FIFTY-FIRST

Annual Report

OF THE

BOARD OF GOVERNORS
of the Federal Reserve System

COVERING OPERATIONS FOR THE YEAR

1964

Digest of Principal Federal Reserve Policy Actions in 1964

Period	Action	Purpose
January–mid-August	Increased the System's holdings of U.S. Government securities, after having reduced them seasonally early in the year. On balance, total holdings rose about $1.1 billion, $300 million of which represented net purchases of securities with maturities of over 1 year. Member bank borrowings averaged about $275 million.	To provide for moderate growth in the reserve base, bank credit, and the money supply for the purpose of facilitating continued expansion of the economy while fostering improvement in the capital account of U.S. international payments, after offsetting seasonal downward pressures on short-term interest rates early in the period.
Mid-August–late November	Increased the System's holdings of U.S. Government securities by about $1.5 billion, of which $600 million represented net purchases of securities with maturities of more than 1 year. Member bank borrowings averaged about $350 million.	To maintain slightly firmer conditions in the money market with a view to minimizing the outflow of funds attracted by higher short-term interest rates abroad while offsetting reserve drains and providing for growth needs of the domestic economy.
Late November	Raised discount rates from 3½ to 4 per cent. Raised maximum interest rates payable on savings deposits held for less than 1 year from 3½ to 4 per cent and those on other time deposits from 4 to 4½ per cent for maturities of 90 days or more and from 1 to 4 per cent for maturities of 30-89 days.	To counter possible capital outflows that might be prompted by any widening spread between money market rates in this country and the higher rates abroad, following a rise in official and market rates in London, while at the same time ensuring that the flow of savings to commercial banks remains ample for the financing of domestic investment.
Late November–December	Increased the System's holdings of U.S. Government securities by about $765 million, part of which represented securities acquired under repurchase agreements. Member bank borrowings averaged about $275 million.	To offset seasonal reserve drains and to accommodate further moderate expansion in aggregate bank reserves while ensuring that the rise in money market rates following the discount rate actions did not restrict the availability of domestic credit.

Mr. Mills abstained on the same grounds as at the preceding meeting.

2. Amendment of continuing authority directive.

The Account Manager suggested that under present conditions the continuing authority directive to the Federal Reserve Bank of New York, which had been amended on January 7, 1964, to raise from $1 billion to $1.5 billion the limit on changes in the System Open Market Account holdings of securities in the period between meetings of the Committee, might appropriately be changed to restore the former figure of $1 billion. Accordingly, the Committee amended Section 1(a) of that directive by inserting "$1 billion" and deleting "$1.5 billion."

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

March 3, 1964

1. Authority to effect transactions in System Account.

Attention was focused at this meeting on two developments of major importance: (1) enactment on February 26 of legislation reducing Federal tax rates on personal and corporate incomes, effective as of the first of the year, and reducing withholding rates on personal incomes from 18 to 14 per cent, effective March 5; and (2) an increase on February 27 from 4 to 5 per cent in the discount rate of the Bank of England.

These events occurred against a background of strength in the domestic economy, a high degree of consumer and business confidence in economic prospects, and further improvement in the U.S. balance of payments. At the same time, commodity price averages were relatively stable, unemployment continued

high, and industrial capacity was being used at less than optimum rates.

In Government securities markets the initial reaction was quite mild both to the tax cut, which had been long anticipated, and to the increase in the Bank of England discount rate. Yields on intermediate- and longer-term issues rose slightly, and the 3-month Treasury bill rate moved up to 3.60 per cent from the levels closer to the 3½ per cent discount rate that had prevailed for several months.

At commercial banks, credit expansion appeared to have resumed in February after a small decline in January, according to the seasonally adjusted figures. The February expansion was relatively large, and the annual rate of growth for the first 2 months of the year probably was close to the 8 per cent average rate of increase in 1963. Preliminary figures indicated that the money supply had drifted down somewhat further from the early January high, but that it was 4 per cent above a year earlier. Savings deposits at commercial banks had tended to grow less vigorously since the first of the year than earlier, but the expansion in time deposits, including negotiable certificates, continued rapid. Preliminary figures indicated that free reserves in February averaged about $100 million, somewhat below the average levels of December and January.

