FRB Annuals

FEDERAL RESERVE BANK OF NEW YORK

ANNUAL REPORT 1963

FEDERAL RESERVE BANK OF NEW YORK

February 26, 1964

To the Member Banks in the
Second Federal Reserve District:

It is with great pleasure that I present our forty-ninth Annual Report, reviewing the economic and financial developments of 1963.

The past year has witnessed impressive achievements but also left important unfinished tasks. The third consecutive year of domestic economic expansion led to new records in production and employment. The United States also made further progress in reducing its balance-of-payments deficit, after a serious setback in the first half of the year. Monetary policy, while taking a moderate turn toward less ease and thus aiding in the advance toward international payments equilibrium, provided bank reserves that permitted a near-record increase in bank credit. Despite the achievements of 1963, unemployment remained high and the balance-of-payments problem still serious as 1964 opened. Further growth at home, the maintenance of price stability, and the necessary corrections in this country's balance of payments will require an imaginative and flexible use of monetary, fiscal, and other policies in the year ahead.

Alfred Hayes

ALFRED HAYES
President

1914 FIFTIETH ANNIVERSARY 1964

Federal Reserve Bank
of New York

FORTY-NINTH ANNUAL REPORT

For the Year
Ended
December 31, 1963

Second Federal Reserve District

Contents:

1963: Achievements and Unfinished Tasks

On many counts, the 1963 performance of the United States economy and, indeed, of the international economic and financial system as a whole, gave grounds for solid satisfaction. The year was one of continued growth, unmarred by setbacks of recession or damaging foreign exchange crises. Yet 1963 also brought a heightened awareness that progress toward optimum resource utilization at stable prices and toward balance-of-payments equilibrium was far from adequate. At the year end, it was apparent that solutions to persisting as well as newly emerging problems would not only require intensified efforts along many established lines but would also call for new policy approaches and changes in the "mix" of policy instruments.

THE YEAR'S ACHIEVEMENTS. A few months before 1963 began, the prospect for continued economic progress had by no means seemed assured. Production and employment in the United States had shown little gain since the summer of 1962, and many observers predicted that the new year would see an economic downturn — a view that gained impetus from the fact that the upswing from the last cyclical trough had already lasted close to two years. A possibility that a major strike might engulf the steel industry by mid-1963 added to the existing uncertainties. The deficit in the United States balance of payments, moreover, was increasing at an alarming rate, and there were indications that it would remain very large in the early part of 1963.

Viewed against this setting, the economy's actual performance in 1963 was impressive. Real output of goods and services rose by more than 4 per cent over the year, slightly more than during 1962. Indeed, by the end of 1963 the economy's expansion had already lasted almost as long as the 1954-57 upswing, and the net gain in output since the trough in activity in early 1961 compared favorably with most earlier postwar cyclical advances. Personal income per capita and corporate profits reached record levels in 1963, employment expanded by over a million persons, and while the over-all jobless rate showed no change, unemployment among married men averaged somewhat lower than in the preceding year. The balance-of-payments drain, after intensifying severely in the second quarter, was sharply reduced in the second half of the year, and the foreign exchange markets remained remarkably stable throughout 1963. These accomplishments are all the more noteworthy if one takes account of the many events during the year that could have had seriously adverse repercussions on the business situation or on international financial markets—including the rejection early in the year of Great Britain's application for membership in the European Economic Community; the widespread unrest connected with the civil rights struggle; the failure of Congress to pass the tax reduction bill; and, above all, the tragic death of President Kennedy at the hands of an assassin in November.

In part, the progress achieved in 1963 was a tribute to the underlying strength and resiliency of both the domestic economy and the existing international economic and financial system. On the domestic front, much of the credit for the continuation of the economic expansion could also be ascribed to the fact that the advance took place in a relatively noninflationary and competitive environment, largely free of the excesses of speculative inventory build-ups that had developed in the course of earlier postwar upswings. Moreover, the achievement of a reasonable wage settlement in the steel industry well before the contract deadline helped to provide a sound underpinning for an orderly and sustained advance, as did the influence of the 1962 changes in depreciation rules and the tax treatment of investment. In the international area, at least some of the improvement in the United States balance-of-payments position could be regarded as stemming from the gradual working of underlying equilibrating forces as well as from the slowly cumulating influence of long-term governmental corrective measures initiated in prior years. More immediate and dramatic effects were, of course, exerted by the Administration's proposal for an interest equalization tax on purchases of new and outstanding foreign securities from foreigners and by monetary policy actions that placed upward pressures on short-term interest rates.

Monetary policy — closely coordinated with debt management — clearly played an important role in the year's accomplishments. A slight firming in policy had taken place late in 1962, and a further turn toward less ease occurred in mid-1963, in response to the serious deterioration in the balance of payments and within the context of an improved business situation. Even with these policy changes, however, the domestic economy remained amply supplied with credit and liquidity throughout the year. The 8 per cent advance in aggregate bank credit almost matched the record postwar gain of the previous year, and the ratio of total liquid assets of the nonbank public to gross national product rose above its level at the recession trough of 1961, contrary to the experience of earlier postwar upswings. At the same time, the modest policy shifts that did occur — including the midyear increases in the discount rate and in Regulation Q ceilings on time deposit rates — played a major role in the reduction of capital outflows and of the over-all payments deficit.

It was encouraging, moreover, that these actions could be carried out as part of a broader complex of Federal Reserve and the Treasury measures designed to strengthen the position of the dollar. The network of reciprocal currency arrangements among central banks was broadened and consolidated, and there was continuing close cooperation among monetary authorities here and abroad. That these arrangements had been refined to a point where they could cope successfully with the most severe sudden emergencies was convincingly demonstrated by the stability of the gold and foreign exchange markets in the face of several extraordinary shocks — most dramatically the assassination of the President of the United States. In turn, the knowledge that the monetary authorities here and abroad were able and willing to act speedily and decisively in times of crisis served as a major deterrent to the emergence of speculative disturbances.

UNFINISHED TASKS: THE DOMESTIC ECONOMY. Almost paradoxically, the relative success with which shorter term domestic and international economic problems were being tackled in 1963 focused attention more forcefully on the nature and magnitude of the structural and longer range problems that remained unresolved. Although many of the issues posed were essentially no different from those that had existed or could have been foreseen a year earlier, the difficulty of arriving at basic solutions tended to place these problems in a new perspective as the year drew to a close, and raised new questions about the priorities that needed to be assigned to different types of solutions.

Domestically, it was striking that, even with a marked further growth in demand and output and a rise in average living standards, the economy continued to operate well below its potential. The over-all unemployment rate was no lower than a year earlier, and all too little progress had been made toward eliminating the numerous pockets of poverty. There were indications, moreover, that the difficulties of finding solutions might increase as a result of structural changes that were emerging or still lay ahead — most notably the dramatic rise in the proportion of younger persons in the labor force and the apparently accelerated pace of mechanization and automation.

A second issue that received increasing attention during 1963 related to the impact of shifts in demand on different sectors and areas of the country. Such shifts have, of course, always occurred in the American economy. But the magnitude of the changes that had taken place in recent years or were now appearing on the horizon seemed in a number of respects to be more substantial than those experienced for some time, and to pose exceptional problems of adjustment. In part, these changes were related to the rapid growth in the demand for services, to the spread of new products and techniques, and to the influence of foreign competition. There was also, however, an indication that for the first time in many years defense and related expenditures in the aggregate might soon be reduced significantly, even within the context of a strengthening in the country's military position. In addition, the conclusion of a test ban treaty with the Soviet Union made the possibility of limited moves toward disarmament appear at least somewhat less remote than in the past.

A third problem that seemed to loom larger by the year's end was that of price stability. If efforts to move the economy closer to its potential should indeed prove successful, could price stability be maintained? Although the general level of prices in the United States had shown remarkably little change in the past six years, it was not clear to what extent this had merely been a result of the fact that the country had operated well below capacity over this period, and to what extent it represented a more basic strengthening in the economy's ability to resist inflationary influences. A note of warning was sounded during the latter months of the year as indications appeared that the firming in the economic picture which had already occurred was beginning to lead to some scattered upward cost and price pressures, well before unemployment had been reduced to a tolerable level. The real test in this area clearly still lay ahead.

In the light of such problems, it became increasingly apparent as 1963 progressed that achievement of optimum resource utilization in an environment of price stability would not only require a relatively rapid rate of increase in the volume of total spending, but would also necessitate a wide range of measures designed to deal with specific problems of economic structure and adaptation to economic change. To cope with the problem of unemployment, for example, and to increase over-all efficiency, much greater stress than in the past would have to be placed on measures to raise the general level of education, to improve and expand particular types of technical training, and to enhance labor mobility as well as equality of access to job opportunities. A more concentrated attack was also required on many of the more specific causes of poverty. While many of these measures called for increased governmental and community efforts, there was a simultaneous need to increase the effectiveness of the Federal, state, and local governments themselves by eliminating unneeded or inefficient operations wherever possible. And there was an equal or even greater need for steps that would enhance the efficiency and competitiveness of the private sector and encourage a freer play for private initiative.

Public and private efforts along these lines would not only help to create the jobs that were needed and to smooth the process of adaptation to major structural shifts in demand and production, but they would also provide the best insurance against the emergence of a renewed inflationary push. Reliance on restrictive practices and inefficient methods — often in an effort to delay or ward off the effects of economic changes — in the past had all too frequently led to higher costs and prices. If a "cost push" was to be avoided, it was essential that labor, businessmen, and farmers alike make every effort to adapt to the changing economic environment in a way consistent with rapid increases in efficiency. At the same time, their willingness to follow this prescription would in appropriate instances need to be strengthened by expanded public and private measures to mitigate the temporary hardships that might be entailed.

While action along such lines seemed a prerequisite to the solution of the longer term economic problems, it was equally true that a vigorous increase in total demand remained essential, both as a direct stimulant to the over-all volume of activity and as a needed lubricant in the process of required structural adjustments. But it was also apparent that the weight of responsibility for assuring an appropriate growth in total demand had fallen too heavily on monetary policy, and that fiscal policy needed to bear a larger share.

These conclusions had seemed evident a year earlier in the light of considerations relating to the United States balance-of-payments position; they now appeared firmly established on purely domestic grounds as well. There seemed no doubt that monetary measures had played a vital role in the promotion and support of the sustained economic expansion during the past three years. But this had entailed large and steady increases in the volume of liquid assets. Consequently, the monetary authorities had to be alert to the danger that a continuation of the existing degree of monetary ease, as the economy more closely approached its full potential, might provide it with a volume of liquidity that exceeded its needs and that could serve as an underpinning for an inflationary outburst at a future date. Moreover, there were signs that instances of speculative abuses or other undue relaxation of standards had tended to increase in some credit markets.

Of course, the existence of some undesirable uses of credit did not in itself necessarily indicate that the over-all volume of liquidity in the economy was already excessive. To some extent, such credit uses might be the result of overconfidence engendered by the sustained nature of economic expansion — an expansion to which credit ease itself had contributed materially. There was also a question to what degree the recent dramatic changes in financial techniques, structure, and institutional arrangements—which in many respects were highly desirable—and the resultant heightening of competition among financial institutions and markets could be held responsible for instances of reduced credit quality. The monetary authorities would have to pay close attention to the impact of these many changes on the direction of credit flows and their implications for monetary policy, as well as to their effects on the longer run strength and efficiency of the banking system.

Nevertheless, there was a definite need for giving new thought to the question of what constituted an appropriate rate of over-all growth in bank credit and liquidity. Monetary policy had proved more flexible in responding to the needs of the economy than had fiscal policy. But this was not a sufficient reason for overburdening monetary tools. On the contrary, it called not only for prompt enactment of the long delayed tax cut, but for institutional changes that would render the fiscal system more capable of responding quickly to changing economic circumstances in the future. These actions were all the more necessary because of the continued need to give monetary policy adequate scope to deal flexibly with the crucial task of defending the international position of the dollar.

UNFINISHED TASKS: THE INTERNATIONAL ECONOMY. Despite progress in the second half of 1963 toward achieving balance in the United States payments position, it was clear that the gains already made had to be consolidated and further inroads made on the deficit in the year ahead. The vital role played by the dollar as the keystone of the international financial system made it imperative — for the rest of the world as well as for the United States — that this process of adjustment be seen through to completion. The need for continued progress in this direction was indeed becoming more urgent with the passage of time because of the cumulative effects of sustained payments imbalances.

While the United States could thus in no way afford to relax its efforts to improve its payments balance, it was important to remember some of the special characteristics of its position. It is often too easily forgotten that the payments difficulties of the United States were in significant part a direct result of the extraordinary success of its earlier efforts to help strengthen the economies of its Western allies. Had these efforts not aided in achieving our goal of increased currency convertibility and thus contributed to the rapid internationalization of financial markets, the United States and other countries would not now have to cope with the problems of highly volatile short-term capital movements; and it was this country's own role in enhancing the attractiveness of investment in Europe which had been a strong factor in the growth of direct American investment abroad. If, moreover, additional pressures on the United States balance-of-payments position were exerted by greatly enlarged foreign demands on the United States capital market, such pressures arose precisely because of the unique size, strength, and accessibility of this market. And it also had to be recognized that the United States' continuing outlays for defense and foreign aid—which contribute to the payments drain despite useful moderating devices such as offsetting foreign military purchases in the United States and the tying of aid—were of vital importance to the security of the countries in whose hands United States dollar liabilities had accumulated, and in sustaining and fostering economic growth and freedom in underdeveloped countries.

A satisfactory solution to the problem of the United States payments deficit did not lie in measures that would weaken the over-all strength of the Free World, nor in steps that would basically jeopardize the further development of a world economic and financial system characterized by growing freedom for private trade, investment, and initiative. Neither, however, was it appropriate for the United States to continue to bear as heavy a share of the responsibility for furthering these objectives as in the past. While important progress in this area was made in 1963, there remained a need for other industrialized countries to assume a relatively larger share of the burdens of mutual defense and foreign aid, to make greater efforts to provide for their internal development by recourse to their own capital markets, and to reduce existing restrictions on the free movement of goods and capital. In this context, the impending 1964 round of GATT negotiations offered a major opportunity for effective trade liberalization—especially by those countries forming regional, and potentially discriminatory, trading areas.

The underdeveloped countries, moreover, faced a greater responsibility to make certain that the United States aid resources they received would be used in a truly effective manner — and there was, indeed, a greatly increased determination in the United States to insist that this responsibility be carried out, and that the procedures used in giving aid be improved. At the same time, there was a clear obligation on the United States itself to strengthen its own economy. Indeed, the very measures that were required for sound economic growth at home — including the encouragement of greater competitiveness, increased stress on productivity, and avoidance of price inflation — were crucial for the improvement of the country's international position.

