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Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System

COVERING OPERATIONS FOR THE YEAR

1963

Period	*Description*	*Purpose*
January-mid-May	Reduced System holdings of U.S. Government securities and then increased them in line with seasonal and moderate growth needs of the economy. Total holdings rose about $470 million on balance, owing mainly to net purchases of issues maturing in more than 1 year. Member bank borrowing rose slightly to a level of about $150 million in the first half of May.	To offset seasonal downward pressures on short-term interest rates early in the period and to provide for growth in bank credit and the money supply at a rate consistent with minimizing capital outflows in accordance with the policy of slightly reduced reserve availability adopted at the December 18, 1962, meeting of the Federal Open Market Committee.
Mid-May-late-July	Reduced the degree of reserve availability slightly further. System holdings of U.S. Government securities increased nearly $1.2 billion, about one-fifth representing net purchases of issues maturing in more than 1 year. Member bank borrowing increased further, averaging $275 million over the period.	To achieve a slightly greater degree of firmness in the money market in order to minimize the outflow of capital while continuing to provide reserves for moderate monetary and credit growth.
Mid-July	Raised the discount rate from 3 to 3½ per cent. Raised maximum interest rates payable by member banks on time deposits (other than savings) and certificates of deposit with maturities of 90 days to 6 months from 2½ to 4 per cent and with maturities of 6 months to 1 year from 3½ to 4 per cent.	To help reduce short-term capital outflows by firming U.S. short-term money market rates and permitting member banks to compete more effectively for foreign and domestic funds.
Late-July-December	Reduced a little further the degree of reserve availability. System holdings of U.S. Government securities increased about $1.1 billion, of which more than one-half represented purchases of securities with maturities of more than 1 year. Member bank borrowing averaged about $325 million over the period.	To attain slightly more firmness in the money market, in the context of a higher discount rate, with a view to minimizing the outflow of funds abroad while offsetting seasonal reserve drains and providing for growth needs of the domestic economy.
November	Raised margin requirements on loans for purchasing or carrying listed securities from 50 to 70 per cent of market value of securities. Also increased retention requirements on proceeds of sales from undermargined accounts from 50 to 70 per cent.	To help prevent excessive use of stock market credit, which had increased sharply since July 1962, when margin requirements were lowered from 70 to 50 per cent.

Votes for this action: Messrs. Martin, Hayes, Balderston, Clay, Irons, King, Mitchell, Robertson, Scanlon, Shepardson, and Wayne. Votes against this action: None.

2. Authority to purchase and sell foreign currencies.

Upon recommendation of the Special Manager of the System Open Market Account, the Committee amended the continuing authority directive for System foreign currency operations to increase from $25 million to $50 million the authorization for purchases of foreign currencies through forward transactions for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements. With this amendment the directive issued to the Federal Reserve Bank of New York 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 on System Foreign Currency Operations reaffirmed by the Federal Open Market Committee on March 5, 1963, as amended on May 28, 1963:

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

The Federal Reserve Bank of New York is also authorized and directed to purchase, in accordance with the Guidelines and for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements, any or all of the foregoing currencies through forward transactions, up to a combined total of $50 million equivalent.

The Federal Reserve Bank of New York is further authorized and directed to purchase and sell, in accordance with the Guidelines and for the purpose of utilizing its holdings of one currency for the settlement of

commitments denominated in other currencies, any or all of the foregoing currencies through forward as well as spot transactions, up to a combined total of $50 million equivalent.

Total foreign currencies held at any one time shall not exceed $1.75 billion.

Votes for this action: Messrs. Martin, Hayes, Balderston, Clay, Irons, King, Mitchell, Robertson, Scanlon, Shepardson, and Wayne. Votes against this action: None.

October 1, 1963

1. Authority to effect transactions in System Account.

The Board's index of industrial production fell back 1 percentage point in August to 126, from a July high of 127. The decline reflected decreases in steel and auto production, where special temporary factors were at work. Nonagricultural employment also was reduced a little in August, and total personal income rose less than in most earlier months. In September the seasonally adjusted unemployment rate continued at about 5.5 per cent.

Retail sales were maintained in August at the advanced level of the preceding month, according to the latest data, but preliminary indications suggested that sales had declined in September. New housing starts fell in August, but the June-August average remained considerably higher than a year earlier.

