reserve positions. Renewed heavy borrowing by businesses around the September tax date suggested that underlying demands for business loans remained strong, and there were indications that interest rate and other terms on bank loans were becoming firmer. Average net borrowed reserves of member banks in the first 4 weeks ending in September were estimated at about $120 million, down from the August average of about $170 million.

Interest rates on Treasury and corporate bonds rose further in September, and State and local government bond yields, which had been relatively stable in August, increased sharply.

Yields on 3-month Treasury bills changed comparatively little over the first 3 weeks of the month, but subsequently the rate moved up about 10 basis points and reached a level of 3.99 per cent on the day preceding this meeting. The Treasury had announced that on October 5 it would auction $4 billion of tax anticipation bills, and the rise in bill rates in part reflected the forthcoming additions to supplies. But it also reflected a general heightening of money market pressures following the mid-September tax date that resulted from strong credit demands and a distribution of bank reserves away from the central money markets. In addition to bill yields, other short-term rates advanced, including the effective rate on Federal funds and rates offered by New York banks on negotiable certificates of deposit with maturities of less than 6 months.

In July and August the deficit in the U.S. balance of payments on the "regular transactions" basis now appeared to have been at an annual rate slightly higher than the $1¼ billion rate recorded in the first half of the year. The trade balance apparently improved somewhat after midyear, but net U.S. private capital outflows increased more as reflows of liquid funds and bank credit appeared to be tapering off. In the second quarter, according to newly available data, outflows of direct investment capital were much larger than most analysts had expected.

Prior to reaching a decision on the appropriate objective of monetary policy at this juncture, the Committee explored several possible alternatives. These included maintaining approximately the current conditions in the money market; supplying reserves in sufficient quantity that the money market rates that had prevailed before the recent increase in pressures would again be approached; and reinforcing the recent trend in the market toward firmer conditions, or at least not offsetting a furtherance of this trend if produced by market forces. The

conclusion of the majority was that it would be desirable to maintain about the current conditions, while a minority favored fostering a return to the general market conditions that had prevailed earlier. Some members of the majority felt that neither domestic nor international considerations warranted further firming at this time, although they did not consider it desirable to pursue the course recommended by the minority. Other members of the majority thought that the main reason for maintaining the status quo, as contrasted with a further firming, was the forthcoming Treasury financing, with Britain's continuing effort to restore the position of sterling mentioned as another consideration. Otherwise, they indicated, factors such as the inflationary pressures they thought were inherent in the strong business outlook and the continuing balance of payments problem might have been persuasive influences to them.

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 that the domestic economy has expanded further in a climate of optimistic business sentiment and firmer financial conditions, and that our international payments have been in deficit since midyear. Some of the uncertainties previously affecting foreign exchange markets have diminished. In this situation, it remains the Federal Open Market Committee's current policy 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, and taking into account the current Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the current conditions in the money market.

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

Messrs. Maisel, Mitchell, and Robertson dissented from the action taken by the Committee on two grounds. First, they felt that the recent sharp increases in both short- and long-term interest rates were partly the result of the fact that nonborrowed reserves were not being supplied at the rate required by the growing economy. They anticipated that there would be still further increases in interest rates and tightening of credit availability in longer-term financial markets if reserve growth continued to be held below the economy's needs. In their judgment evidence was lacking that inflation either existed or was just around the corner and, accordingly, their preference was to see no greater credit restraint develop at this time. To assure such an outcome they favored open market operations designed to move conditions in the central money markets back to around their averages for the month of September. Second, the dissenting members felt that the language in the directive referring to "maintaining about the current conditions in the money market" was vague and open to misinterpretation, especially in the light of the sharp tightening in market conditions that actually had taken place over the past month when open market operations were being conducted under a similar "no change" directive. In particular, they were concerned that the wording of the directive would permit further tightening of credit conditions, even though couched in terms which could be otherwise construed.

October 12, 1965

Authority to effect transactions in System Account.

Information that had become available in the 2-week period since the previous Committee meeting lent further confirmation

to the view that domestic economic activity was generally strong and was continuing to expand.

Industrial production appeared to have declined slightly in September, principally because excess steel inventories were beginning to be reduced. The labor market remained strong, however, and the unemployment rate dropped to 4.4 per cent, the lowest level in many years. Retail sales remained at a high level.