During the year considerable attention was paid to the long-run problems of international liquidity. There was general agreement that no present shortage of liquidity existed, and it was quite clear that for the United States its own balance of payments remained the matter of first priority. The initiation in 1963 of formal studies looking forward to the time when the United States deficit would no longer be adding to the liquidity of the rest of the world was welcome. It was equally clear, however, that a solid foundation for meeting future liquidity needs already existed in the International Monetary Fund and in the cooperative arrangements undertaken by the monetary authorities of the leading industrial countries in the recent past. There could be no doubt, moreover, that the dollar's role as the major reserve currency, which had served the world so well, had to continue if further progress was to be made. Indeed, it had to be recognized that suggestions for revolutionary changes in the international financial mechanism were fraught with danger. Just as increases in the volume of liquidity at home were not the full answer to the problems of the domestic economy, major attention in the international area needed to be paid not only to over-all liquidity but to the nature and uses of any new liquidity instruments that might be created, as well as to the extent to which their employment would be compatible with the exercise of the basic disciplines necessary for achieving and maintaining payments equilibrium.

A LOOK AHEAD. As the year closed, it remained clear that solutions to both current and longer range economic problems would have to be found within an environment of sustained growth. But it was also becoming increasingly evident that the nature and quality of economic growth could be as important as its magnitude. Monetary policy would play a part in the effort to deal with these problems, but fiscal policy as well as a wide range of other policy instruments would have to assume an expanding role.

This was the case abroad as well as in the United States, in part because in a world of freely convertible currencies no nation can disregard the policies being carried out in other leading countries, or the effects its own policies are having elsewhere. Looking ahead to 1964, the measures adopted by those European countries that currently face inflationary tendencies will be of considerable importance for the United States. Altogether, the achievement of a soundly based advance both here and abroad is likely to prove a complex task calling for sterner internal disciplines and a greater measure of mutuality in international relations than have yet been attained.

THE AMERICAN ECONOMY IN 1963

Business Conditions: The Third Year of Expansion

Through most of 1963, as the American economy achieved its third successive year of sustained growth, business sentiment regarding short-term prospects was generally favorable, reflecting both rising profits and the anticipation of a tax cut. This was in marked contrast to the general feeling of uneasiness that had prevailed during much of 1962. Thus, even though over-all activity was curtailed by unusually severe weather in January and retail sales continued to edge downward through May, it was readily apparent by mid-April that most areas of the economy had broken out of the pattern of sluggishness that had characterized the last half of 1962. The underlying business optimism—as reflected, for example, in the spring surveys of capital spending plans which pointed to gains in plant and equipment outlays over the balance of the year—was reinforced when the steel industry in April found demand strong enough to put selective price increases into effect.

The subsequent expansion in over-all activity well fulfilled these expectations—though of course there continued to be occasional setbacks in individual sectors. Housing starts fell off in June and August, for example, following a surge in the preceding several months. Steel production also declined during the summer months under the influence of a large overhang of inventories that had been built up during the first half of the year in anticipation of a possible steel strike, and automobile output dropped sharply in August because of a greater than usual concentration of model change-overs. While these developments caused declines in a number of the broad monthly measures of activity, they were generally regarded at the time as temporary interruptions of a continuing expansion—an appraisal that proved correct. One barometer of business confidence—the stock market—actually pushed upward in August and, in September, rose above the previous all-time high reached in December 1961.

Although business sentiment during the fall seemed to reflect a gradually growing disappointment that a reduction in taxes had not yet materialized, most measures of actual activity showed further gains. Indeed, the advances in gross national product (GNP) in the third and fourth quarters were the largest in two years (see Chart 1). This momentum served as reassurance regarding the underlying strength of the economy when the world was shocked by the assassination of President Kennedy on November 22. By the year's end, the current expansion, which had begun in March 1961, had lasted for thirty-four months. This exceeded the length of the cyclical advance that had started in May 1958 and almost equaled that of the 1954-57 upswing. The economy was, however, still not utilizing all of its resources. The unemployment rate in December, at 5½ per cent, was the same as a year earlier and, indeed, had shown little change since early 1962; manufacturers, moreover, were still operating below their preferred rates of capacity utilization. Thus, it was gratifying that President Johnson gave his full support

QUARTERLY CHANGES IN GROSS NATIONAL PRODUCT AND INVENTORY INVESTMENT. GNP showed sizable gains in all four quarters of 1963 and, compared with 1962, swings in inventory investment were very mild.

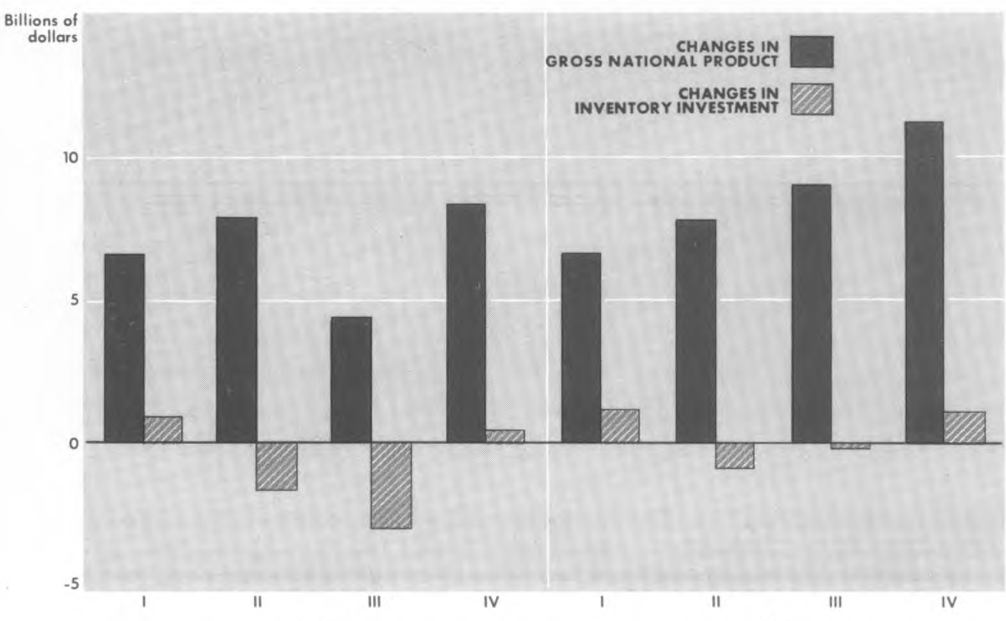


CHART 1

Seasonally adjusted annual rates.

to an early-1964 enactment of the proposed tax cut, which in turn seemed to buoy confidence in the prospect for further economic expansion.

STANDARDS OF ECONOMIC PERFORMANCE. Whether one is satisfied with the performance of an economy depends, of course, on the standards by which that performance is judged. Measured against the gains in production that had been expected, or against historical rates of growth of physical output, the economy's achievements in 1963 have to be marked down as good. In climbing to $585 billion, GNP reached a level above the upper end of the range that the Council of Economic Advisers had forecast at the year's start — and this forecast had been based on the assumption of a mid-1963 tax cut. The rise in GNP from the fourth quarter of 1962 to the final quarter of 1963 amounted to nearly $35 billion. Measured in constant prices, the over-the-year advance was 4.3 per cent, with the gain since the business-cycle trough in 1961 running at an annual rate of nearly 5½ per cent. This exceeded the gains in each of the preceding cyclical upswings since World War II, except that of 1949-53, which had been boosted by the step-up in military production for the Korean war. Taking a longer view, the advance in GNP in constant prices in 1963 was considerably above the 3.2 per cent annual average rate of growth experienced so far this century, and even compared favorably with the rate of growth during the immediate postwar years up through 1957—a period when backlogs of unfilled demands stimulated production.

Along with the growth in over-all output, there were many other indications of the economy's impressive performance in 1963. During the summer more than 70 million Americans were at work—an all-time high—and disposable income per capita for the year as a whole rose above the $2,100 mark—nearly a 2 per cent gain in constant prices. Sales of domestic and imported cars finally topped the previous record set in 1955, and the steel industry had its best year since 1957, turning out over 109 million tons of ingots. With credit conditions remaining generally easy in the mortgage market, work was begun on more than 1.6 million new private nonfarm housing units. Partly in response to these high levels of activity, corporate profits rose to a new record, and profit margins continued to be maintained, in contrast to the declines in margins that occurred after the first year and a half of expansion in the preceding postwar cycles.

Rapid growth or the setting of new production records, however, is not necessarily the most relevant standard for judging the economy. The potential level of output is also important, and in this respect 1963's performance could have been better. To be sure, there is no completely accurate measurement of what the economy might have produced in 1963, since estimates of this potential based on historical relationships may not fully take into account the structural changes in technology and labor-force composition that have been occurring. It is noteworthy, however, that, even if no attempt is made to measure potential output, 1963's performance left much to be desired. GNP (in constant dollars) has since 1959 grown at an average annual rate that is about the same as the growth rate over the 1946-57 period. Yet, there was an interruption in growth during the 1958 recession, which could have been made up fully in the past few years only with better than pre-1957 growth rates. A similar interruption appears in the Federal Reserve's index of industrial production.

Whatever the measurement, there was little disagreement that the shortfall from the economy's potential was directly reflected in the unemployment rate, which has remained high during the past several years and in 1963 averaged 5.7 per cent of the civilian labor force. It was encouraging that the unemployment rate for married men averaged lower than in 1962, suggesting that cases of severe hardship from unemployment may have been somewhat less widespread than a year earlier. In contrast, the jobless rates for unmarried adult men and for teen-agers other than married males both rose in 1963, in part reflecting the structural and educational aspects of the nation's unemployment problem.

It is, of course, impossible to determine just how many of those who were unemployed or who were potential job applicants could have been put to work even if a sufficient number of jobs had been available. Certainly some of the unemployed were voluntarily between jobs or were out of work for seasonal reasons; this type of unemployment has existed even in periods when jobs have been extremely plentiful. In addition, there undoubtedly were many in the remaining unemployment total who were considered by potential employers to be "unemployable" with their present training and at the going wage in their present localities. Many such persons are much in need of more job training before they can realistically be considered as part of an immediately usable untapped potential. Also, more guidance may well be needed as to available employment opportunities in other localities and, quite possibly, in some cases with regard to practical wage expectations. The experience in 1963 in such communities as Buffalo, Detroit, Gary-Hammond, and Youngstown — where additional jobs became available with gains in steel and automobile production — demonstrates, however, that, even at the current high levels of output, increases in demand remain a powerful force in putting people back to work.

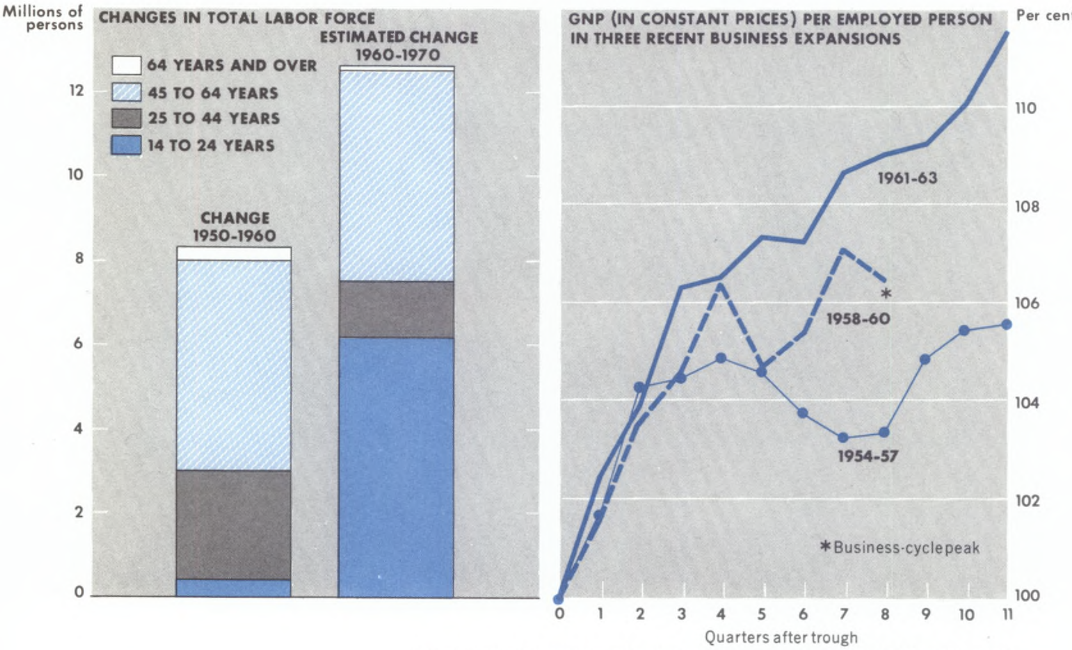
The gap between actual and potential performance was also reflected in the continued presence in 1963 of a larger than desired amount of unused industrial capacity. There are, of course, conceptual and technical difficulties associated with the measurement of capacity. It is not known for certain, for example, how much of reported capacity is realistically operational and how much is obsolete or, on the other hand, whether some capacity is not reported. Some of these difficulties may not be so important when comparisons are made over reasonably short periods of time, however; and it may be significant in this regard that there did seem to be some improvement in over-all utilization rates, concentrated in the first half of 1963. Moreover, output in some individual sectors—notably the aluminum, paper, and textile industries—apparently was fairly close to practical capacity. Nevertheless, according to the McGraw-Hill survey, manufacturers as a group were at the end of September still operating at about 7 percentage points below what they indicated as their preferred utilization rate; and there was little apparent closing of this gap during the remainder of the year.

CHALLENGE FOR THE FUTURE. The challenge of stepping up the rate of growth of our economy appears even greater for the years ahead because of the more rapid increase that is expected in the labor force and that may occur in productivity. Some glimpse of the coming surge in job applicants was already apparent in 1963, as the youths who were born in the baby boom following World War II began to reach the age at which many seek either permanent or part-time employment. Thus, the number of 16- and 17-year-olds in the labor force jumped by about 250,000 in 1963, in contrast to decreases in this age group in the two preceding years. By 1970, according to Labor Department projections, the prospect is that there will be nearly 20 million persons under twenty-five years of age in the labor force—an increase of 6 million persons, or 45 per cent, over the number in this age bracket in 1960; during the 1950's, the size of this age bracket grew by only 370,000, or less than 3 per cent (see Chart 2).