Although the volume of new private security issues was fairly light in February, yields on new corporate issues had been under some upward pressure in recent weeks. In part this reflected renewed market discussions of the possibility of higher interest rate levels in coming months.

Tentative figures on the U.S. balance of payments in February suggested that the deficit in that month was below the reduced January level despite a sizable increase in domestic acquisitions of foreign bonds. Through December the U.S. trade balance was continuing to improve, and in January imports were relatively stable for the eighth month in a row.

The Committee agreed that it was too early to assess the effects of either the tax cut or the increase in the Bank of England discount rate on the domestic economy and the U.S. balance of payments, and that no change in monetary policy was in order at present. It now appeared that the uncertainties about the domestic outlook related mainly to the pace at which the economy would advance over coming months rather than to the question of whether it would advance. The ultimate effects of the tax cut on the international payments balance seemed likely to be mixed. On the one hand, rising levels of domestic output might lead to increased imports and thus reduce the recently highly favorable trade balance. On the other hand, improved business activity might dampen net capital outflows even in the absence of a significant rise in domestic interest rates, by increasing the attractiveness of investment in this country to both domestic and foreign investors. The main threat to continued favorable developments in the balance of payments appeared to be posed by the possibility of larger outflows of volatile funds in response to interest rate increases abroad. As yet, however, there was no indication of any movement of short-term funds from the United States to Great Britain as a result of the discount rate action of the Bank of England and the associated increases in market rates in London.

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

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 that it is likely to receive additional stimulus from the recently enacted reduction in Federal income tax rates. This policy also takes into account the fact that the balance of payments position is still adverse, despite a tendency to reduced deficits, and that the effects of increases in money rates in important European countries are as yet uncertain. In addition, it recognizes the increases in bank credit, money supply, and the reserve base of recent months.

To implement this policy, System open market operations shall be conducted with a view to maintaining about the same conditions in the money market as have prevailed in recent weeks, while accommodating moderate expansion in aggregate bank reserves.

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

Mr. Mills dissented because he interpreted the statistics reflecting developments in bank reserves since the beginning of February as indicating that the Committee had moved to a more restrictive credit policy under successive directives that called for "maintaining about the same conditions in the money market as have prevailed in recent weeks." He felt that repeating this language in the directive issued at the present meeting would indicate a definite shift toward a restrictive credit policy, which in his opinion was objectionable.

2. Amendment of continuing authority directive.

The Committee amended the preamble and paragraph (a) of Section 1 of its continuing authority directive to the Federal Reserve Bank of New York with respect to transactions in U.S. Government securities, repurchase agreements, and bankers' acceptances (1) to increase from $1 billion to $1.5 billion the limit on changes in holdings of U.S. Government securities in the System Open Market Account between meetings of the Committee, and (2) to clarify the language of this part of the directive. The language of the directive previously in effect is set forth in the preface to this record of Federal Open Market Committee policy actions for 1964. As amended, the preamble and paragraph (a) of Section 1 of the directive read 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 U.S. Government securities in the open market, from or to Government securities dealers and foreign 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 $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.

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

The increase in the dollar limit on changes in security holdings was made on the recommendation of the Account Manager. The limit of $1 billion originally had been adopted on June 22, 1955, when the executive committee of the Federal Open Market Committee, to which the full Committee formerly had issued its directives, was abolished. Since 1955 the amplitude of fluctuation in market factors affecting member bank reserves and, consequently, in System Account holdings of Government securities, had increased considerably. On several occasions, most recently on January 7, 1964, the Account Manager had reported that greater leeway probably would be required over the period immediately ahead, and the Committee temporarily had increased this limit from $1 billion to $1.5 billion. Because it seemed likely that the greater leeway would be required more often in the future, it appeared desirable to provide for the larger limit on a continuing basis.

With respect to the language changes, it was noted that certain phrases in the directive previously in effect were susceptible to differing interpretations; that the beginning and the end of the period to which the restriction applied were not specified as

precisely as desirable; and that the Committee's intent regarding operations following a meeting at which no action was taken with respect to a current economic policy directive (such as at the meeting held on June 21, 1962) was not clear. The language revisions were made for purposes of clarification on these points and were not intended to affect the substance of the directive.