According to weekly estimates, the industrial commodity price index had edged up since mid-August, bringing the total rise to 1.5 per cent since the summer of 1964, but foodstuffs continued to decline from their July peak and the total wholesale price index remained at the June-August level. The consumer price index, after rising more than 1 per cent from March to July, declined two-tenths of 1 per cent in August due to the drop in average food prices.

Sales of new domestic automobiles in September remained at the 8.9 million annual rate of the previous 3 months, and prices for the 1966 models—most of which had now been introduced—appeared close to those for the 1965 models. The growth of consumer instalment credit slowed in August, on a seasonally adjusted basis, but early reports for September suggested a return of the rate of net borrowing to levels somewhat above August.

New orders for durable goods showed somewhat less decline in August than preliminary figures had indicated, due mainly to an upward revision in new orders for defense production. Business inventory accumulation in August was not as large as in July; but for the 2 months combined accumulation exceeded the second-quarter rate and approached the high rate of the first quarter. Construction expenditures during the third quarter were unchanged from their second quarter level as higher outlays for business, other private nonresidential, and public construction offset a downdrift in residential construction activity.

In financial markets there was a slackening in the pace of bank credit expansion in September. The annual rate of growth in the third quarter was estimated at 5.5 per cent compared with approximately 12.5 per cent and 10 per cent in the first and second quarters, respectively. However, when security loans were excluded, total loans rose at an annual rate of about 13 per cent in the third quarter, which was 1 percentage point above the 1964 rate. The demand for business loans had been strong recently after moderating somewhat in late August and early September; for the month of September as a whole such loans expanded at an annual rate of almost 13 per cent.

Following a slowdown in August, the money supply rose in September at a seasonally adjusted annual rate of almost 12 per cent; this reflected in part an unusually sharp reduction of U.S. Government deposits. For the year to date the money supply had grown at an annual rate of 3.8 per cent, a little below the rate for 1964. Time and savings deposit growth in September was at an annual rate of 12 per cent, considerably below the rates of the previous 2 months. While savings deposit inflows remained strong, run-offs of negotiable certificates of deposit were heavy during the September tax and dividend period and only about half had been replaced by the end of the month. Certain major banks had recently pushed their offering rates on certificates to, or close to, the ceiling of 4.5 per cent.

Money market conditions had eased slightly since the period of considerable pressure toward the end of September, with bill rates and other interest rates dropping back somewhat. The supply situation as to Treasury bills had been eased considerably by the System's large purchases of bills to supply needed reserves during the late September period. This abatement of market pressures enabled the Treasury to auction $4 billion of tax anticipation bills at somewhat lower rates than earlier anticipated, and the demand for these bills in the secondary market

proved to be better than many had expected earlier. The Treasury was expected to announce in late October the terms of its November refunding; $3.3 billion of maturing securities were held by the public. Trading activity in the stock market remained heavy, although the volume was somewhat below the high daily average for the month of September. Prices continued to move in a rather narrow range at about the highs reached in the spring of the year.

U.S. foreign trade showed some improvement in July and August. The trade surplus exceeded a $6½ billion annual rate in those months as exports rose by about 4 per cent in July and again in August while the growth in imports appeared to have tapered off. Nevertheless, preliminary data for the third quarter suggested a payments deficit on the "regular transactions" basis at an annual rate in the order of magnitude of $1¼ billion, and it appeared that in September the "official settlements" balance may have reverted to deficit on a seasonally adjusted basis. In foreign exchange markets the outstanding recent development had been the further recovery of sterling, which was now trading at a spot rate above par.

In the Committee's discussion of the course of monetary policy, some members noted that any significant move toward further firming would almost inevitably soon require consideration of changes in the discount rate and in the maximum rates of interest permitted to be paid on time and savings deposits. It was the predominant view that such changes would not be advisable at this particular time. Accordingly, the discussion focused on a relatively narrow range of policy objectives during the forthcoming 3-week period. Most members of the Committee believed that the best short-run alternative would be to maintain about the existing degree of money market firmness, recognizing that objectives expressed in terms such as bill rates, net borrowed reserves, and Federal funds rates might not prove to be mutually compatible. In this regard, there was some disposition to feel that the level of net borrowed reserves, one of the indicators of market conditions, should be assigned a less prominent role than usual in the current context. Other members of the Committee, who expressed concern about potential inflationary pressures against a background of large cumulative increases in bank credit and the international payments problem, thought that any doubts in the conduct of open market operations should be resolved on the side of a firmer market tone. On the other hand, some members felt that in the absence of clear evidence of a break-out of inflationary conditions care should be exercised against basing actions on expectations, and that any doubts therefore should be resolved on the side of easing bank reserve positions slightly.