Price advances for industrial goods had become more widespread, but with few exceptions the increases were modest and there continued to be offsetting declines. Through mid-August the monthly index for industrial commodities had changed little. and the subsequent weekly indexes continued stable. The consumer price index, which had risen appreciably in June and July, showed no change in August.

Despite the fact that some key measures had recently leveled off or shown modest declines after earlier rapid advances, GNP in the third quarter was indicated to be substantially above the

$580 billion annual rate reported for the second quarter of the year—perhaps as high as $589 billion.

In capital markets, corporate and municipal financing volume was relatively small in September. It appeared likely that corporate financing would decline further in October, but that State and local government financing would be sharply higher. Yields on new corporate bond issues had stabilized in recent weeks, while yields on municipal bonds had increased moderately further. Both were at the highest levels in over a year. Common stock prices in early September breached their late 1961 high, but most recently declined moderately.

In the Government securities market, long-term yields edged off from the highs reached in early September when the Treasury's advance refunding was announced. Yields on 3-month bills remained around the 3⅜ per cent level.

Preliminary estimates indicated that bank credit expanded considerably in September—by over $2 billion after seasonal adjustment—with all of the rise in loans. About half of the estimated increase was in security loans, reflecting in large part dealer borrowing in connection with the Treasury's advance refunding. Business loan growth also was somewhat larger than earlier in the year.

The seasonally adjusted money supply in the first half of September was estimated to have risen by about $400 million from the August average, following a decline of $200 million in August. Growth in time and savings deposits had continued large but at a slower rate than in August. Free reserves, although down sharply in the latest week, averaged about the same over the past 4 weeks as they had in the preceding 4 weeks.

The balance of payments apparently had improved somewhat in the third quarter, but the deficit evidently was still large. Industrial activity abroad continued its upward course.

While there were some differences of opinion within the Committee on monetary policy for the next 3 weeks, the range among types of policies contemplated was relatively narrow. Some

members favored seeking slightly less ease in the money market, on the grounds that the balance of payments problem remained serious while prospects for domestic economic activity appeared to them to be relatively encouraging. Others thought such a shift would be inappropriate in view of the continuing underutilization of domestic resources. After discussion, a decision against any change in policy at this time was reached by the Committee. The following current policy directive, which differed from the one adopted at the preceding meeting only by deletion from the second paragraph of the earlier reference to the Treasury refunding operation, was issued to the Federal Reserve Bank of New York:

It is the Committee's current policy to accommodate moderate growth in bank credit, while putting increased emphasis on money market conditions that would contribute to an improvement in the capital account of the U.S. balance of payments. This policy takes into consideration the continuing adverse balance of payments position and its cumulative effects and the high level of domestic business activity, as well as the increases in bank credit, money supply, and the reserve base in recent months. At the same time, however, it recognizes the continuing underutilization of resources.

To implement this policy, System open market operations shall be conducted with a view to maintaining the prevailing degree of firmness in the money market, while accommodating moderate expansion in aggregate bank reserves.

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

Messrs. Hayes, Balderston, Mills, and Shepardson dissented because they favored seeking slightly less ease in the money market. Mr. Hayes commented that even a small modification in policy of the sort he favored would, in his judgment, have some significance; he did not feel that all policy changes had to be dramatic.

2. Amendment of continuing authority directive.

In accordance with the recommendation of the Account Manager, Section 1(a) of the continuing authority directive issued to the Federal Reserve Bank of New York was amended to raise from $1 billion to $1.5 billion the limit on changes in holdings of securities in the System Open Market Account between meetings of the Committee. A similar action had been taken at the meeting of June 18, 1963, but the former figure was restored at the meeting of July 30, 1963. With the action at this meeting, the wording of Section 1(a) shown in the entry for June 18, 1963, was again adopted.