The sheer size of the group of new entrants into the labor market renders far from easy the task of absorbing them smoothly and quickly into useful employment. Rapid productivity gains, while gratifying in themselves, may complicate the task further. Such gains have already proceeded at a more rapid rate in the current expansion than in the two previous business upswings (see Chart 2) and may well continue to be large, in part reflecting mechanization and automation.

Changes in technology, to be sure, have in the past created many new jobs —

THE CHALLENGE OF ACHIEVING FULL EMPLOYMENT. The expected surge in the labor force, as the youths born in the postwar baby boom come of age, and the prospect of further rapid gains in productivity present the economy with a twofold challenge to its ability to provide sufficient employment opportunities for all who want to work.



Productivity data are derived by dividing GNP in 1954 dollars by total employment. The figures for the quarterly troughs in general business activity–1954-III, 1958-II, and 1961-I–are set equal to 100.

CHART 2

not only in fields that were unknown several years earlier but also in existing fields, since lower costs, if reflected in lower prices, tend to broaden a product's market. On the other hand, technological progress has also made some jobs obsolete; and the higher the level of productivity the fewer the number of new jobs created by any given growth in sales. In the steel industry, for example, which spent about $1.2 billion for new plant and equipment in 1963 and plans to spend another $1.9 billion in 1964, the new basic oxygen furnaces apparently can produce about three times as much output per man-hour as was produced by the open hearth process. And in the farm sector, which as late as 1950 provided jobs for about one out of every eight workers, productivity gains have been so rapid that employment has dropped by a third over the past thirteen years despite a 15 per cent gain in output.

To find ways of dealing with the problems created by the accelerated rise in the labor force and by technological progress is a major challenge for the nation. Certainly, part of the solution, as mentioned earlier, would seem to lie in raising the over-all level of education of the work force as well as in providing more specific job training. Thus, there is a need to ensure that young people remain in school long enough, and learn enough, to be able to keep pace with the rapid changes in job demands that are constantly raising the general educational requirements placed upon workers. It is also necessary to provide for effective vocational training for some of these youths and to establish facilities for retraining persons who are or may become unemployed as technology advances. The $91 million spent in 1963 under the Manpower Development and Training Act reflects a recognition by the Federal Government of the need and the Governmental responsibility to improve the specific skills of individual workers. Broadened union-apprenticeship programs and private retraining facilities are also necessary and are only gradually being given the attention they deserve; and the same is true of mechanisms guiding a worker into localities where jobs are available once he possesses the needed education and training. At the same time, however, the very ability of the economy to create these job openings will depend to an important extent on the rate of over-all economic growth. Indeed, without adequate creation of additional jobs, training and labor mobility can go to waste and even add to feelings of frustration.

NEED FOR CONTINUED PRICE STABILITY. The pressing need for rapid economic growth in the years ahead must not obscure the equally important necessity of maintaining over-all price stability such as has characterized the past six years. Only if prices and costs are kept substantially stable can the nation hope to solve the problem of reconciling economic growth with balance-of-payments progress.

Price developments in 1963 were, on the whole, relatively free from inflationary overtones, in gratifying contrast to the appreciable pressures on wages and prices in some foreign industrialized nations. There was, to be sure, a somewhat larger rise in the consumer price index during 1963 than in other recent years, but the advance was still considerably less than that experienced in the 1956-57 period (see Chart 3). Food prices rose somewhat further over the year, and prices for consumer services continued their postwar uptrend. Among commodities other than food and services, prices went up during the year for such diverse items as

RELATIVELY STABLE PRICES. Although the increase in consumer prices in 1963 was a little larger than the annual average rise in the preceding five years, the advance was less than in the 1956-57 period. Total wholesale prices again showed little net change over the year, but there was a noticeable strengthening in prices of industrial commodities after April.

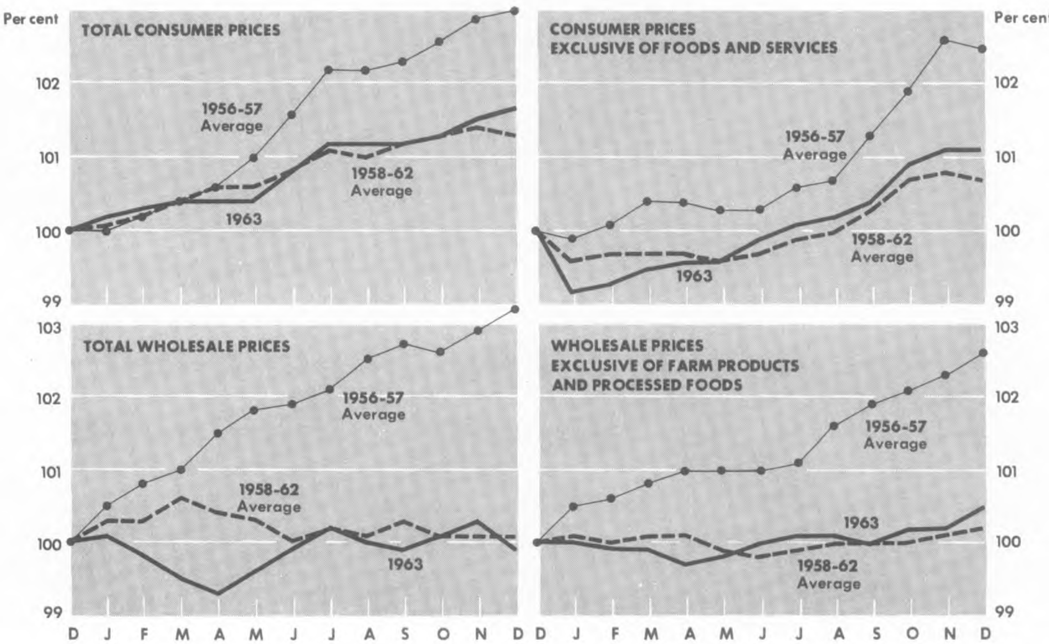


CHART 3

Monthly figures for each year are shown in terms of an index with the value for December of the preceding year set equal to 100.

petroleum fuels, newspapers, cigarettes, and apparel. At the wholesale level, the over-all index continued to show the same over-the-year stability that had characterized the preceding five years, as declines in the prices of farm products and processed foods offset a small net advance in industrial goods prices.

Over-the-year changes do not, however, offer a complete picture of the price situation in 1963, and during the last half of the year in particular much of the "business news" seemed to be about price increases. This impression was only in part based on increased strength in world commodity prices. More specifically, the steel industry, after having raised prices on a selected group of items in

April, broadened the list further in October so that about three fourths of the industry's total tonnage was raised in price during the year. The over-all increase averaged just under 2 per cent. Increases in wholesale prices were also announced for such commodities as aluminum, lead, carpets, several types of machinery, and some construction materials. Reflecting this flurry of price rises, the wholesale index for all industrial commodities edged upward by 0.8 per cent from a four-year low in April to 101.2 per cent of the 1957-59 average by the end of the year. Moreover, it is possible that prices in actual transactions rose somewhat more than shown by the official index, owing to the fact that some reporting firms may have failed to indicate changes in discounts previously available. During a business upswing—particularly if it has proceeded for some time—such changes would most likely tend to be largely in the direction of lowering or wiping out discounts and thus raising actual prices paid by buyers.

On the other hand, there still were encouraging signs of continued substantial stability in industrial prices in 1963. Along with the second flurry of increases—after those in April—some price hikes were rescinded, while price reductions for such important materials as some chemicals, fuels, and leather were also announced. Moreover, the decision by the automobile manufacturers to introduce the new models at about the same price as a year earlier, together with an apparently widespread practice on the part of fabricators of absorbing increases in materials costs, seemed to underscore the absence of significant inflationary pressures.

It remains true that further economic expansion strong enough to bring businesses closer to their preferred operating rates could strengthen the forces making for higher prices, as could further rises in world commodity prices. There is a need, therefore, for businessmen and labor unions to continue to exercise restraint in their wage and pricing decisions. Efforts directed at modernizing productive facilities and raising productivity must be transmitted into lower prices in a significant number of instances if upward pressures on the general price indexes are to remain minimal. Some encouragement can be derived from the fact that during the past several years the rapid gains in productivity have on average been sufficient to offset wage increases, which in turn have been proportionately smaller on average than in most of the earlier postwar years. The substantial rise in the labor force that is expected in the years ahead may help to provide a continuing restraint on upward wage pressures. The strength of foreign competition should also act as a disciplining influence on domestic pricing decisions and wage demands.

Monetary Policy: Moderate Movement from Ease

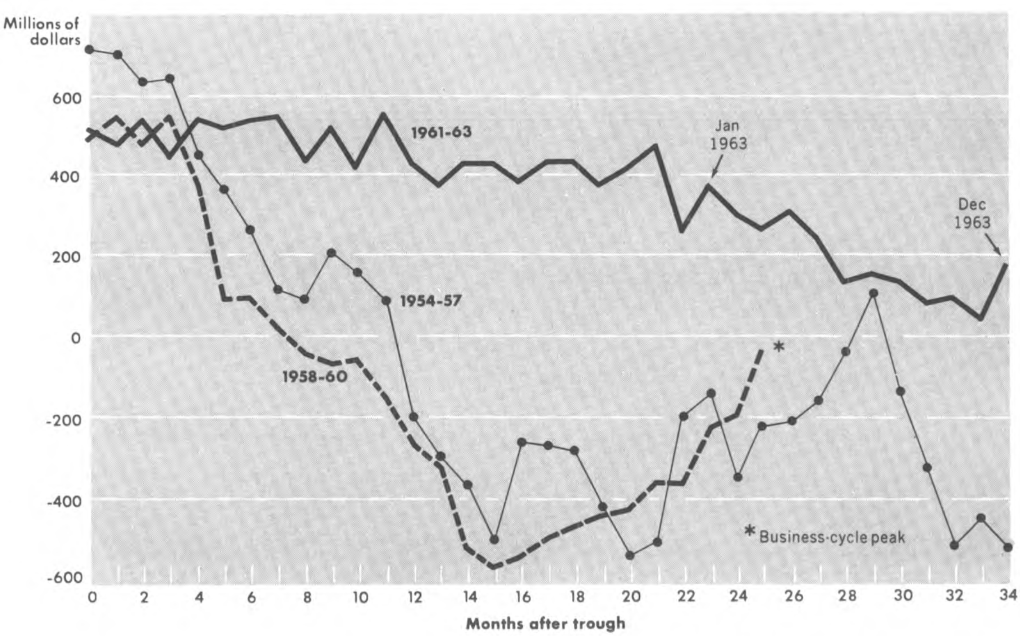
With domestic economic activity expanding at a good rate throughout the year and with business sentiment generally confident, monetary policy took a modest further turn toward less ease in 1963. Nevertheless, another major expansion of bank credit—only a little less than the record postwar rate of increase in 1962—was readily accommodated within the framework of that policy. The gradual turn in policy was prompted primarily by the need to reduce the deficit in the nation's balance of payments, but the steps taken were compatible with domestic economic and credit developments as well. Thus, in broad terms, 1963 did not witness any sharp shifts but rather only gradual modifications in policies pursued earlier, as the authorities continued to take advantage of the inherent flexibility of monetary policy—probing toward less ease, while maintaining the possibility of halting or even reversing the process should domestic economic developments have made such steps necessary.

In promoting firmer short-term interest rates while continuing to encourage growth in bank credit, the Federal Reserve had less need to resort to the special operating techniques that had been employed during the preceding two years. To be sure, the System once again provided reserves through purchases of coupon securities, but at a reduced rate. Moreover, the concentration of Treasury bill sales in the three-month area—a characteristic of 1962—was less often necessary in the firm money market environment of 1963. The System, in fact, increased its Treasury bill holdings by $1.7 billion during the year.

The first step in shaping Federal Reserve policy during 1963 was taken just prior to the end of 1962 when the Federal Open Market Committee voted to conduct System operations during the immediate post-Christmas period "with a view to offsetting the anticipated seasonal easing of Treasury bill rates, if necessary through maintaining a firmer tone in money markets, while continuing to provide moderate reserve expansion in the banking system". The money market was somewhat firmer in the months that followed. Thus, during January-May 1963 the interest rate on Federal funds was seldom below the discount rate, and the market rate on three-month Treasury bills edged up to the 2.88-2.98 per cent range, compared with a 2.87 per cent average in December 1962. At the same time, free reserves averaged about $300 million, compared with about $400 million during the last half of 1962. Even so, free reserves remained well above the levels that had prevailed two years or so after the two previous business-cycle troughs (see Chart 4).

With the accumulating evidence of the sharp second-quarter deterioration in the balance of payments (see section on The International Economy in 1963), the System attempted to promote somewhat more firmness in the money market. Market rates on Treasury bills, which had begun to edge upward in June, rose more sharply in the first weeks of July. On July 16 the discount rate was raised at this and six other Federal Reserve Banks to 3½ per cent from the 3 per cent level that had been in effect since mid-1960; the other five Reserve Banks followed suit shortly thereafter. At the same time, the Board of Governors revised Regulation Q to increase to 4 per cent the maximum rate of interest that member banks could pay on time deposits with maturities from ninety days to one year.

FREE RESERVES. Although free reserves declined in 1963, they were still appreciably above the levels that had prevailed after a similar length of the expansion phase of the two preceding business cycles.



Member bank free reserves are excess reserves less borrowings from the Federal Reserve Banks. Troughs in general business activity: August 1954, April 1958, and February 1961.

CHART 4

These actions were designed primarily to curb short-term capital outflows, which in the second quarter had once again become very substantial. At the same time these moves, as well as a further slight firming in money market conditions during the remainder of the year, clearly were permitted by the increased strength of the domestic economy. Reflecting the effects of these modest changes in policy, member bank borrowings from the Federal Reserve were consistently above $300 million from July through December, compared with a June average of $236 million and somewhat lower levels in the earlier months of the year. Free reserves declined in June, and then edged off further later in the summer, but still averaged about $100 million over the last five months of the year.

In early November, the Board of Governors announced an increase from 50 to 70 per cent in the minimum equity or "margin" that buyers of stock must supply in purchasing securities with credit obtained from banks or brokers. The change reversed a reduction in margin requirements in July 1962 following the sharp second quarter 1962 break in the stock market and reduction in credit use. In the intervening sixteen months, the volume of outstanding stock market credit had risen markedly to the highest total since the data began to be collected in 1931.

In cooperation with the Federal Reserve's efforts to raise short-term interest rates, the Treasury continued through early 1963 to augment the supply of the regular three- and six-month bills. For the year as a whole, however, these additions were smaller in amount than in 1962, and the Treasury actually reduced temporarily the supply of bills auctioned in mid-November, as it was thought that short-term rates had by then reached an appropriate relation with rates in other money centers. The introduction of a new monthly series of one-year bills—which in dollar amount more than replaced the quarterly series that had previously been offered—also brought some upward pressure on bill rates. The change was primarily designed, however, to put these offerings even more on a routine basis.