At the conclusion of the discussion, 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 that over-all domestic economic activity has expanded further in a continuing climate of optimistic business sentiment and firmer financial conditions, and that our international payments have been in deficit on the "regular transactions" basis since midyear. In this situation, it remains the Federal Open Market Committee's current policy 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, and taking into account the Treasury financing schedule, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining a firm tone in the money market.

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

November 2, 1965

Authority to effect transactions in System Account.

Gross national product advanced at an annual rate of $11 billion in the third quarter of 1965, according to preliminary estimates, compared with an increase of $9.5 billion in the preceding quarter. Although the adjustment of steel inventories was producing a considerable drop in the rate of business inventory accumulation and a leveling off in industrial production in the fourth quarter, another substantial rise in GNP appeared likely as marked further gains were expected in outlays for business fixed investment, in Federal defense outlays, and in consumer incomes and spending.

Contrary to earlier indications, average prices of industrial commodities were stable from mid-August to mid-September, and weekly estimates showed little change through late October. The consumer price index rose by two-tenths of 1 per cent in September, the amount by which it had declined in August, with seasonal increases in apparel and fuels accounting for much of the rise.

Partial data for October suggested that industrial production might have been maintained at about the September level, 1 per cent below the previous month, despite a further decline in steel output. In September, strikes in a number of industries and the impact of "Hurricane Betsy" on crude oil output had served to reinforce the effects of the steel contraction on total output; subsequently, however, settlement of the strikes and recovery of oil production had acted to offset the further contraction.

Growth in the money supply was rapid in early October—although less so than during September—partly because U.S. Government deposits were reduced further. Loan demand at commercial banks continued strong and seemed likely to remain vigorous over the final months of the year despite reduced needs for funds by firms that had been stockpiling steel. Net borrowed reserves of member banks averaged about $130 million in October, compared with about $140 million in September and $170 million in August.

Interest rates on short- and long-term Treasury securities, which had declined in the first half of October, subsequently edged up again. The general tone of security markets was cautious in the face of good business prospects and heavy actual and anticipated demands for funds. Average prices of common stocks rose to new highs on very heavy trading volume. On the day preceding this meeting the Treasury offered a 4¼ per cent 18-month note for cash, to refund issues maturing on November 15. It was expected that the Treasury also would auction between $2 billion and $2.5 billion of tax anticipation bills within the next few weeks.

The U.S. trade surplus improved substantially in the third quarter, according to preliminary estimates, to an annual rate somewhat over $6 billion. The latest information on the over-all balance of payments in the quarter, however, indicated that the deficit on the "regular transactions" basis was considerably larger than had been estimated earlier—at an annual rate about double that of the first half—and that the surplus on the "official settlements" basis was smaller than had been anticipated. In September, taken alone, the accounts were in deficit on both bases of calculation.

The Committee agreed that the Treasury financing now in process precluded a change in monetary policy at this time. The possibility was noted that market forces might exert upward pressure on interest rates over coming weeks, and divergent views were expressed regarding the appropriate response in such an eventuality. Some members advocated active resistance to any such forces, while others favored permitting rates to rise in response to them.

Views also differed with respect to the type of policy that was likely to be required following completion of the Treasury

financing. Some members felt that it would prove desirable then for the System to adopt a firmer policy stance, and a possible increase in the discount rate was mentioned in this connection. These members thought a firmer policy, by reducing the rate of bank credit expansion and damping incipient inflationary pressures, would prove helpful both in promoting the sustainability of the domestic expansion and in ameliorating the balance of payments problem. Other members were of the opinion that current domestic and international conditions did not warrant a firmer policy on the part of the Committee nor an increase in the discount rate. They disagreed with the view that such actions would help to maintain the domestic expansion, and they did not consider general instruments of monetary policy to be the appropriate means for dealing with the balance of payments problem 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 that over-all domestic economic activity has expanded further in a continuing climate of optimistic business sentiment and firmer financial conditions, and that our international payments have remained in deficit. In this situation, it remains the Federal Open Market Committee's current policy 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, and taking into account the Treasury financing schedule, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the same conditions in the money market that have prevailed since the last meeting of the Committee.

