

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

<i>Period</i>	<i>Action</i>	<i>Purpose</i>
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.

position to feel that the level of net borrowed reserves, one of the indicators of market conditions, should be assigned a less prominent role than usual in the current context. Other members of the Committee, who expressed concern about potential inflationary pressures against a background of large cumulative increases in bank credit and the international payments problem, thought that any doubts in the conduct of open market operations should be resolved on the side of a firmer market tone. On the other hand, some members felt that in the absence of clear evidence of a break-out of inflationary conditions care should be exercised against basing actions on expectations, and that any doubts therefore should be resolved on the side of easing bank reserve positions slightly.

At the conclusion of the discussion, 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 that over-all domestic economic activity has expanded further in a continuing climate of optimistic business sentiment and firmer financial conditions, and that our international payments have been in deficit on the "regular transactions" basis since midyear. In this situation, it remains the Federal Open Market Committee's current policy 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, and taking into account the Treasury financing schedule, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining a firm tone in the money market.

Votes for this action: Messrs. Martin, Hayes, Balderston, Daane, Ellis, Galusha, Maisel, Mitchell, Robertson, Scanlon, Shepardson, and Irons. Votes against this action: None.

November 2, 1965

Authority to effect transactions in System Account.

Gross national product advanced at an annual rate of \$11 billion in the third quarter of 1965, according to preliminary estimates, compared with an increase of \$9.5 billion in the preceding quarter. Although the adjustment of steel inventories was producing a considerable drop in the rate of business inventory accumulation and a leveling off in industrial production in the fourth quarter, another substantial rise in GNP appeared likely as marked further gains were expected in outlays for business fixed investment, in Federal defense outlays, and in consumer incomes and spending.

Contrary to earlier indications, average prices of industrial commodities were stable from mid-August to mid-September, and weekly estimates showed little change through late October. The consumer price index rose by two-tenths of 1 per cent in September, the amount by which it had declined in August, with seasonal increases in apparel and fuels accounting for much of the rise.

Partial data for October suggested that industrial production might have been maintained at about the September level, 1 per cent below the previous month, despite a further decline in steel output. In September, strikes in a number of industries and the impact of "Hurricane Betsy" on crude oil output had served to reinforce the effects of the steel contraction on total output; subsequently, however, settlement of the strikes and recovery of oil production had acted to offset the further contraction.

Growth in the money supply was rapid in early October—although less so than during September—partly because U.S. Government deposits were reduced further. Loan demand at commercial banks continued strong and seemed likely to remain vigorous over the final months of the year despite reduced needs for funds by firms that had been stockpiling steel. Net borrowed

reserves of member banks averaged about \$130 million in October, compared with about \$140 million in September and \$170 million in August.

Interest rates on short- and long-term Treasury securities, which had declined in the first half of October, subsequently edged up again. The general tone of security markets was cautious in the face of good business prospects and heavy actual and anticipated demands for funds. Average prices of common stocks rose to new highs on very heavy trading volume. On the day preceding this meeting the Treasury offered a 4¼ per cent 18-month note for cash, to refund issues maturing on November 15. It was expected that the Treasury also would auction between \$2 billion and \$2.5 billion of tax anticipation bills within the next few weeks.

The U.S. trade surplus improved substantially in the third quarter, according to preliminary estimates, to an annual rate somewhat over \$6 billion. The latest information on the over-all balance of payments in the quarter, however, indicated that the deficit on the "regular transactions" basis was considerably larger than had been estimated earlier—at an annual rate about double that of the first half—and that the surplus on the "official settlements" basis was smaller than had been anticipated. In September, taken alone, the accounts were in deficit on both bases of calculation.

The Committee agreed that the Treasury financing now in process precluded a change in monetary policy at this time. The possibility was noted that market forces might exert upward pressure on interest rates over coming weeks, and divergent views were expressed regarding the appropriate response in such an eventuality. Some members advocated active resistance to any such forces, while others favored permitting rates to rise in response to them.

Views also differed with respect to the type of policy that was likely to be required following completion of the Treasury

financing. Some members felt that it would prove desirable then for the System to adopt a firmer policy stance, and a possible increase in the discount rate was mentioned in this connection. These members thought a firmer policy, by reducing the rate of bank credit expansion and damping incipient inflationary pressures, would prove helpful both in promoting the sustainability of the domestic expansion and in ameliorating the balance of payments problem. Other members were of the opinion that current domestic and international conditions did not warrant a firmer policy on the part of the Committee nor an increase in the discount rate. They disagreed with the view that such actions would help to maintain the domestic expansion, and they did not consider general instruments of monetary policy to be the appropriate means for dealing with the balance of payments problem under present circumstances.

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 that over-all domestic economic activity has expanded further in a continuing climate of optimistic business sentiment and firmer financial conditions, and that our international payments have remained in deficit. In this situation, it remains the Federal Open Market Committee's current policy 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, and taking into account the Treasury financing schedule, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the same conditions in the money market that have prevailed since the last meeting of the Committee.

Votes for this action: Messrs. Martin, Hayes, Balderston, Daane, Ellis, Galusha, Maisel, Mitchell, Patterson, Robertson, Scanlon, and Shepardson.

Votes against this action: None.