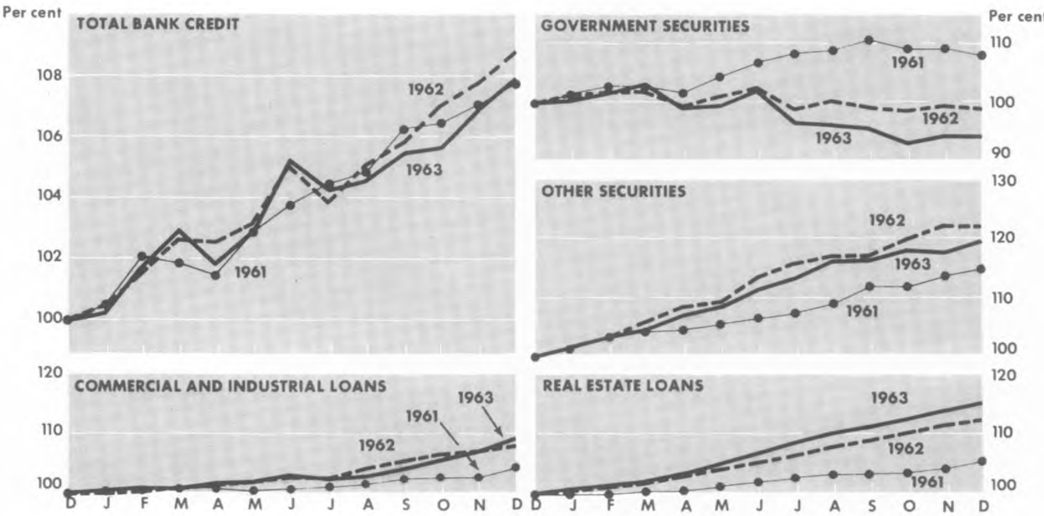
In addition to these operations in the short-term area, the Treasury conducted two advance refundings as well as four regular quarterly refundings and sold three new coupon issues for cash. In two of these cash offerings, the Treasury ventured into a new area: the marketing of long-term bonds through sales at auction to the highest bidding syndicate. The first of these auctions was an unqualified success, with the Treasury selling the bonds at a highly acceptable rate and the winning syndicate distributing the securities easily and rapidly. In the second auction of bonds, the Treasury also obtained closely priced competitive bids at rates near current market levels, but the issue was distributed only slowly to final investors. As a result of this combination of operations in the short-term and long-term sectors, debt management during the year contributed to the objective of bringing United States money market rates into better alignment with those in other leading centers; at the same time the average maturity of the total marketable debt outstanding was lengthened from four years eleven months at the end of 1962 to five years one month at the end of 1963.

BANK CREDIT AND BANK LIQUIDITY. Despite the slightly firmer tone in the money market in 1963, the banking system had a plentiful supply of funds to lend and invest. Indeed, growth in reserves was sufficiently ample, and credit demands sufficiently strong, to bring about another large rise in bank credit in 1963—some $18.6 billion, or 8 per cent (see Chart 5). As in 1962, the principal counterpart of this increase in credit was a substantial growth in time deposits, for which reserve requirements are relatively low—a growth that was in part encouraged by the further liberalization of Regulation Q.

In addition to their efforts at expanding the total amount of bank credit outstanding, banks in 1963 continued to shift the composition of their portfolios in search of higher earnings to offset the increased cost of obtaining funds. This shift largely involved in 1963 a net movement by commercial banks out of United States Government securities into higher yielding tax-exempt issues of state and local governments and into mortgages. In 1962, by contrast, bank holdings of Government securities had shown little net change over the year. Bank demand for tax exempts was again large in 1963, although it appeared to be tapering off in the latter months of the year. The volume of outstanding real estate loans continued to expand rapidly, however, with the over-the-year increase of $5.3 billion being about a third larger than in 1962.

The continued willingness on the part of banks to take on tax exempts and mortgages reflected to some extent the relatively modest character of the rise in business loan demands until late in the year. Commercial and industrial loans had already in 1962 fallen substantially behind the upward pace set in the two previous cyclical expansions. Even with the pickup in such loans toward the end of 1963, their over-all rate of expansion since the business-cycle trough in 1961 fell still further behind the 1954-57 performance. Since internal sources of funds were in ample supply at nonfinancial corporations — in part as a result of the 1962 measures revising depreciation guidelines and granting tax credit on investment expenditures—and with the over-all need for new investment held in check by conservative inventory policies as well as by the continued presence of excess

FURTHER EXPANSION IN BANK CREDIT. Total bank credit increased substantially in 1963, a gain that was only slightly less than the postwar record advance of the preceding year. Bank holdings of tax exempts moved strongly upward until the end of the year when business loans began to gain strength. Bank investment in real estate loans continued heavy throughout 1963. United States Government securities held by banks, in contrast, showed a net decline over the year.



The scale in the panel showing total bank credit differs from those in the other panels. Only selected categories in bank loan portfolios are shown. All data are seasonally adjusted. Monthly figures for each year are shown in terms of an index with the value for December of the preceding year set equal to 100.

CHART 5

capacity, businessmen simply had no reason to look for substantial additional amounts of bank financing. Business, in fact, also curtailed its recourse to equity financing. Flotations of new stock issues of nonfinancial corporations in 1963 actually fell short of company repurchases of outstanding stock, and the net volume of nonfinancial corporate bond issues was slightly smaller than in 1961 and 1962.

There did not seem to be any unwillingness, or lack of ability, of banks to meet the loan demands that did arise. To be sure, bank liquidity positions — as measured by the ratio of short-term liquid assets to deposits — declined further during 1963, and loan-deposit ratios were at or near postwar highs. The levels reached by these measures may not, however, have implied as much of a constraint in 1963 as in earlier years, in view of the substantially larger proportion of deposits currently held in the form of time rather than demand deposits. In any event, bankers were seeking out new loans both at home and abroad throughout the year and would undoubtedly have made more funds available to businesses had the demand been present.

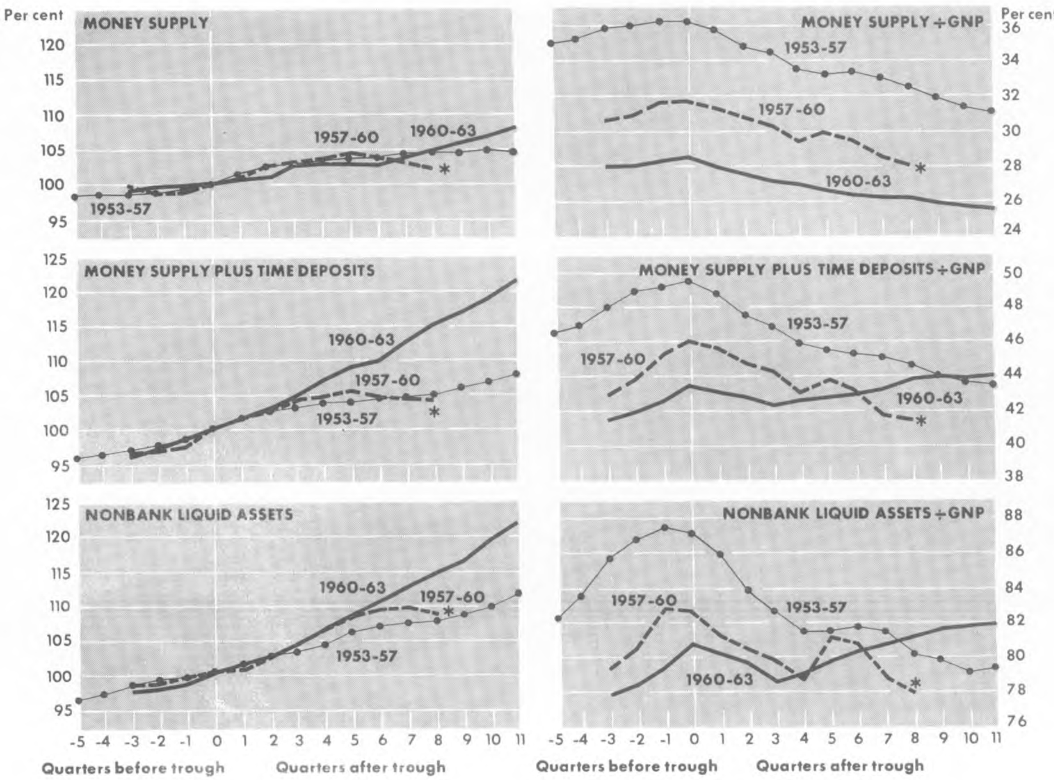
LIQUIDITY POSITION OF THE PUBLIC. The available indicators suggest that nonbank liquidity was little affected by the move toward less monetary ease. Total liquid assets held by the nonbank public rose by 7.6 per cent in 1963, not much less than the advance recorded in 1962, despite the increased attractiveness of the stock market and long-term securities as alternative outlets for savings. This gain was larger than the rate of advance in GNP. As a result, the ratio of such assets to GNP continued to move upward in 1963, in marked contrast to the declines that had occurred during the two previous expansions (see Chart 6).

The increase in nonbank liquidity in 1963 — like that of 1962 — reflected the acquisition of a wide variety of assets. As mentioned earlier, there continued to be a large flow of funds into time deposits, in part reflecting the further liberalization of Regulation Q which especially stimulated a somewhat more widespread use of negotiable time certificates of deposit. Nevertheless, the full-year increase in time deposits at commercial banks did not quite match the very large gain registered in 1962. Demand deposits, on the other hand, rose more rapidly than in 1962, reflecting in part the somewhat faster pace of the business advance. The volume of funds placed with competing financial institutions—such as savings and loan associations and mutual savings banks—also showed a large over-the-year increase, approximately repeating the 1962 performance.

With the substantial increase in demand deposits, the money supply (defined narrowly to include privately held demand deposits plus currency outside banks) expanded more than twice as rapidly in 1963 as in 1962. The gain, however, still fell short of the increase in GNP, so that the ratio of the money supply to GNP continued its long-term decline. On the other hand, the money supply plus time deposits did grow more rapidly than GNP. The ratio of this broader measure to GNP rose during 1963, and in the third and fourth quarters was at a level above that at the comparable stage of the 1954-57 upswing.

There are good reasons for emphasizing the broader measure that includes time deposits. Monetary policy, by supplying reserves liberally, can encourage banks

THE PUBLIC'S LIQUIDITY. Measures of nonbank liquidity continued upward in 1963, with the money supply growing more than twice as rapidly as in the preceding year. Moreover, the ratios of money supply plus time deposits to GNP and of total nonbank liquid assets to GNP both moved higher during the year. These ratios were not only above their levels at the 1961 recession trough but also above the comparable ratios after the expansion phases of the preceding two cycles had lasted for a similar period.



* Business-cycle peak

Money supply (comprising demand deposits and currency in the hands of the public) and money supply plus time deposits at commercial banks are quarterly averages of daily figures. Nonbank liquid assets, which include money supply, time deposits, savings deposits and shares, and United States Government savings bonds and marketable securities due in less than one year, are averages of the figures for the last Wednesday of the month preceding, and of the three months in, each quarter. All data are seasonally adjusted. Quarterly troughs in general business activity: 1954-III, 1958-II, and 1961-I. For each cycle the data begin at the preceding business-cycle peak.

CHART 6

to make loans and investments, which in turn add to the deposits held by the nonbank public. Although bank lending or purchase of securities generally gives rise initially to demand deposits—and hence to an increase in the money supply—this effect may be only temporary. Once the funds so created have worked their way through the economy, a part of the total deposit expansion usually ends up as time deposits. While these time deposits are not counted as part of the money supply narrowly defined, they can be converted into money with little delay and then channeled into the general stream of spending. Thus, the large rise during 1963 in money supply plus time deposits, and in total nonbank liquid assets, underscores the fact that credit and liquidity were amply available during the year.

INTEREST RATES. While facilitating further economic growth, monetary policy also contributed to the improved balance-of-payments performance of the second half of 1963. Short-term interest rates rose appreciably over the year — reflecting, of course, not only the effects of Federal Reserve operations but also such important influences as a further substantial enlargement of certificates of deposit outstanding and the moderate increase in Treasury bill supplies. Toward the end of the year the rate on three-month Treasury bills was fluctuating in a narrow band just above 3.50 per cent, compared with the 2.87 per cent level in December 1962 (see Chart 7). As indicated earlier, this increase brought United States rates into better alignment with short-term rates in the major foreign markets.

Rates on long-term Governments also rose somewhat in 1963, reflecting among other factors the lessened over-all monetary ease and the increased supply of long-term Treasury bonds outstanding. The extent of the rise was moderated, however, by the continued large flow of funds into the longer term markets. The spread between the bill rate and rates on coupon issues thus narrowed during the year. Similar-sized spreads between these two rates had, however, occurred around mid-1959 and again for a time during the second quarter of 1960; in these periods the bill rate had been at about the same levels as during 1963.

The large influx of funds into the longer term market served to moderate not only the upward movement in yields on Government coupon issues, but also that for other types of long-term debt. Mortgage interest rates actually receded further, following declines in each of the preceding three years. As a result, mortgage rates returned to the levels that had prevailed in 1958, a development which together with lower downpayments and longer maturities was a factor in the continued surge in residential construction activity during the year. In the corporate sector, yields on

INTEREST RATE MOVEMENTS. With the slight turn toward less ease in monetary policy, short-term rates moved appreciably upward in 1963. Yields on long-term Treasury and corporate obligations also rose somewhat, while mortgage interest rates continued to edge downward, reaching the lowest level since 1957.