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

November 23, 1965

1. Authority to effect transactions in System Account.

Prospects for continued substantial gains in business activity in the current quarter and in early 1966 were firmer than 3 weeks earlier, according to reports at this meeting. It now appeared that the fourth-quarter reduction in the rate of business inventory accumulation might be somewhat smaller than anticipated earlier, and the outlook was strong for all major categories of final demand except residential construction, which had declined slightly in the third quarter.

Industrial production increased somewhat in October as another large monthly decline in steel output was more than offset by production gains in business equipment, defense, and some consumer goods industries. Retail sales rose appreciably in the month to a new record level. The demand for labor continued strong, and the unemployment rate edged down further to 4.3 per cent from 4.4 per cent in September.

According to a private survey taken in October, businesses planned to spend about 8 per cent more on new plant and equipment in 1966 than they had in 1965. It was possible that the actual gain in capital spending would be larger than these plans implied; in each of the past 4 years expenditures rose substantially more than indicated by this survey in the preceding autumn.

The index of industrial prices edged up in October, and weekly estimates suggested a further slight rise in November. Since midyear the average of these prices had advanced at an annual rate of about 1 per cent, compared with a rate of about 2 per cent in the preceding 9 months.

The money supply increased substantially in October; for the first 10 months of the year growth was at a 4.4 per cent annual rate, about the same as in the year 1964. Time and savings deposits continued to expand at the third-quarter annual rate of nearly 17 per cent. In late October and early November interest rates on negotiable certificates of deposit at New York banks generally were at the maximums permissible under the Board's Regulation Q.

Bank credit grew at a rapid pace in October, with much of the expansion accounted for by acquisitions of U.S. Government issues and loans to Government security dealers reflecting Treasury financing activity. Business loan expansion moderated, partly because of liquidation of inventory borrowings by metals-using firms but also, perhaps, because of increased capital market financing. Corporate bond issues were large in recent weeks, and the calendar of forthcoming issues was heavy.

Rates on 3-month Treasury bills fluctuated in a 4.04-4.10 per cent range recently, on balance rising somewhat. Yields on corporate and municipal bonds and on Treasury notes and bonds advanced further in early November. The initial reception to the Treasury's November refunding, involving sale of an 18-month 4¼ per cent note for cash, was less favorable than expected. This introduced a new element of uncertainty in the Government securities market, although the reaction was moderated by purchases of the new security on a "when issued" basis for Treasury investment accounts. In a telephone conference meeting held on November 4 to review the situation, the Committee agreed that the Manager should make similar purchases for the System Account if he judged that circumstances warranted them. Such purchases, however, did not prove necessary. Subsequently, yields on Treasury notes and bonds retreated somewhat from their peaks and the tone in the corporate market improved, although municipal yields continued to move up. A Treasury auction on November 17 of $2.5 billion of tax anticipation bills due in June proceeded uneventfully. The Treasury was expected to announce, before the end of the year, another cash financing to be held in January.

Starting with preliminary data for the third quarter, the Department of Commerce began summarizing the U.S. international payments position in a new way, involving "liquidity" and "official settlements" balances.[1] On the previously used "regular transactions" basis of calculation, the deficit (seasonally adjusted) was $615 million in the third quarter and $1.3 billion in the first 3 quarters. On the "liquidity" basis, the third-quarter deficit was $485 million and that for the first 3 quarters $940 million. The alternative "official settlements" balance showed a surplus in the third quarter of $260 million, and a deficit in the first 3 quarters of $160 million. The outlook, based partly on available data for October, appeared to be for a deficit on the "regular transactions" basis in the fourth quarter at about the same rate as in the year to date, but a shift in the "official settlements" balance from surplus in the third quarter to deficit in the fourth.

