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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, 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 domestic resources and had questions about the sustainability of the recent rate of growth in aggregate demand.

While the consensus favored no change in policy, the first paragraph of the current economic policy directive was revised to reflect the improved balance of payments position and the recent further expansion in the domestic economy. The second paragraph also was revised, to include a reference to the forthcoming Treasury financing and to employ language that, in the opinion of a majority, specified more clearly than the previous language the desired degree of money market firmness. The directive was issued to the Federal Reserve Bank of New York in the following form:

It is the Federal Open Market Committee's current policy to accommodate moderate growth in bank credit, while maintaining conditions in the money market that would contribute to continued improvement in the capital account of the U.S. balance of payments. This policy takes into consideration the fact that domestic economic activity is expanding further, although with a margin of underutilized resources; and the fact that the balance of payments position is still adverse despite a tendency to reduced deficits. It also recognizes the increases in bank credit, money supply, and the reserve base of recent months.

To implement this policy, and taking into account the imminent Treasury refinancing, System open market operations shall be conducted with a view to maintaining the degree of firmness in the money market that has prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves.

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

2. Authority to purchase and sell foreign currencies.

The Committee authorized the Federal Reserve Bank of New York to undertake negotiation of a standby reciprocal currency (swap) arrangement with the Bank of Japan in the amount of $150 million.

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

It was agreed that the reciprocal currency arrangement with Japan, when negotiated, would complete the set of such arrangements that the Committee presently contemplated. Note was taken of the fact that Japan, unlike other countries with which the System had entered into reciprocal currency arrangements, had not yet removed all restrictions on payments and transfers for current international transactions. A majority of the Committee believed, however, that it was appropriate to negotiate the arrangement at the present time because Japan was a country of major importance in international trade and finance and because the remaining restrictions on current account transactions were relatively minor and could be expected to be removed soon.

Mr. Mills indicated that in addition to substantive criticisms and objections to a reciprocal currency arrangement with Japan, his reasons for dissenting went beyond this particular transaction. He believed that there was an undesirable drift away from the original and more orthodox objectives in the System's foreign currency operations and by his dissent he also desired to crystallize awareness of this tendency within the Committee. Mr. Mitchell's dissent was based on a question as to whether the agreement with Japan was entirely compatible with what he understood to be the original purpose of the System's reciprocal currency arrangements—to ameliorate the balance of payments problem of the United States. He doubted that the short-term international financial position of the United States was sufficiently strong as yet to undertake assisting other countries with their balance of payments problems, or that short-term credits made available as a result of the swap arrangement would be basically helpful to the Japanese.

It was the view of the majority, on the other hand, that the arrangement was desirable because capital flows between Japan and the United States were subject to reversals in direction, and, more generally, because the reciprocal currency arrangements were best viewed as a mutual defense under which short-term credit would be extended by either party when required by the other.

In a related action the Committee modified the amounts and form of the dollar limitations specified in the continuing authority directive for System foreign currency operations. In place of the previous limit of $1.75 billion on total foreign currency holdings at any one time, two separate limits were specified: a limit of $1.95 billion on foreign currencies held under reciprocal currency arrangements, and a limit of $150 million on foreign currencies held as a result of outright purchase. The former figure was equal to the sum of the amounts currently specified by the Committee for all individual authorized reciprocal currency arrangements, and therefore 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. The limit of $150 million on forward transactions that had been previously specified was retained.

Reflecting these actions, 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 May 28, 1963; provided that the aggregate amount of foreign currencies held under reciprocal currency arrangements shall not exceed $1.95 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 $150 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.

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

Messrs. Mills and Mitchell voted favorably on this directive despite their opposition to a reciprocal currency arrangement with the Bank of Japan because the Committee earlier had approved negotiation of such an arrangement in an action to which their dissents were already recorded.

November 12, 1963

1. Authority to effect transactions in System Account.

Information available for October indicated a pick-up in domestic economic activity and broad stability in price indexes, but a continued high rate of unemployment. Industrial production was estimated at or fractionally above the September level,