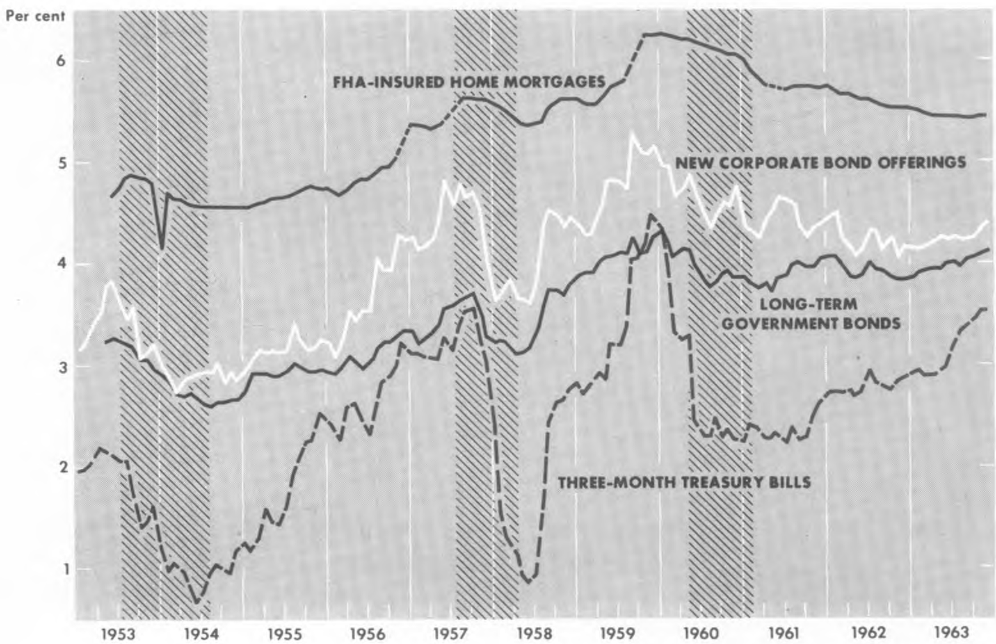


CHART 7

Shaded areas show recessions as dated by the National Bureau of Economic Reasearch.

new issues advanced slightly from the levels that had prevailed at the end of 1962 but remained below the rates of other recent years, reflecting the relatively ample availability of long-term funds. Funds were also in ready supply in the market for municipal securities, but the substantial demands placed on the capital markets by state and local governments pushed yields on tax exempts noticeably upward during the latter part of the year. The net result of these various forces was that interest rates tended to converge during 1963 into a narrower range than at any time since the end of 1959 (see Chart 7).

THE INTERNATIONAL ECONOMY IN 1963

Further advances toward international payments equilibrium among the industrial countries were recorded in 1963. The United States, in particular, succeeded in reducing its full-year deficit on regular transactions despite a serious first-half setback. Many of the other industrial nations, typically creditors in recent years, also moved significantly closer to payments balance last year, although Germany proved to be a very important exception. Nevertheless, the adjustment process remained difficult. As the year ended, it was clear that both the United States and the surplus countries of Western Europe would have to persist in their endeavors to ameliorate payments imbalances.

Although progress toward international equilibrium was slow and uneven, cooperative measures of national monetary authorities — based in good part on the broadened network of reciprocal currency arrangements among central banks — enabled the exchange markets to take in stride several major potential disturbances. Meanwhile, fresh emphasis was laid on consideration of the future of the international monetary system. The so-called Group of Ten (representatives of ten large industrial nations whose combined international reserves account for about two thirds of the world total) decided in September to formalize their continuing examination of the question of international liquidity. At the same time, the International Monetary Fund (IMF) began a parallel and coordinated inquiry on the subject.

Domestic growth in the underdeveloped parts of the world again failed to keep pace with the progress achieved by the industrial countries. In part, this reflected the fact that many of the poorer nations were making only slow headway toward mobilizing and making most effective use of their own resources, which in turn limited their ability to attract additional funds from abroad. With the plight of much of Latin America, Asia, and Africa remaining serious, the industrial countries continued their efforts to promote economic growth and stability in these areas.

Slow Progress Toward Equilibrium

The United States in 1963 demonstrated its determination and capacity to reduce its payments deficit, and thus took a major step toward eventual achievement of external equilibrium. After a sharp deterioration in the United States payments position during the first six months of the year, the United States authorities stepped up their attack on the problem, introducing a broad new range of policy measures. Following these actions, there was a dramatic improvement in the payments situation (see Chart 8); at a seasonally adjusted annual rate, the deficit on regular transactions fell from roughly $4.5 billion in the first half of the year to about $1.6 billion in the second half. For the year as a whole the deficit on regular transactions was an estimated $3.0 billion, representing a moderate improvement over the $3.6 billion deficit on such transactions recorded in 1962.

The worsening of the United States balance of payments on regular transactions in the first half of 1963 was due primarily to a marked rise in the outflow of private United States capital. Of particular importance was the exceptional increase in foreign securities issues in the New York capital market. Most of the issues originated in Canada, Japan, and those Western European countries where long-term borrowing costs were generally higher than in the United States (see Chart 9). United States private direct investments abroad and recorded short-term capital outflows were also very large during these same months.

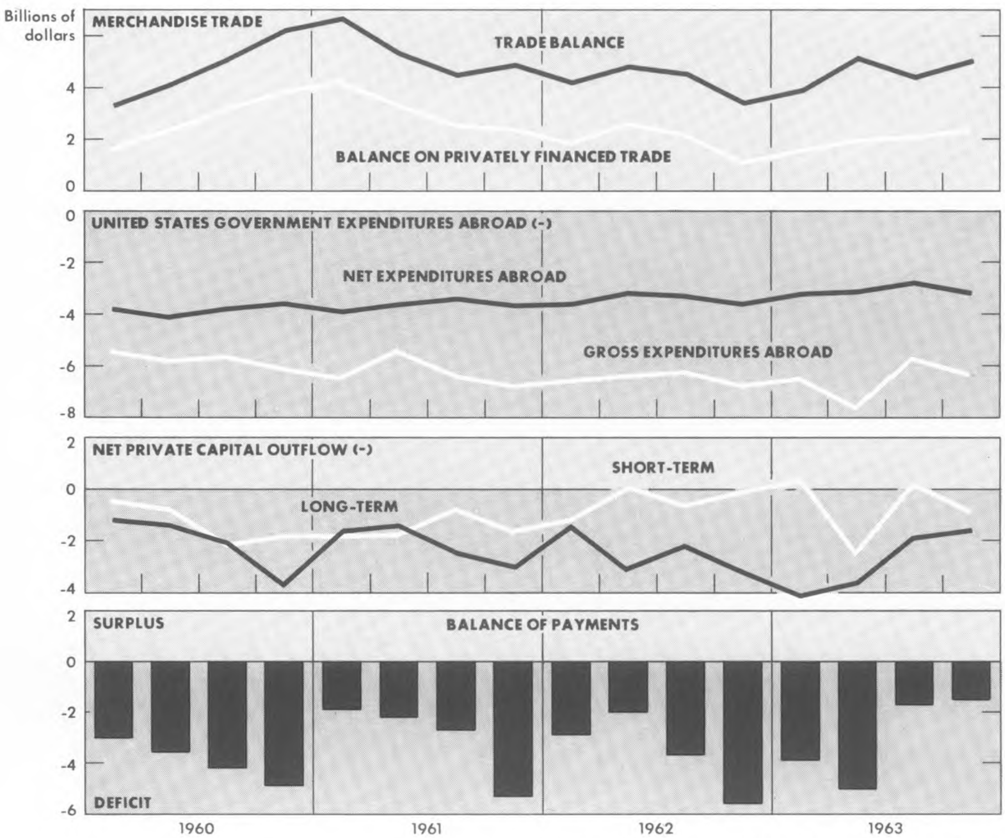
The official United States response to these adverse developments came shortly after midyear. The Federal Reserve's decisions to increase the discount rate and to raise maximum interest rates on major categories of time and savings deposits permitted under Regulation Q were announced on July 16. Both actions were aimed specifically at minimizing short-term capital outflows—the recorded portion of which had climbed in the second quarter to a seasonally adjusted annual rate of approximately $2½ billion — by bringing United States short-term interest rates into closer alignment with the higher rates prevalent in other countries (see Chart 10).

Two days later, on July 18, President Kennedy presented a Special Balance-of-Payments Message to Congress urging enactment of a temporary interest equalization tax on purchases by Americans from foreigners of new or outstanding foreign securities of three or more years' maturity originating in any industrial nation. The principal object of the proposed legislation was to reduce foreign securities issues in New York by increasing costs to foreigners of long-term financing in the United States by approximately 1 per cent per annum. Subsequently, an understanding was reached with the Canadian Government to exempt new Canadian issues needed to maintain an unimpeded flow of trade and payments between the two countries; the Canadian authorities simultaneously agreed not to increase Canada's

BALANCE-OF-PAYMENTS CONCEPTS

The deficit on regular transactions measures the balance of all foreign transactions of United States residents plus all transactions resulting from the foreign activities of the United States Government, notably foreign aid and military expenditures. It records the size of the over-all imbalance in the United States international payments exclusive of specially negotiated transactions of the United States Government with other industrial nations, such as debt and military prepayments and sales of special Treasury debt obligations. Two alternative measures of the deficit—which include some or all of these special Government transactions "above the line" as inflows of foreign capital—are also presented by the Department of Commerce in the official statistical accounts. These two measures are estimates of the change in the United States liquidity position after allowing for all or part of the specially negotiated transactions; they differ from one another in their treatment of those Treasury borrowings from foreign official institutions that are convertible into cash at very short notice. For the last two years the two alternative measures compare as follows. The balance on regular and all special transactions was $2.2 billion in 1962 and $1.9 billion in 1963; the balance on regular and all special transactions except convertible, nonmarketable Treasury bonds was $2.2 billion in 1962 and $2.6 billion in 1963. Of the three measures, the balance on regular transactions is the most useful estimate of the magnitude of the over-all payments problem that must be solved, although special Government transactions, by absorbing dollars held by foreign central banks, have a significant effect on the size of the United States gold outflow associated with any given deficit on regular transactions.

UNITED STATES BALANCE OF PAYMENTS AND SOME MAJOR COMPONENTS. **The United States balance on regular transactions improved dramatically in the second half of 1963, largely reflecting the efforts of the United States authorities to curb short-term and long-term capital outflows. As a result, there was a significant reduction in the deficit for the full year.**



The balance of payments on regular transactions shown here excludes United States Government receipts arising from sales of special Treasury obligations and from specially negotiated debt and military prepayments. United States Government gross expenditures abroad include military expenditures and foreign aid outlays, net of scheduled loan repayments. United States Government net expenditures abroad consist of gross expenditures less military sales to foreign countries and Government aid spent in the United States. The balance on privately financed trade excludes exports financed by United States aid. All data are seasonally adjusted annual rates.

CHART 8

LONG-TERM GOVERNMENT BOND YIELDS. There was a moderate increase in most United States long-term interest rates in 1963, but long-term borrowing costs here remained lower than in most other major industrial countries.

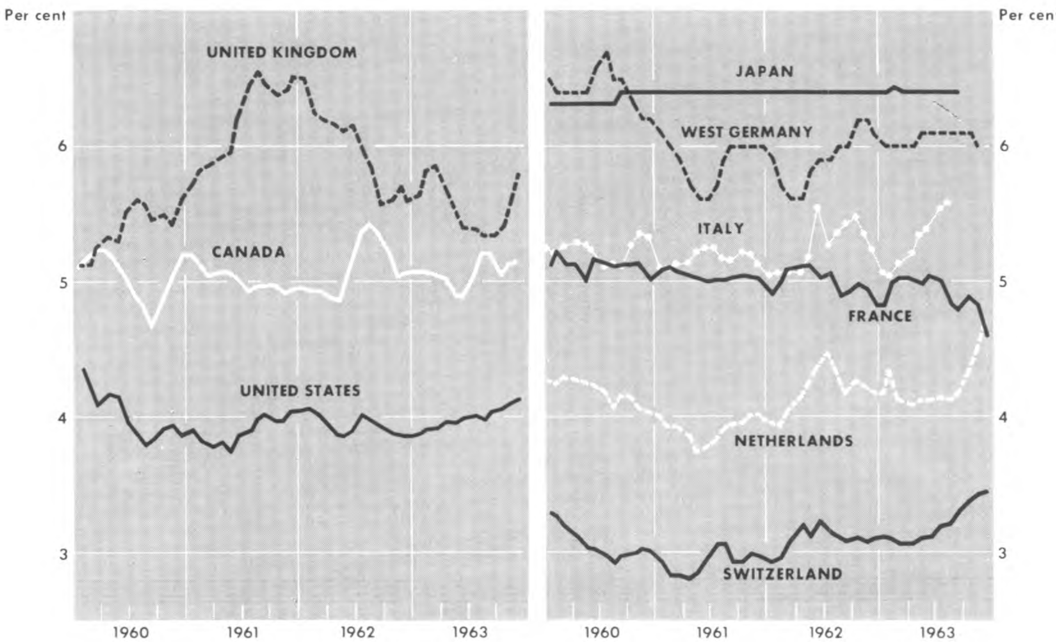


CHART 9

official reserves through the proceeds of borrowings in the United States. The President also listed a variety of other measures, including further economies in Government overseas expenditures, that would be taken or intensified by the Administration in order to restore payments balance. He concluded the message by announcing that the United States had arranged a $500 million stand-by facility with the IMF, mainly to make possible further repayments to the Fund by foreign countries holding dollars at a time when the Fund's dollar holdings had risen to approximately their normal limit of 75 per cent of the United States quota.

These intensified efforts by the Administration and the Federal Reserve System contributed to the second-half recovery of the United States payments balance. As short-term interest rates here rose, and despite subsequent increases in several central bank discount rates abroad, the recorded outward movement of United States short-term funds declined significantly in the second half of 1963. For the year as a whole, net recorded short-term capital outflows totaled roughly three quarters of a billion dollars, as against one half billion dollars in 1962.

The outward movement of long-term United States funds also declined in the second half of 1963. This reflected directly the interest equalization tax proposal, which had a dramatic impact on the volume of new foreign securities issues. Even so, United States purchases of new issues for the year as a whole totaled almost $1.3 billion, a new record (see Chart 11). More than three quarters of total flota-

SHORT-TERM INTEREST RATES IN SELECTED COUNTRIES. The increase in short-term interest rates in the United States in 1963 reflected efforts to stem outflows of short-term funds. In most other major industrial nations, there was a similar tendency for short-term rates to rise — especially in the second half of the year — as programs to curb inflation were continued. This tendency was particularly pronounced in some continental European countries.

