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.

Conditions in financial markets generally were affected relatively little by the Treasury's recently completed advance refunding, in which about $9¼ billion of securities maturing within 3 years were exchanged for longer-term issues. Yields on long-term Government bonds increased slightly, but corporate and municipal bond yields showed little change. This relatively small reaction was attributed to continuing large flows of long-term savings and to investor confidence in current levels of interest rates. The downdrift in Treasury bill rates that was evident earlier continued during the exchange period, but it halted, at least temporarily, after a sale of a $1 billion bill strip by the Treasury. It was reported that the Treasury planned to redeem the remaining issues maturing on August 15 with the proceeds of additional short-term financing.

The balance of payments deficit for the second quarter was somewhat lower than estimated earlier, but tentative figures for the first 3 weeks of July showed an increase much larger than expected on seasonal grounds. Supporting detail was not yet available to indicate the categories of the payments accounts in which the increase had occurred.

It was the consensus of the Committee that domestic and international developments, on balance, did not require a change in policy. Recent and prospective Treasury financing activity also militated against a policy change. Some members thought that it would be desirable to maintain as firm a short-term interest rate structure as possible within the context of a generally unchanged policy, in light of the continuing balance of payments problem and particularly in view of an apparent deterioration in the U.S. payments balance in recent weeks. Other members thought such a course was unjustified because the data reflecting recent worsening were highly tentative; the causes of the deterioration were not yet clear; and domestic circumstances in their judgment called for continuing the existing degree of monetary ease. It was agreed, however, that the balance of payments problem warranted continuing close attention by the Committee.

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 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, and seeking to avoid the emergence of inflationary pressures. This policy takes into account the continued orderly expansion in economic activity, accompanied recently by a more rapid expansion in money supply and little over-all change in interest rates. It also gives consideration to the relative stability in average commodity prices; the underutilization of manpower and other resources; the apparent deterioration in the international payments balance in the first weeks of July; and the interest rate advances in recent months in important markets abroad.

To implement this policy, and taking into account Treasury financing activity, 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, Mills, Mitchell, Robertson, Shepardson, Shuford, Swan, and Wayne. Votes against this action: None.

August 18, 1964

Authority to effect transactions in System Account.

In July, according to reports at this meeting, domestic business activity continued to expand in an orderly fashion. The industrial production index recorded a substantial further gain as output of materials, business equipment, and consumer goods all increased. Retail sales, which had declined in June according to revised figures, renewed their earlier rise and exceeded the May peak. The unemployment rate declined appreciably to 4.9 per cent—moving below the 5 per cent level for the first time since early 1960—as a result of both a rise in employment and some further withdrawals from the labor force.

Price indexes for some sensitive industrial materials such as nonferrous metals and steel scrap, which had been rising in July, moved up further in early August, partly in reaction to the military incident in Southeast Asia and the renewed fighting on Cyprus. Such price changes, together with discussion of possible advances in steel prices and speculation about the outcome of current wage negotiations in the auto industry, had led to some revival of press comments suggesting the possibility of inflationary developments. However, the broad wholesale index in July continued to show little change and was at about the same level as a year earlier. Wage rate advances remained moderate, and unit labor costs in manufacturing appeared to have changed little thus far in 1964.

The money supply grew at an annual rate of 8.5 per cent in July, as it had in June, following a lower average rate of increase earlier in the year. While total bank credit declined in July, mainly because banks drew down their Government securities holdings substantially and reduced their loans to securities brokers and dealers and to finance companies, it rebounded sharply at weekly reporting banks in early August, as both loans and investments increased. Free reserves at member banks averaged about $130 million in July, but then declined to about $90 million in the first 2 weeks of August as bank borrowings rose above recent average levels.

In capital markets, the securities issued in the Treasury's July advance refunding and August refinancing were still in the process of absorption. Yields on Government and corporate bonds had changed little in recent weeks despite uncertainties created by events in the Far East and in the Mediterranean. Yields on Treasury bills returned to about 3.50 per cent in mid-August, after dropping as low as 3.42 per cent in July.