In the course of the Committee's discussion some members expressed the opinion that an overt move to a firmer monetary policy, in the form of an increase in the Federal Reserve discount rate, would be in order in the very near future, assuming economic conditions continued as at present. To facilitate orderly market adjustments in the event such an action was taken, they advocated open market operations directed toward maintaining the present, or if necessary a somewhat greater, degree of reserve availability. In the judgment of these members a discount rate increase would contribute to more balanced and sustainable economic growth domestically and to a stronger dollar internationally, by countering the inflationary pressures inherent in the prospects for rising aggregate demands, augmented by increasing Federal defense expenditures, and declining margins

[1] The "liquidity" balance reflects changes in U.S. reserves and in liquid U.S. liabilities to all foreigners; it differs from the "regular transactions" balance by including debt prepayments and military prepayments as receipts that reduce the deficit instead of helping to finance it. The "official settlements" balance reflects changes in U.S. reserves and in liquid and certain nonliquid U.S. liabilities to foreign official accounts, mainly monetary authorities. It differs from the "liquidity" balance by (1) treating changes in U.S. liabilities to foreigners other than official agencies as ordinary capital flows, and (2) treating changes in certain nonliquid liabilities to foreign monetary authorities as financing items rather than capital flows.

of unutilized resources. The view also was expressed that a discount rate increase and a concurrent upward adjustment in the maximum rates permitted to be paid by member banks on time deposits would help eliminate obstacles to the efficient flow of funds in credit markets that had resulted from recent changes in the interest rate structure. The members of this group thought that postponement of these steps might pose a serious problem of deposit run-offs for banks if market rates rose further at a time when the rates being paid for time certificates of deposit were pressing against current regulatory ceilings. Also, if these actions were not taken shortly, Treasury financing operations might preclude their being taken for some time.

Other members of the Committee, while sympathetic with the need for some firming of policy, expressed a preference for initially restraining growth in bank credit by a slight reduction in net reserve availability, and for considering an increase in the discount rate if and when market rates rose further. The possibility was noted that, in the present sensitive state of financial markets, discount rate action might lead to undesirably large market reactions. It also was suggested that if higher market rates, confirming the need for a discount rate increase, were to eventuate, they should reflect the pressure of rising credit demands against a steadily growing reserve base. The members of this group believed that a course of action such as they favored could be accommodated under a current economic policy directive similar to the one issued by the Committee at its meeting on November 2, 1965.

Still other members thought that neither a reduction in reserve availability nor a higher discount rate was warranted at this time; in their judgment a continuation of present System policies was best calculated to maintain the current strong performance of the economy. They noted that the rate of increase in industrial commodity prices had slackened recently, and they saw no present evidence of pervasive inflationary pressures. Also, they felt that it would be desirable to await the detailed information on Federal budget prospects that would be available in January before considering an increase in the discount rate.

At the conclusion of the discussion 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 that over-all domestic economic activity is continuing a rate of expansion comparable to that of the third quarter despite the contractive effect of a reduction in steel inventories. Business sentiment continues optimistic and financial conditions are firmer. Meanwhile, our international payments have remained in deficit. In this situation, it remains the Federal Open Market Committee's current policy 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 until the next meeting of the Committee shall be conducted with a view to maintaining about the same conditions in the money market that have prevailed since the last meeting of the Committee.

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

2. Authority to purchase and sell foreign currencies.

At this meeting the Committee amended its continuing authority directive for foreign currency operations by adding a new final paragraph reading as follows:

The Federal Reserve Bank of New York is also authorized and directed to assume commitments for forward sales of lire up to $500 million equivalent as a means of facilitating the retention of dollar holdings by private foreign holders.

Concurrently, the Committee amended Section 4(2) of its guidelines for System foreign currency operations by adding the phrase, "directly or indirectly" after the first clause. As amended, Section 4 read as follows:

4. *Transactions in Forward Exchange*

Transactions in forward exchange, either outright or in conjunction with spot transactions, may be undertaken:

(1) When forward premiums or discounts are inconsistent with interest rate differentials and are giving rise to disequilibrating movements of short-term funds;

(2) When it is deemed appropriate to supplement existing market supplies of forward cover, directly or indirectly, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders;

(3) To allow greater flexibility in covering System commitments, including those under swap arrangements;

(4) To facilitate the use of holdings of one currency for the settlement of commitments denominated in other currencies.

Forward sales of authorized currencies to the U.S. Stabilization Fund out of existing System holdings or in conjunction with spot purchases of such currencies also may be undertaken in order to allow greater flexibility in covering commitments of the U.S. Treasury.

In all other cases, proposals of the Special Manager to initiate forward operations shall be submitted to the Committee for advance approval.

Votes for these actions. Messrs. Martin, Hayes, Balderston, Daane, Ellis, Galusha, Maisel, Mitchell, Patterson, Robertson, Scanlon, and Shepardson. Votes against these actions: None.