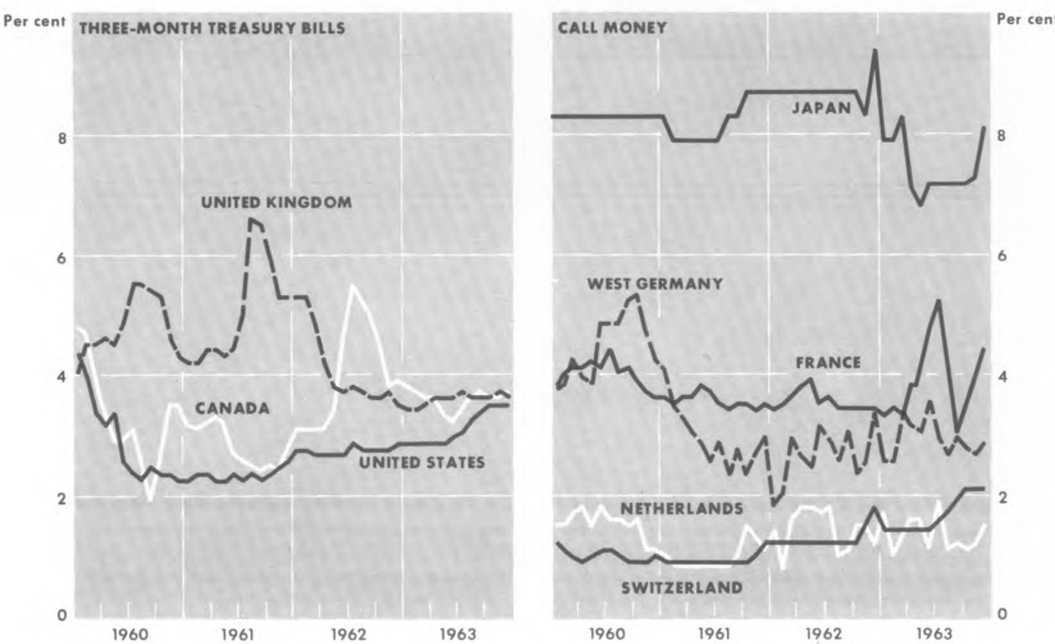


CHART 10

UNITED STATES PURCHASES OF FOREIGN SECURITIES ISSUED IN THIS COUNTRY. The volume of new foreign securities purchased by United States investors — mainly Canadian, Western European, and Japanese issues — attained record proportions in 1963. However, the proposed interest equalization tax sharply curtailed such foreign flotations in the second half of the year.

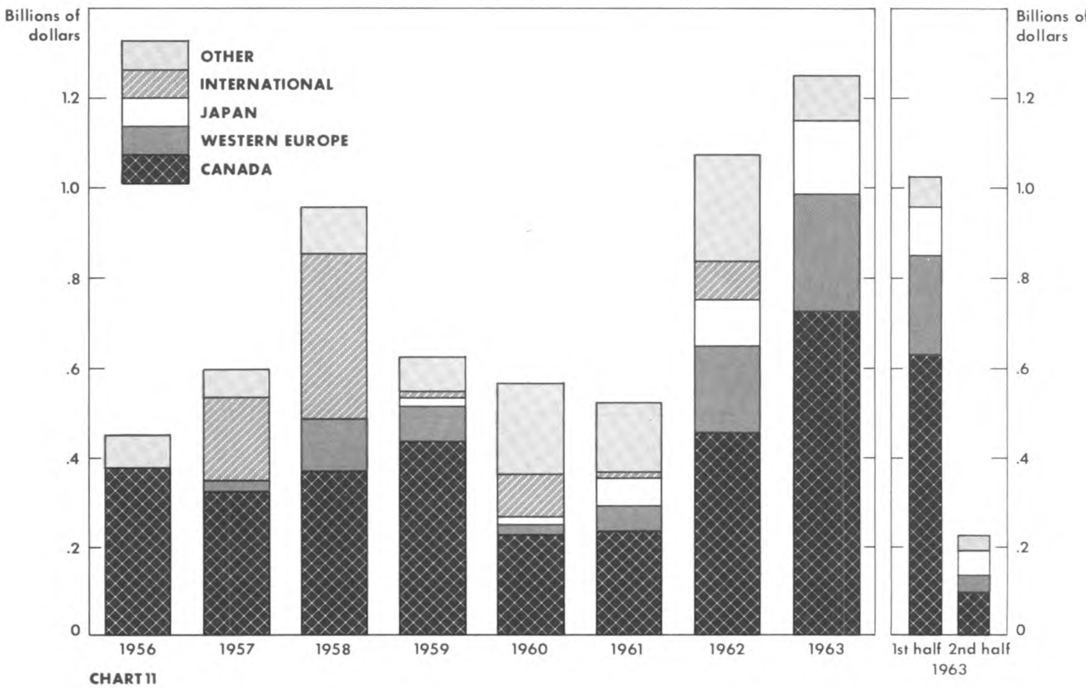


CHART 11

tions originated in Canada, Western Europe, and Japan — areas now fully or partially affected by the proposed special tax. The increase in United States portfolio investments was paralleled by a rise in direct investments abroad, particularly in manufacturing and oil refining facilities. As a result, the total net outflow of long-term capital from the United States in 1963 approximated $3.2 billion, up from $2.8 billion in 1962. Income on United States foreign investments, however, also continued to rise, reaching a new high of $4.1 billion.

Contributing to the reduction in the over-all United States payments deficit in 1963 was a significant improvement in the merchandise trade balance. Merchandise exports rose almost 6 per cent. Agricultural exports were strong, reflecting in part poor harvests in Europe. Exports to Canada also increased, as the Canadian Government removed the last of the remaining special surcharges and domestic restraints imposed as part of the program to protect the Canadian dollar in 1962. The magnitude of the increase in United States exports suggests that the slow-working long-term factors tending to improve this country's balance-of-payments position — including price and wage stability here in the face of strong inflationary pressures in several major competitor countries abroad, as well as United States export promotion and improved export financing facilities — may at last have begun to take hold. It must be recognized, however, that a substantial portion of the over-all 1963 increase reflected shipments financed by larger Government aid outlays.

Largely as a consequence of the continued expansion in domestic business activity in 1963, United States merchandise imports rose roughly 5 per cent. The rise was concentrated in the second half of the year, when a more normal relationship was restored between import volume and gross national product. Increased purchases of finished manufactures from Western Europe and Japan and of industrial materials from Latin America and Canada, both familiar developments in a cyclical expansion, were primarily responsible.

In order to finance part of the $3.0 billion deficit on regular transactions, the United States Government negotiated a number of special transactions with other industrial nations. The Treasury sold $660 million equivalent, net of redemptions, of nonmarketable debt obligations, and received $232 million of nonscheduled Government loan repayments from France and the Netherlands. The United States also received some advances on military exports. These special transactions can also be recorded as inflows in the United States international accounts rather than as part of the settlement item (see page 34), yielding a 1963 deficit on regular and all special transactions equal to $1.9 billion. Of this amount, approximately $1.5 billion was added to foreign holdings of liquid dollars and $461 million was used to purchase gold from this country, while official United States holdings of convertible foreign currencies rose by somewhat over $100 million.

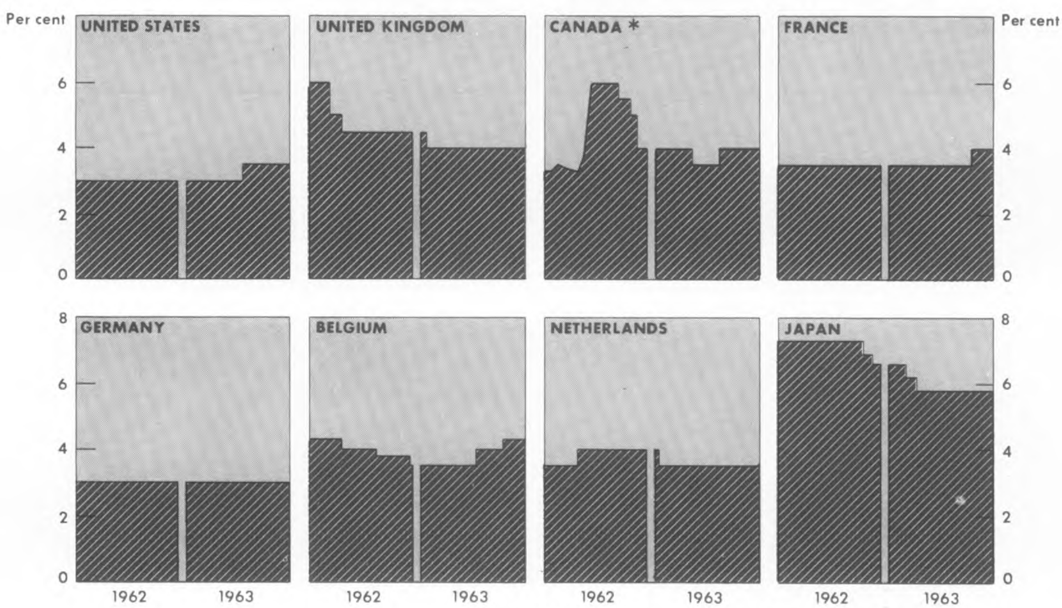
Gold purchases constituted a significantly smaller proportion of the settlement payments than in 1962. In part, the reduced United States gold losses reflected the sale of special United States Treasury debt obligations. The United States gold position also benefited from enlarged total Free World gold availabilities, resulting from an increase in world production and unusually heavy gold sales by the Soviet Union. In addition, private gold hoarding almost certainly declined in 1963, as confidence in established currency parities was bolstered by active central bank cooperation in the London gold market as well as in the foreign exchange markets. Thus, official gold reserves of Free World countries increased by more than $800 million, compared with just over $300 million in 1962. The 1963 increment to such monetary gold stocks was in fact the largest of any year since World War II.

As the United States payments situation continued to improve, many of the principal industrial countries abroad that had previously experienced substantial balance-of-payments surpluses moved toward equilibrium from the opposite direction. The most striking changes were recorded in France and Italy, where widespread price and wage increases took place. The French payments surplus was substantially diminished in the second half; and the French Government instituted a broad anti-inflationary program in September, while the Bank of France raised its discount rate in November. In Italy, where determined anti-inflationary measures were forestalled by an uncertain political situation, the swing from a small surplus in 1962 was actually so large as to result in a substantial payments deficit in 1963. Balance-of-payments surpluses also shrank in the United Kingdom and a number of the other industrial nations, following in many cases a relaxation of domestic monetary and fiscal restraints. In Germany and the Netherlands, on the other hand, sizable payments surpluses reappeared. Germany's return to the status of a major creditor followed only a relatively short period of external balance for that country. In a few countries, notably Canada and Belgium as well as France, central bank discount rates were raised during the year (see Chart 12).

The movement toward international equilibrium was reinforced in 1963 by the continuing tendency of wages and prices to rise more rapidly in Western Europe and Japan than in the United States. The movement was given impetus also by a variety of measures further relaxing trade and payments restrictions in those same areas abroad. In some cases, such liberalization measures were included in broader programs aimed at relieving domestic inflationary pressures. Nevertheless, numerous controls still remained in force at the year end, many of which seemed no longer essential for either domestic or balance-of-payments purposes.

In May, the leading countries adopted broad principles under the General Agreement on Tariffs and Trade (GATT) for reducing tariffs in the forthcoming round of negotiations — the "Kennedy Round" — to be based on the new bargaining authority granted the United States President by the Trade Expansion Act of 1962. Under the 1962 Act, the President has general authority to decrease virtually all United States tariffs by 50 per cent; in addition, he has special authority to negotiate with the European Economic Community (EEC) for reductions of up to 100 per cent in duties on goods for which the EEC and the United States together furnish more than 80 per cent of world exports. This special authority, which was provided on the assumption that the United Kingdom would become an EEC member, was to have applied to a wide variety of products. However, it was rendered virtually inoperative — and prospects for the Kennedy Round cast into doubt — when the EEC suspended negotiations for the entry of the United Kingdom in January 1963. Further problems arose as a consequence of the subsequent EEC insistence on a relatively restrictive import policy affecting poultry and other agricultural products, and also because the EEC sought concessions from the

CENTRAL BANK DISCOUNT RATES. After declining or remaining unchanged in the last half of 1962 and the first half of 1963, discount rates in several major industrial countries moved up in the second half of the year, as monetary authorities acted to curb actual or potential inflationary pressures and to bring short-term interest rates into somewhat closer alignment with those abroad.



* Canada established a fixed discount rate in June 1962. Prior to that, the discount rate was set at 1/4 per cent above the weekly average tender rate for ninety-day Treasury bills; data shown are end of month.

CHART 12

United States prior to the application of the general rule of equal percentage tariff reductions in the forthcoming negotiations. According to a principle finally agreed upon, high individual tariffs would be cut relatively more than low tariffs where it is established through bargaining that there are significant disparities and a substantial amount of trade is affected.

A more encouraging trend in 1963 concerned the signs of evolution of a more active and integrated European capital market. Capital markets in the separate European countries have generally been either too small or too restricted to satisfy all the growing capital needs of governments and industry in Europe. European borrowers, consequently, have had increasing recourse to the large and efficient New York capital market, thus adding to the strain on the United States balance of payments. However, in 1963, prompted in part by the interest equalization tax proposal, the European countries took a number of steps — both officially and upon private initiative — to enlarge and partially unify their national markets. Nevertheless, many legal and institutional impediments still remained at the year end to impede such expansion and integration. The eventual development of a unified and self-reliant European capital market could have beneficial effects for the international payments mechanism by permitting and facilitating an increasing amount of equilibrating flows of long-term funds.

Improving the International Monetary Mechanism

The international monetary mechanism has long been under study and review by the central banks and treasuries of all leading industrial nations. Means for improving the mechanism have been discussed at the regular monthly Bank for International Settlements (BIS) meetings of central bankers, at the Paris meetings of the various committees of the Organization for Economic Cooperation and Development (OECD), and at the IMF. The cooperative measures of 1961-63, evolved through such contacts, were a direct response to liquidity needs as they arose. In 1963, it was decided to put these studies on a more formal basis. It was quite evident that international liquidity was currently adequate to satisfy the needs of the world economy, and that it would be likely to remain so in the near future. But the possibility could not be excluded that the growth of world economic activity might be hampered by a liquidity shortage at some future date if adequate preparations were not made in advance.

Looking forward to the eventual elimination of the United States deficit, President Kennedy in his speech at the September IMF meeting in Washington, as well as in his July Balance-of-Payments Message, expressed this country's willingness to study and discuss measures that would lead to a further evolution and strengthening of the international monetary system. Other governments expressed similar views. The leading financial nations represented in the Group of Ten therefore agreed to undertake a comprehensive inquiry, looking toward the 1964 IMF meeting in Tokyo. Senior officials of the BIS, IMF, and OECD are participating in the deliberations of this group, which consists of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom, and the United States. The IMF is also conducting an inquiry and is expected to submit a special report on its own potential contribution to future monetary arrangements.