The deficit in the U.S. balance of payments was substantial in July, and, according to tentative data, also in the first half of

August. The deficit in the second quarter now was estimated at a seasonally adjusted annual rate of nearly $3 billion, compared with $900 million in the first quarter. The trade surplus declined by about $1 billion (annual rate) from the first to the second quarter, and domestic issues of foreign securities rose. Long-term bank lending to foreigners declined in the second quarter, but the outflow of short-term bank credit and liquid funds remained at near-record levels.

The Committee decided to modify its policy objectives at this time in the direction of slightly firmer money market conditions, including moderately lower free reserves and moderately higher short-term interest rates. It was agreed that this modest policy shift should be implemented cautiously. Some members favored this action primarily for balance of payments reasons, with the object of reducing outflows of funds attracted by the differentials of foreign over domestic short-term interest rates. In the judgment of these members the domestic business expansion was sufficiently vigorous to permit such a policy change. Other members thought that somewhat less ease in the money market, and a lower rate of monetary growth than that experienced in June and July, were also desirable on domestic grounds.

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 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, and seeking to avoid the emergence of inflationary pressures. This policy takes into account the continued orderly expansion in economic activity, and essential stability in interest rates, unit labor costs, and commodity price averages, including the moderate reactions in markets generally to military incidents in the Far East and Mediterranean. It also gives consideration to the recent improvement in rates of unemployment and industrial capacity utilization, the substantial increases in the money supply in June and July, and the large U.S. balance of payments deficit in July.

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

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

In the opinion of the members dissenting from this action, a firmer policy was not called for at present by domestic conditions. Moreover, they believed that, with the market already somewhat tighter, even a slight policy shift might affect interest rate expectations and trigger market reactions leading to much firmer conditions than intended. This risk was considered particularly great at present because of the relatively low level of liquidity in the banking system. While sharing the concern of the majority with regard to balance of payments developments in July and early August following the deterioration in the second quarter, the dissenting members did not believe that these developments warranted the risk they saw in the action taken. In advancing their reasons for this judgment, individual members of the dissenting group noted the uncertainty as to whether the deficits since midyear constituted a trend, and the lack of information on the role of capital outflows in these deficits. Some expressed doubt that a slight shift in policy of the sort envisaged would have a significant impact on capital outflows, and some indicated that they believed means other than general monetary policy were preferable for coping with the balance of payments problem under prevailing domestic conditions.

September 8, 1964

Authority to effect transactions in System Account.

Available data for August indicated that domestic business activity was continuing to expand in an atmosphere of confidence but not ebullience. From weekly reports it appeared that

retail sales had increased further in August. Industrial production probably was at least maintained and may have risen further. Nonfarm employment remained strong, totaling about 1.6 million higher than a year earlier, although the unemployment rate moved back up to 5.1 per cent from 4.9 per cent in July.

Manufacturers' inventories continued to increase at a slow pace in July, and stock–sales ratios declined appreciably to a new low for the recent period. Wholesale prices of industrial materials remained stable on the average in August, although prices of some nonferrous metals rose further.

Surveys of consumer and business spending plans suggested continued strong demands in the period immediately ahead. In the July Census Bureau survey of consumer buying intentions, plans to buy new cars and household durable goods were reported more frequently than a year earlier, while plans to buy used cars and houses were somewhat less numerous. The August Commerce–SEC survey of business capital spending plans indicated some further upward revision in anticipated outlays for the year. Capital spending in 1964 was now projected at a level 12.7 per cent above 1963, compared with a rise of 12.0 per cent indicated in the May survey and 10.1 per cent in the February survey.

Bank credit rose sharply in August after declining moderately in July. The movements in both months reflected in part changes in bank holdings of Government securities related to Treasury financing operations. The money supply increased at a considerably slower rate than it had in the two preceding months. Free reserves averaged about $110 million in August, and for the most recent statement week, the one ending September 2, they were estimated to have declined to $44 million. Member bank borrowings in August averaged $310 million, the highest level since March.

The interest rate on 3-month Treasury bills in recent weeks continued at around the 3.50 per cent level. However, market rates on bills maturing in December were depressed relative to rates on surrounding maturities because of their special attrac-