In dissenting from the action on the continuing authority directive, neither Mr. Mills nor Mr. Robertson expressed objections to the increase in the dollar limit or to the revisions in language. Mr. Mills dissented because he favored resumption of the directive procedure that had been in effect prior to December 19, 1961, when the Committee had issued a single directive at each meeting rather than the separate "continuing authority" and "current economic policy" directives that had been employed since that date. He thought that in the earlier, single directive the Committee's intent with respect to current policy had been expressed more clearly in clause (b) of paragraph 1 than it was in the current economic policy directives of the present type. Mr. Robertson dissented because he felt that the present continuing authority directive provided inadequate restrictions on, and guidelines for, operations in the System Open Market Account.

3. 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, 1964, and their assumption of duties, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. The action taken with respect to the continuing authority directive for domestic open market transactions has been described in the preceding portion of the entry for this date.

The Committee reaffirmed its authorization regarding open market transactions in foreign currencies, its guidelines for System foreign currency operations, and its continuing authority directive on foreign currency operations, in the form in which all three were outstanding at the beginning of the year 1964, as set forth in the preface to this record of policy actions.

Votes for these actions: Messrs. Martin, Hayes, Balderston, Daane, Hickman, Mills, Mitchell, Robertson, Shepardson, Shuford, Swan, and Wayne. Votes against these actions: None.

March 24, 1964

Authority to effect transactions in System Account.

Reports at this meeting indicated that the economy continued to show moderate upward momentum. The industrial production index rose by about one-half of a percentage point in February to a level 6 per cent above a year earlier. Both total employment and the labor force increased, and the unemployment rate declined slightly to 5.4 per cent from 5.6 per cent in January. Retail sales reached a new high in February, 4 per cent above a year earlier. Sales in the first 2 weeks of March maintained the same moderate gain over the year-earlier level and did not show any significant immediate response to the reduction in the withholding tax rate, effective March 5.

The Commerce–SEC survey of business plant and equipment expenditure plans for 1964, taken in February, confirmed earlier indications by a private survey of a larger increase in outlays this year than expected earlier. The Government survey indicated that these outlays would be 10 per cent above their 1963 level, a gain of about twice that of the previous year. However, businesses were continuing to follow conservative inventory policies; inventories declined in January from levels that were already unusually low relative to sales.

Indexes of wholesale prices continued stable despite increases for a number of commodities, particularly nonferrous metals. The average for industrial commodities in February and early

March was about 0.5 per cent higher than a year earlier and little changed from 2 years or 3 years earlier. The consumer price index in January was up 1.6 per cent from January 1963. Stock market prices continued to rise in early March.

Commercial bank credit expanded considerably more than seasonally in the first 3 weeks of March, according to data for city banks. The largest gains were in short-term Government security holdings and in loans to security dealers and finance companies; business loans apparently rose less than usual. The seasonally adjusted money supply increased in the first half of March, bringing the annual rate of growth so far this year to 3.4 per cent compared with 3.8 per cent in 1963 as a whole. Time and savings deposits rose moderately in the same period.

Short-term financial markets took the March tax-date pressures in stride. The yield on 3-month Treasury bills edged lower in the first week of the month and remained relatively stable over the following 2 weeks in the range of 3.53-3.56 per cent, as the market gained confidence that the increase in the Bank of England discount rate would not be followed immediately by a trend toward tighter monetary conditions in this country. In longer-term markets, prices of Treasury, State and local government, and corporate bonds tended lower in recent weeks. Yields on intermediate- and long-term Governments moved to their highest levels since early 1960, partly as a result of market expectations that rates probably would be moving upward in coming months. It was reported that the Treasury was considering an offering of securities for cash, with payment scheduled toward the end of the first week in April.

The latest balance of payments figures suggested that the United States was making unexpectedly rapid progress in reducing its international deficit. Tentative figures for the first 3 weeks of March showed a substantial surplus and raised the possibility that payments for the first quarter as a whole might approach balance for the first time since 1957.

The Committee agreed that neither domestic nor international