Monetary arrangements for easing short-run pressures in the foreign exchange markets were also improved in 1963. These arrangements had begun in early 1961 with an informal agreement among several European central banks to cooperate in easing the exchange market strains that followed the revaluations of the German mark and the Dutch guilder. This agreement was immediately followed by the resumption of market operations in convertible foreign currencies by the United States Treasury and, somewhat later, by the Federal Reserve System. During 1963, as they have been from the start, foreign exchange operations for both Treasury and Federal Reserve System accounts were conducted by the Federal Reserve Bank of New York. System operations have been based largely on a network of reciprocal currency, or "swap", arrangements with a number of foreign central banks and with the BIS. The swap network, begun in early 1962, was extended and consolidated in 1963. In particular, the arrangement with the Bank of England, initially fixed at $50 million in May 1962, was raised in May 1963 to $500 million, greatly reinforcing market confidence in the stability of the sterling-dollar parity relationship. The swap lines with the central banks of five other countries and with the BIS were also increased over the course of the year, and new agreements were negotiated with the Bank of Sweden and the Bank of Japan. At the end of the year, the network covered eleven foreign central banks, plus the BIS, and involved a total amount of $2,050 million, most of which remains on a stand-by basis.

The exchange markets were orderly in 1963, despite several potentially disturbing events. The stability of the exchanges was due in large part to the markets' confidence in the adequacy of the network of cooperative international monetary arrangements to deter even major and sustained speculation against any of the leading currencies. The first test came early in the year when a brief but intensive speculative attack on sterling developed, following the failure of negotiations for British entry into the EEC. Prompt action by the Bank of England in cooperation with other monetary authorities forcefully and successfully counteracted a speculative outflow from London, primarily to the European continent. By the time the Chancellor of the Exchequer announced early in April that the United Kingdom had obtained credits of $250 million equivalent from several continental European central banks to reinforce its defenses during the previous two months, uneasiness in the market had largely disappeared. The Bank of England also utilized part of its swap line with the Federal Reserve Bank of New York, which then amounted to only $50 million.

Another major test of cooperative monetary arrangements came on Friday, November 22, and during the next few days, following the assassination of President Kennedy. Immediately upon receiving the news, the Federal Reserve Bank of New York offered sizable amounts of five major foreign currencies at existing market rates in order to maintain orderly conditions in the exchange markets. By the end of the day, the Bank had also contacted leading foreign central banks and worked out a coordinated approach for official intervention in the major exchange markets during succeeding days. In addition, the Federal Reserve System concluded increases of $50 million each in its swap lines with the Swiss National Bank and the BIS, underscoring the flexibility of these reciprocal currency arrangements. On the following Saturday and Monday, when the New York market was closed, operations by the foreign central banks in their respective markets reinforced the New York Federal Reserve Bank's intervention of Friday. Given this prompt cooperative action by the various monetary authorities, foreign exchange markets remained orderly, and speculative movements were held to a minimum.

A variety of short-term, reversible flows of funds were minimized and counteracted through coordinated efforts in 1963. During the spring and summer months, when there was almost continuous buying pressure on the German mark, strains in the mark-dollar exchange market were resisted by closely coordinated action of the German Federal Bank and the Federal Reserve Bank of New York. The latter intervened heavily in New York for both Treasury and Federal Reserve accounts, partly through drawings on its reciprocal currency agreement with the German central bank. A substantial part of the drawings under the swap arrangement was repaid as early as August, and the mark-dollar remained fairly quiet until November. At that time renewed buying pressure on the mark again occasioned official intervention by the German and American authorities. Similar stabilizing operations were conducted during the year to smooth flows into and out of several other leading currencies, including the Swiss franc, the Dutch guilder, the Italian lira, sterling, and the Canadian dollar.

During the year, the Treasury sold a number of nonmarketable bonds to foreign central banks and treasuries. These issues, the bulk of which were denominated in the holder's currency, helped strengthen United States exchange resources while providing foreign monetary authorities with an investment opportunity for accumulated dollars; they thus represent a second line of defense behind the central bank swap network. These borrowings were additional evidence of the efficiency with which the international monetary mechanism operated in 1963. By the end of the year it was clear that the network of cooperative currency arrangements, backed by IMF quotas and supplementary borrowing facilities, was capable of mobilizing truly impressive resources in support of any currency temporarily under duress. At the same time, it was also evident that these arrangements were facilitating progress toward international equilibrium. The atmosphere of calm and confidence in the exchange markets, sustained by the concerted official action, provided financial authorities with a margin of time to adopt and carry out appropriate policy solutions in an orderly manner.

Relations Between Developed and Underdeveloped Nations

The search continued in 1963 for an appropriate balance between the efforts of the underdeveloped countries themselves to bring about more rapid and sustained economic growth and the efforts of the industrial nations in contributing to such growth. Each passing year appears to re-emphasize the magnitude and difficulty of the development task. Again in 1963, many nations of Latin America, Asia, and Africa were plagued by inflation and balance-of-payments problems and by population pressures and food shortages. To be sure, progress was clearly being made in some underdeveloped countries in bringing policies into line with the requirements of economic development through such steps as improvements in education and tax and land reforms. On the whole, however, such progress was slow and halting, and in a number of countries serious setbacks occurred, in part because political problems hampered the effective utilization of domestic resources or implementation of needed economic reforms.

The industrial nations once more had to face the fact that a substantial contribution on their part was a very important element in the success of even the most concerted efforts of the underdeveloped countries. One important contribution, it was recognized, was growth in the developed world itself, which would enlarge demand for the output of primary-goods-producing nations. In this regard, it was encouraging that the demand for primary commodities was sufficiently strong to help raise the prices of a number of such products. This was especially true for the prices of metals and foodstuffs which, in some cases, reached their highest level since 1958.

The possibilities of smoothing short-term fluctuations in commodity prices and the export earnings of underdeveloped countries through concerted action also received considerable attention. In March, the IMF created supplementary drawing facilities for the primary-producing countries to support their balances of payments in the event of temporary declines in their export proceeds; and, later in the year, ratification of the International Coffee Agreement by the United States Senate raised hopes that the market for this major commodity would now become more stable. In general, greater recognition appeared to be given by the developed countries to the potential contribution generous trade policies could make in facilitating economic development. There remained a very real danger, however, that this contribution might be vitiated through the emergence of separate trading blocs from which large groups of underdeveloped countries might be excluded.

The industrial nations also made efforts in 1963 with regard to a third potential contribution — that of financial assistance. The total amount of all foreign economic assistance disbursed to countries in Asia, Africa, and Latin America was again increased, with special attention being paid to opportunities for the multilateral coordination of aid. The member countries of the International Development Association (IDA), an affiliate of the International Bank for Reconstruction and Development (IBRD), agreed to add $750 million to the institution's resources through increased contributions, and the IBRD itself proposed to make more loans for development purposes, participate more actively in project planning, and gradually relax terms on some categories of loans. In addition, foreign aid consortia formed over the last few years for such countries as Greece, India, Pakistan, and Turkey continued their support of economic development. Among individual lending nations, the United Kingdom and Germany eased terms of repayment of loans to underdeveloped areas.

On the other hand, the industrial nations also placed increased emphasis on the quality and effectiveness of their aid. This consideration was especially important for the United States. There was a clear need to reappraise the foreign aid program in the light of past achievements and of the continuing balance-of-payments problem, and reviews of the program and its administration suggested that there was indeed room for economy without reducing the over-all effectiveness of aid. The results of this reappraisal began to be reflected in Administration and Congressional decisions during the year.

The International Outlook

Despite the progress toward international equilibrium recorded in 1963, the over-all payments situation remained significantly out of balance. Much still had to be done — by surplus countries as well as by those with external deficits — to ensure a further approach toward international equilibrium in 1964. As regards the longer range question of international liquidity, the experiences of recent years and the formal studies under way in the Group of Ten and the IMF should help in assessing any need for future measures designed to maintain the viable international monetary system that has emerged from the intensive cooperation of recent years.

The leading nations will also have to deal directly with the longer range question of the growth of world trade, when the Kennedy Round of GATT negotiations begins in 1964. The outcome of the bargaining will depend largely on the attitudes and policies adopted by the major participants. If tariffs and other barriers to multilateral free trade are reduced substantially along the lines implied by the United States Trade Expansion Act, world trade should grow at a rate that would help ensure continued high levels of economic activity in the industrial nations. Rising world trade would also be of great benefit to the developing nations. By adopting liberal trade policies, while also continuing to cooperate in the improvement of the international monetary mechanism and in eliminating payments imbalances, the leading nations could go far toward assuring sustained economic growth in the Free World.

THIS BANK'S OPERATIONS

Volume and Trend of the Bank's Operations

DOMESTIC OPERATIONS. The volume of operations expanded moderately in 1963 in most of the Bank's departments. One particularly significant exception was coin activity in the Cash Department, which contracted sharply.

During 1963 this Bank processed 665 million checks, amounting to $379 billion (excluding United States Government checks). This represented an increase over 1962 of nearly 5 per cent in the number of items handled and a decrease of about 1 per cent in the dollar volume. The decline in dollar volume reflected in part the greater use of this Bank's wire transfer facilities by New York City banks in paying for late deliveries of securities, as against the alternative of effecting payments by drawing checks on this Bank. As a consequence, the dollar volume of checks drawn on this Bank during 1963 declined by about 7 per cent. In contrast, the dollar volume of checks processed, other than those drawn on this Bank, increased during 1963 to $258 billion from $253 billion in 1962. The number of checks handled, on the other hand, was not significantly affected by changing bank practices in making payments for securities. In fact, the 1963 rise of nearly 5 per cent in the number of checks handled was higher than the 4 per cent average annual rise during 1953-62.

The decline in the dollar volume of checks drawn on this Bank was more than offset by an increase in the use of wire transfer facilities. The dollar volume of transfers (exclusive of Treasury transfers between Federal Reserve Districts) totaled $1.4 trillion in 1963, a rise of about 7 per cent over 1962. The number of transfers handled during 1963 was also 7 per cent above 1962.

During 1963 continued efforts were directed toward promoting the application of high-speed electronic equipment in the check collection function of this Bank. The number of checks handled on electronic equipment rose substantially during 1963. Since the electronic handling of checks requires that all checks be properly encoded, the Magnetic Ink Character Recognition (MICR) program of the American Bankers Association remained a subject of active interest to the Bank during 1963. An August survey showed that 91 per cent of the checks handled by this Bank bore MICR routing symbol-transit numbers. By the end of the year

SOME MEASURES OF THE VOLUME OF OPERATIONS OF THE FEDERAL RESERVE BANK OF NEW YORK (Including Buffalo Branch)

Number of pieces handled (in thousands)*	**1963**	**1962**
Currency received	1,351,268	1,333,299
Coin received	1,601,876	1,999,074
Gold bars and bags of gold coin handled	177	221
Checks handled:		
United States Government checks	60,403	58,804
All other	665,207	635,073
Postal money orders handled	35,151	35,502
Collection items handled:		
United States Government coupons paid	4,124	4,284
Credits for direct sendings of collection items	315	334
All other	18,634	17,215
Issues, redemptions, exchanges by fiscal agency departments:		
United States savings bonds	29,327	28,051†
All other obligations of the United States and Federal agencies	7,420	6,895
Obligations of the International Bank for Reconstruction and Development	36	119
Safekeeping of securities:		
Pieces received and delivered	7,922	8,105
Coupons detached	6,020	5,464
Wire transfers of funds‡	833	777
Amounts handled (in millions of dollars)		
Discounts and advances§	14,547	5,353
Currency received	8,965	8,833
Coin received	179	228
Gold bars and bags of gold coin handled	2,515	3,181
Checks handled:		
United States Government checks	23,367	23,034
All other	379,428	384,135
Postal money orders handled	643	649
Collection items handled:		
United States Government coupons paid	2,806	2,511
Credits for direct sendings of collection items	724	646
All other	3,038	2,822
Issues, redemptions, exchanges by fiscal agency departments:		
United States savings bonds	1,889	1,689†
All other obligations of the United States and Federal agencies	546,146	501,923
Obligations of the International Bank for Reconstruction and Development	300	419
Safekeeping of securities:		
Par value pieces received and delivered	713,535	720,577
Wire transfers of funds‡	1,400,795	1,304,308

* Two or more checks, coupons, etc., handled as a single item are counted as one "piece".
† Revised.
‡ Excludes Treasury transfers between Federal Reserve Districts.
§ The number of discounts and advances handled in 1963 was 1,369, compared with 910 in 1962.

all banks in the Second District had some checks in circulation bearing such numbers. In addition, an increased number of depositing banks started to encode the dollar amount on checks during 1963 in order to qualify such checks fully for high-speed electronic handling.

Coin received by this Bank declined during 1963 for a second consecutive year, reflecting a nation-wide shortage of coin of all denominations. Although the Mint stepped up its shipments of coin to this Bank during 1963, the increase was not large enough to counteract a sharp decline in coin deposit receipts from banks. As a result, the number of coins received by this Bank during 1963 was 20 per cent less, and the dollar volume 21 per cent less, than during 1962. These reductions were more than twice as large as the corresponding declines between 1961 and 1962. The shortage of coin necessitated a general rationing of coin shipments to banks throughout the year; at various times of the year — whenever demand for coin was particularly strong — only token shipments could be made.

A further moderate expansion in the Treasury's refunding and financing operations during 1963 again boosted the volume of this Bank's fiscal agency operations, although not by so great a margin as in the previous year. The dollar volume of all Government obligations, other than United States savings bonds, processed by this Bank in 1963 was $546 billion — an increase of about 9 per cent over the 1962 volume, which compares with a 13 per cent increase the year before. The 1963 rise was distributed about equally between an expansion in interdistrict transfers of securities and a rise in securities received and delivered in connection with cash and refunding offerings by the Treasury and Federal agencies. The number of pieces handled during 1963 was 7.4 million, 8 per cent more than in 1962.

This Bank's operations connected with the servicing of United States savings bonds also rose during 1963. The dollar volume of issues, redemptions, and exchanges of savings bonds increased by 12 per cent in 1963, to $1,889 million, from a revised 1962 figure of $1,689 million, thus reversing a five-year downward trend in these activities. The number of items handled during 1963 increased by only 5 per cent over the revised 1962 figure. There also was a significant rise during 1963 in noncash collection activities of this Bank.

Lending activities of this Bank expanded sharply during 1963, as moderately less easy reserve positions caused member banks to make greater use of the "discount window". As a result, the aggregate volume of Second District member bank borrowing during 1963 nearly tripled, compared with 1962. Nevertheless, the proportion of member banks that borrowed at least once during the year — 40 per cent — was only slightly higher than that reported for 1962. Moreover, the 1963 volume of advances to member banks was only half as large as the postwar high of $29.4 billion reached in 1957.

The moderate rise in the volume of operations of this Bank during 1963 necessitated an increase in employment, but the 1.7 per cent increase in the average number of employees at this Bank during 1963 was less than the increases in employment in the past two years, when employment rose on the average by 2.4 per cent annually. At the end of 1963, the Bank's officers and staff numbered 4,135, including 248 at the Buffalo Branch.

