FIFTY SECOND

# Annual Report

OF THE

BOARD OF GOVERNORS

OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

*1965*

## Digest of Principal Federal Reserve Policy Actions in 1965

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

ing 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 reduc-





tions 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