In 1964 and 1965 the Italian authorities had dealt with large international payments surpluses in the same manner they had employed in 1961 and 1962; namely, channeling back into private hands dollars that otherwise would have added to their official reserves, by providing commercial banks in that country with forward cover into lire without cost. In 1965, as in 1962, the U.S. Treasury had facilitated such operations by acquiring some of the technical commitments to Italian commercial banks for forward sales of lire. The contracts acquired by the Treasury in 1962 ultimately were all reacquired by the Italian authorities when the balance of payments of that country subsequently shifted to a deficit.

The Committee noted that the operations that had been undertaken by the Italian authorities were beneficial in reducing strains on the international payments structure and that the assumption by the U.S. Treasury of some of the forward commitments reduced the pressure on the Bank of Italy to convert part of its total dollar holdings—spot and forward—into gold. The Committee concluded that it was desirable for the System to participate along with the U.S. Treasury in this cooperative undertaking with the Italian authorities, consistent with the System's general policy of operating parallel with the Treasury whenever appropriate.

December 14, 1965

1. Authority to effect transactions in System Account.

Reports at this meeting indicated that economic activity was increasing vigorously and that the outlook appeared more expansive than previously. Recent developments in financial markets reflected the actions by the Board of Governors, effective December 6, approving increases in Federal Reserve discount rates from 4 to 4½ per cent and increasing to 5½ per cent the maximum rate member banks were permitted to pay on time deposits other than savings deposits.[2]

With respect to business activity, in November the rise in nonfarm employment was the largest for any month in 1965, and the unemployment rate again declined, to 4.2 per cent. Retail sales were maintained at their record October volume. Despite further reductions in output of steel mill products, industrial production rose substantially from an October level that itself had been revised upward.

[2] These actions are described in the entry for December 3, 1965, in the Record of Policy Actions of the Board of Governors (see pp. 63-70).

Estimates of the recent pace of business investment also had been raised. Inventory accumulation was larger in the third quarter than previously indicated and the rate of accumulation showed an unexpectedly small decline in October. A Commerce–SEC survey of business expenditures on plant and equipment revealed that outlays in the second half of 1965 were running above earlier projections and that for the year as a whole they would exceed 1964 outlays by over 15 per cent.

As to the outlook, the new Commerce–SEC survey also indicated that businesses planned to increase capital expenditures further in the first half of 1966 at a rate about as rapid as in 1965 and considerably higher than that implied by a recent private survey reporting plans for all of 1966. According to a Census Bureau survey taken in mid-October, consumers intended to buy new cars and major household durable goods at a high rate over the following 6 months. Federal expenditures, particularly outlays for defense, had been rising rapidly since midyear on a national-income-account basis, and a further substantial increase in the first half of 1966 was implied by tentative new administration estimates of Government expenditures in the current fiscal year.

Average prices of industrial commodities continued to edge up in November, but the total wholesale price index increased more as a result of a renewed rise in food prices. The consumer price index advanced by two-tenths of 1 per cent in October, to a level 1.8 per cent above a year earlier.

At commercial banks, growth in business loans in November was moderately above the reduced October pace. Total bank credit continued to expand at a rapid rate, partly because of further Treasury financing activity. The money supply rose by only a small amount, but time and savings deposits continued to grow at an annual rate of nearly 17 per cent despite a relatively modest net increase in negotiable certificates of deposit. Following the Federal Reserve actions of December 6 most large banks raised their prime rate on business loans from 4½ to 5 per cent and a number of banks increased their offering rates on new certificates of deposit. Excess reserves of member banks, which had averaged about $80 million less than their borrowings in November, were estimated to have exceeded borrowings slightly in the statement week ending December 8; this reflected System open market operations directed to the provision of reserves in order to facilitate market adjustments to the official rate actions.

In security markets initial reactions to the increases in the discount rate and the maximum rate on time deposits were swift but orderly. Short- and long-term security yields, which generally had been under upward pressure prior to the actions, rose sharply on December 6, the day the actions became effective. Yields on long-term Treasury, corporate, and municipal bonds generally moved up about 5-10 basis points, and those on intermediate-term Treasury securities and on Treasury bills advanced 15-20 basis points. For the rest of the week market yields were relatively stable, with the 3-month Treasury bill rate fluctuating in a narrow range around 4.35 per cent and some bond prices showing a slight improvement. On the following Monday (the day preceding this meeting), however, most market rates advanced again, apparently partly because of reports implying further strengthening of the economic outlook. Money market conditions, which had been comfortable in the preceding week, again became firm.