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

3. Authority to purchase and sell foreign currencies.

On March 5, 1963, the Committee had authorized the Federal Reserve Bank of New York to undertake forward purchases of foreign currencies, within a specified dollar limit, for the purpose of permitting greater flexibility in covering commitments under reciprocal currency (swap) agreements. On May 28, 1963, forward and spot transactions were authorized for the additional purpose of settling commitments denominated in one currency by use of System holdings of another, within a separately specified dollar limit. At this meeting the Committee authorized purchases of foreign currencies through spot transactions and sales through forward transactions for the purpose of restraining short-term outflows of funds induced by arbitrage considerations. This authority was considered likely to prove useful when relationships among spot and forward foreign currency prices and interest rate differentials provided incentives for arbitrage operations involving potentially heavy outflows of short-term funds.

Concurrently with this action, the dollar limitations on forward operations for each of the two specific purposes previously authorized were removed, and a new dollar limit of $150 million equivalent was specified for all three types of authorized forward operations taken together, in order to provide greater flexibility in these operations.

These actions were reflected in the following amended continuing authority directive for transactions in foreign currencies, issued to the Federal Reserve Bank of New York:

> 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 on System Foreign Currency Operations reaffirmed by the Federal Open Market Committee on March 5, 1963, as amended May 28, 1963:
>
> Pounds sterling
> French francs
> German marks
> Italian lire
> Netherlands guilders
> Swiss francs
> Belgian francs
> Canadian dollars
> Austrian schillings
> Swedish kronor
>
> 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 $150 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; and
>
> (c) purchases through spot transactions and sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations.
>
> Total foreign currencies held at any one time shall not exceed $1.75 billion.

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

October 22, 1963

1. Authority to effect transactions in System Account.

The domestic business situation and outlook appeared generally favorable at the time of this meeting. Increases in September were recorded for new orders received by durable goods producers, new housing starts, and average hours of work. These series are among those that had tended in the past to move ahead of over-all activity. There was a note of caution in the economic appraisals, however, as some key measures, such as industrial production and the rate of unemployment, were unchanged in September, and retail sales declined. Weekly data for early October suggested that more recently retail trade was recovering and output was rising in the auto industry. GNP in the third quarter was estimated to have advanced by $9 billion, on a seasonally adjusted annual rate basis, to $588.5 billion.

Despite numerous announcements of price increases, the index of wholesale prices remained in the narrow range prevailing for several years. Stock market prices rose appreciably to about their previous peak on heavy trading volume. Stock market credit increased sharply in September.

Security financing by State and local governments was light in September, but estimates for October suggested sharp expansion. Corporate financing remained moderate in September, but contrary to earlier estimates was now expected to be somewhat larger in October. Yields on corporate and municipal bonds had declined slightly from their September highs. A more cautious tone had developed in the U.S. Government securities market. Yields on all maturities of Government securities edged up during the first half of October and at midmonth were generally at their highest levels of the year. On the day preceding this meeting the

3-month Treasury bill rate closed at 3.46 per cent, 9 basis points above its level of 3 weeks earlier. The upward pressure on bill rates reflected, in part, sizable Treasury additions to bill supplies. It was reported that the Treasury planned to announce shortly the terms on which it would refinance $7.6 billion of securities maturing November 15, 1963.

Bank credit, which had increased sharply in September, declined in early October mainly because of loan repayments by security dealers and finance companies. Business loans in early October continued to expand more rapidly than usual at this time of the year. Both the money supply and commercial bank time and saving deposits, seasonally adjusted, were estimated to have increased more rapidly in the first half of October than in the month of September. Free reserves at member banks averaged about $50 million in the 4 weeks ending October 16, compared with nearly $150 million in the preceding 4 weeks.

The balance of payments deficit showed a marked decline in the third quarter, on the basis of preliminary estimates. The improvement reflected primarily sharp reductions in capital outflows stemming in part from the effects of the proposed interest equalization tax and increases in domestic interest rates, especially short-term rates, that were associated with the July rise in Federal Reserve Bank discount rates. Economic activity in most foreign countries continued to expand.

With respect to monetary policy for the next 3 weeks, the Committee favored maintaining an "even keel" in the money market in view of the imminent Treasury financing. Some members, however, expressed concern about recent rates of increase in member bank reserves and in the public's liquid asset holdings and about the outlook for commodity prices. Others emphasized the marked improvement in the third quarter balance of payments figures, which they felt reduced the urgency of achieving greater money market firmness for the sake of moderating capital outflows. They also noted the continuing margin of underutilized