With respect to the U.S. balance of payments, direct investment outflows in the third quarter were now reported to have been substantially smaller than in the first 2 quarters. On the other hand, imports in the 4 months after midyear were larger than previously indicated and were one-sixth greater than in the corresponding period of 1964. Preliminary data for October and November suggested that there would be some improvement in the "regular transactions" balance in the fourth quarter as compared with the third, but thus far a deficit was indicated on this basis of calculation as well as on the "liquidity" and

"official settlements" bases. Abroad, the Bank of Canada raised its discount rate from 4¼ to 4¾ per cent immediately after the increase in the Federal Reserve discount rate, and rates in Euro-dollar markets rose more than seasonally.

The Committee agreed that open market operations in the period until its next meeting should be directed toward moderating any further adjustments that might occur in money and credit markets. Maintaining relatively steady financial market conditions during the next few weeks was deemed particularly desirable because of the large and shifting seasonal pressures typical of this period and because of the likelihood that the Treasury would be engaging in financing operations early in the new year, with the first stage probably under way before the year-end.

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 that domestic economic expansion is gaining in strength in a climate of optimistic business sentiment, with continuing active demands for credit and some further upward creep in prices. Although there appears to have been some recent improvement in our international payments, the need for further progress remains. In this situation, it is the Federal Open Market Committee's policy to complement other recent measures taken to resist the emergence of inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, while accommodating moderate growth in the reserve base, bank credit, and the money supply.

Until the next meeting of the Committee, and taking into account the forthcoming Treasury financing activity and widely fluctuating seasonal pressures at this time of year in addition to the recent increase in Reserve Bank discount rates, System open market operations shall be directed to moderating any further adjustments in money and credit markets that may develop.

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

2. Ratification of amendment of continuing authority directive.

On the morning of December 6 the Manager of the System Account had reported that the remaining "leeway" at that time for open market purchases, under the limitation established in Section 1(a) of the Committee's continuing authority directive on changes in holdings of U.S. Government securities in the System Open Market Account between meetings of the Committee, was $322 million, and that it was conceivable that purchases in excess of that amount might be necessary before the Committee's next meeting to carry out the intent of the current economic policy directive then in effect. Committee members approved (those outside of Washington by telegram) an amendment to Section 1(a) of the continuing authority directive, raising from $1.5 billion to $2.0 billion the limit on changes in holdings of Government securities between meetings. 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 at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $2.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting.

The December 6 action was ratified at this meeting of the Committee.

Votes for ratification of this action: Messrs. Martin, Hayes, Balderston, Ellis, Galusha, Maisel, Mitchell, Patterson, Robertson, Scanlon, and Shepardson. Votes against ratification of this action: None.

OPERATIONS OF THE SYSTEM OPEN MARKET ACCOUNT

The following two reports describe the actions taken during 1965 to carry out the policy directives of the Federal Open Market Committee. The first one is a chronological review of operations in domestic securities. In providing the reserve base for rapid expansion in commercial bank credit and for substantial growth in the money supply—and in view of the public's changing preferences for currency, demand deposits, and time deposits—the Federal Reserve acquired during the year $3.7 billion, net, of U.S. Government securities (including repurchase agreements).

The report on operations in domestic securities was prepared by Alan R. Holmes, Manager of the System Open Market Account, who supervises these operations. It is written from the vantage point of the Trading Desk at the Federal Reserve Bank of New York, where operations in these securities are effected to carry out the policy directives of the Federal Open Market Committee. The report stresses the factors—including variations in reserve elements, money market tendencies, and Treasury financings—that the Manager takes into account in the day-to-day provision of bank reserves.

The second report is a review of Federal Reserve operations in foreign currencies. The Federal Reserve has been buying and selling such currencies since early 1962 as part of the efforts to defend the dollar and strengthen the world payments system. During 1965 the volume of Federal Reserve operations in foreign currencies was substantial, and the reciprocal currency, or "swap," network linking the Federal Reserve with foreign central banks and the Bank for International Settlements was enlarged by $450 million.

The report on foreign currency operations was prepared by Charles A. Coombs, Special Manager of the System Open Market Account, who supervises the Federal Reserve's operations in such