FOREIGN AND INTERNATIONAL OPERATIONS. Gold, dollar, and other assets held for foreign and international account increased for the sixth consecutive year, resulting in a new high of $28.8 billion as the year ended.

Foreign accounts, in which all Federal Reserve Banks participate, rose by nearly $2 billion to a total of $20.7 billion. Except for a decline of $76 million in dollar deposits, each type of asset held at the Bank increased. United States Government securities, in particular, rose by $1.7 billion. Earmarked gold increased $142 million, and miscellaneous securities (including bankers' acceptances) advanced by $222 million. The accounts of the international organizations, in which the other Federal Reserve Banks do not participate, registered a nominal rise, up by $65 million to a total of $8.1 billion at the year end.

Gold operations were somewhat under the level of the preceding year both in number of transactions and in dollar value, reflecting a falling-off in purchases from and sales to the United States Treasury as well as a sizable drop in imports and exports. There was relatively minor demand for loans against gold under earmark; four credits, aggregating $87 million, were made available to banks in three countries in order to assist them in meeting seasonal and other temporary dollar requirements. Each of the credits was utilized in full, but at the year end only $32 million was outstanding.

Cooperative arrangements among the monetary authorities of the major industrial countries were further expanded during the year. At the year end Federal Reserve swap facilities totaling $2,050 million were in effect with the monetary authorities of eleven countries plus the Bank for International Settlements, while United States Treasury securities denominated in foreign currencies had risen to the equivalent of $760 million.

Financial Statements

STATEMENT OF CONDITION
(In thousands of dollars)

Assets	**DEC. 31, 1963**	**DEC. 31, 1962**
Gold certificate account	3,608,466	3,394,817
Redemption fund for Federal Reserve notes	334,006	302,818
Federal Reserve notes of other Banks	109,996	94,866
Other cash	31,676	42,078
Total cash	4,084,144	3,834,579
Discounts and advances	9,998	15,474
Acceptances	161,720	110,254
United States Government securities	8,707,557	7,868,600
Total loans and securities	8,879,275	7,994,328
Other assets:		
Cash items in process of collection	1,688,500	1,604,892
Bank premises	8,110	8,413
All other	105,935	90,286
Total other assets	1,802,545	1,703,591
Total Assets	**14,765,964**	**13,532,498**

STATEMENT OF CONDITION
(In thousands of dollars)

Liabilities	DEC. 31, 1963	DEC. 31, 1962
Federal Reserve notes	7,939,568	7,234,647
Deposits:		
Member bank reserve accounts	4,994,535	4,643,682
United States Treasurer — general account	227,126	117,026
Foreign*	54,054	58,121
Other	167,741	289,176
Total deposits	5,443,456	5,108,005
Other liabilities:		
Deferred availability cash items	967,104	795,421
All other	21,014	18,358
Total other liabilities	988,118	813,779
Total Liabilities	**14,371,142**	**13,156,431**
Capital Accounts		
Capital paid in	131,607	125,356
Surplus	263,215	250,711
Total Capital Accounts	**394,822**	**376,067**
Total Liabilities and Capital Accounts	**14,765,964**	**13,532,498**
Contingent liability on acceptances purchased for foreign correspondents†	24,673	24,464
Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities combined	29.5%	30.0%

* After deducting participations of other Federal Reserve Banks amounting to	116,960	188,760
† After deducting participations of other Federal Reserve Banks amounting to	67,179	61,057

STATEMENT OF EARNINGS AND EXPENSES FOR THE CALENDAR YEARS 1963 AND 1962 (In thousands of dollars)

	1963	1962
Total current earnings	291,817	261,931
Net expenses	39,099	36,115
Current net earnings	252,718	225,816
Additions to current net earnings:		
Profit on sales of United States Government securities (net)	77	492
All other	113	120
Total additions	190	612
Deductions from current net earnings	11	408
Net additions	179	204
Net earnings available for distribution	**252,897**	**226,020**
Dividends paid	7,743	7,419
Paid United States Treasury (as interest on Federal Reserve notes)	232,650	210,886
Transferred to surplus	12,504	7,715
Surplus Account		
Surplus—beginning of year	250,711	242,996
Transferred from net earnings for year	12,504	7,715
Surplus — end of year	**263,215**	**250,711**

Changes in Membership

During 1963 the total number of commercial banks in this District that are members of the Federal Reserve System declined from 449 to 426. The net decrease of 23 banks was the result of the organization of one new national bank, and mergers of 22 member banks with other members and two member banks with nonmembers. The 426 banks constitute 84 per cent of all national banks, state banks, and trust companies in this District and hold 96 per cent of the total assets of all such institutions in this District.

NUMBER OF OPERATING MEMBER AND NONMEMBER BANKS IN SECOND FEDERAL RESERVE DISTRICT AT THE YEAR END

(Exclusive of savings banks, private bankers and industrial banks)

	DECEMBER 31, 1963			DECEMBER 31, 1962		
Type of Bank	**Members**	**Non-members**	**Per cent members**	**Members**	**Non-members**	**Per cent members**
National banks*	296	0	100	310	0	100
State banks and trust companies	130	80	62	139	80	63
Total	**426**	**80**	**84**	**449**	**80**	**85**

* Includes one national bank located in Virgin Islands.

CHANGES IN FEDERAL RESERVE MEMBERSHIP IN SECOND DISTRICT DURING 1963

Total membership beginning of year	**449**
Increases:	
New national bank	1
Decreases:	
Member banks combined with other members	22
Member banks combined with nonmembers	2
Total membership at end of year	**426**

Changes in Directors and Officers

CHANGES IN DIRECTORS. In November 1963, member banks in Group 3 elected Robert H. Fearon a Class A director of the Federal Reserve Bank of New York for the term of three years beginning January 1, 1964. Mr. Fearon, President of The Oneida Valley National Bank of Oneida, Oneida, N.Y., succeeded A. Leonard Mott, President of The First National Bank of Moravia, Moravia, N.Y., whose term expired December 31, 1963.

At the same time, member banks in Group 3 re-elected Albert L. Nickerson a Class B director for the three-year term beginning January 1, 1964. Mr. Nickerson is Chairman of the Board of Socony Mobil Oil Company, Inc., New York, N.Y.

Also in November 1963, the Board of Governors of the Federal Reserve System redesignated Philip D. Reed as *Chairman* of the Board of Directors of the Bank and *Federal Reserve Agent* for the year 1964. Mr. Reed is a former Chairman of the Board of General Electric Company, New York, N.Y. At the same time, the Board of Governors reappointed James DeCamp Wise as *Deputy Chairman* for the year 1964. Mr. Wise is a former Chairman of the Board of Bigelow-Sanford, Inc., New York, N.Y.

In November 1963, the Board of Governors also reappointed Everett N. Case as a Class C director of this Bank for the three-year term beginning January 1, 1964. Mr. Case is President of the Alfred P. Sloan Foundation, New York, N.Y.

At the Buffalo Branch of the Federal Reserve Bank of New York, Arthur S. Hamlin, President of The Canandaigua National Bank and Trust Company, Canandaigua, N.Y., was appointed in May 1963 by the Board of Directors of the Federal Reserve Bank of New York as a director of the Branch for the unexpired portion of the term ending December 31, 1965. Mr. Hamlin succeeded J. Monroe Hodges, President of The Exchange National Bank of Olean, Olean, N.Y., who died on April 13, 1963. In November 1963, the Board of Directors of this Bank designated Whitworth Ferguson, President of Ferguson Electric Construction Co., Inc., Buffalo, N.Y., as *Chairman* of the Board of Directors of the Branch for the year 1964. At the same time, the Board of Directors appointed Charles W. Millard, Jr., a director of the Branch for the three-year term beginning January 1, 1964. Mr. Millard, Chairman of the Board and President of Manufacturers and Traders Trust Company, Buffalo, N.Y., succeeded John M. Galvin, Chairman of the Executive Committee of The Marine Trust Company of Western New York, Buffalo, N.Y., whose term expired December 31, 1963. Also in

November 1963, Thomas E. LaMont, who is engaged in farming in Albion, Orleans County, N.Y., was reappointed by the Board of Governors of the Federal Reserve System as a director of the Buffalo Branch for the three-year term beginning January 1, 1964.

CHANGES IN OFFICERS. Since February 1963, one officer has resigned and six officers have retired.

Herbert H. Kimball, Vice President in charge of the Accounting and Planning function, retired effective September 17, 1963. Mr. Kimball had joined the Bank's staff as an officer in 1931.

Donald J. Cameron, General Auditor, retired effective November 1, 1963. Mr. Cameron, an officer since 1933, had completed forty-six years of service with the Bank. Mr. Cameron died on January 27, 1964.

Todd G. Tiebout, Vice President and General Counsel, retired effective December 1, 1963. Mr. Tiebout, the senior officer in charge of the Legal Department since August 1953, had been an officer of the Bank since 1933.

M. Monroe Myers, Assistant Cashier of the Buffalo Branch, retired effective January 1, 1964. Mr. Myers had joined the Bank's staff in 1942. He had transferred to the Buffalo Branch in 1943 and had been an officer of the Branch since 1945.

Norman P. Davis, Assistant Vice President assigned to the Accounting and Planning function, retired effective February 1, 1964. Mr. Davis had been a member of the Bank's staff since 1932 and had been an officer since 1938.

Harold W. Lewis, Manager of the Security Custody Department, retired effective February 16, 1964. Mr. Lewis had completed almost forty-six years of service with the Bank and had been an officer since 1961.

John F. Pierce, Chief Examiner, resigned effective February 29, 1964 to accept appointment as Governor of the proposed central bank of Trinidad and Tobago.

The following additional changes in official staff, including the appointment of four new officers, have taken place since February 1963.

William H. Braun, Jr., formerly Assistant Counsel, was appointed Assistant Vice President, effective July 1, 1963, and assigned to the Loans and Credits function. Effective August 19, 1963, Mr. Braun was assigned to Accounting and Planning, continuing his assignment to the Loans and Credits function.

Frank W. Schiff, formerly Manager of the Research Department, was appointed Assistant Vice President, effective July 1, 1963, and assigned to the Research and

Statistics function.

Bruce K. MacLaury, formerly Chief of the Public Information Division, Public Information Department, was appointed an officer with the title of Manager, effective July 11, 1963, and assigned to the Foreign Department.

Francis H. Schott, Manager, formerly assigned to the Foreign Department, was assigned to the Research Department, effective July 11, 1963.

Harold A. Bilby, Vice President, in charge of Government Bond and Safekeeping of Securities, Loans and Credits, and at the time Building Operating and Service, was also assigned responsibility for the Accounting and Planning function, effective August 19, 1963.

Robert Lindsay, Senior Economist, Research Department, was granted a one-year leave of absence, commencing in September 1963, to accept a visiting faculty appointment at the School of Business Administration, University of California, Berkeley, California.

Harold M. Wessel, formerly Assistant Vice President, Buffalo Branch, was appointed Assistant Vice President at the Head Office, effective September 1, 1963, and assigned to the Cash and Collections function. His appointment as an officer of the Branch terminated as of the same date.

George J. Doll, formerly Cashier, Buffalo Branch, was appointed Assistant Vice President of the Branch effective September 1, 1963. His appointment as Cashier was continued.

John P. Jensen, formerly Assistant Vice President in the Cash and Collections function, was appointed General Auditor, effective November 1, 1963.

John J. Clarke, formerly Assistant General Counsel, was appointed Vice President and General Counsel, effective December 1, 1963.

Thomas C. Sloane, formerly Assistant Counsel, was appointed Assistant General Counsel, effective December 1, 1963.

Peter Fousek, formerly Manager of the Foreign Department, was appointed Assistant Vice President, effective January 2, 1964, and assigned to the Foreign function.

Robert G. Link, formerly Assistant Vice President in the Research and Statistics function, was appointed Adviser, effective January 2, 1964, and assigned to the Research and Statistics function.

Peter D. Sternlight, formerly Manager of the Securities Department, was appointed Assistant Vice President, effective January 2, 1964, and assigned to Open Market Operations and Treasury Issues.

Gerald E. Beach, formerly Chief of the Food Supply Division, Service Department, was appointed Manager, effective January 2, 1964, and assigned to the Security Custody Department.

Richard A. Debs, formerly an Attorney in the Legal Department, was appointed Assistant Counsel, effective January 2, 1964.

James H. Oltman, formerly an Attorney in the Legal Department, was appointed Assistant Counsel, effective January 2, 1964.

Robert C. Thoman, Manager of the Collection Department, was also appointed Assistant Secretary, effective January 2, 1964, the appointment of Paul Meek, Manager of the Securities Department, as Assistant Secretary being terminated on the same date. Effective January 3, 1964, Mr. Thoman's assignment as Manager was changed to the Government Bond and Safekeeping Department.

Robert L. Cooper, Manager, formerly assigned to the Securities Department, was assigned to the newly established Acceptance Department in Open Market Operations and Treasury Issues, effective January 3, 1964.

Karl L. Ege, Manager, formerly assigned to the Savings Bond Department, was assigned to the Collection Department, effective January 3, 1964.

Walter S. Rushmore, Manager, formerly assigned to the Government Bond and Safekeeping Department, was assigned to the Savings Bond Department, effective January 3, 1964.

Walter H. Rozell, Jr., Vice President, in charge of Personnel, was also assigned responsibility for Building Operating and Service, effective February 1, 1964, replacing Harold A. Bilby as Vice President in charge of that function.

Lawrence E. Quackenbush, Assistant Vice President, formerly assigned to Building Operating and Service, was assigned to Bank Supervision and Relations and to Administration of Regulations T and U, effective February 1, 1964. In his new assignment, Mr. Quackenbush will be concerned primarily with matters relating to the examination of banks.

Frederick L. Smedley, Assistant Vice President, assigned to Personnel, was also assigned to Building Operating and Service, effective February 1, 1964.

Aloysius J. Stanton, Manager, formerly assigned to the Check Mechanization Department, was assigned to the Check Department, effective February 1, 1964, when the Check Mechanization Department was merged into the Check Department.

MEMBER OF FEDERAL ADVISORY COUNCIL - 1964. The Board of Directors of this Bank selected William H. Moore to serve during 1964 as the member of the Federal Advisory Council representing the Second Federal Reserve District. Mr. Moore is Chairman of the Board of Bankers Trust Company, New York, N.Y. He replaced George A. Murphy, Chairman of the Board of Irving Trust Company, New York, N. Y., who had served as a member of the Council for the past three years.

Directors of the Federal Reserve Bank of New York

DIRECTORS	Term expires Dec. 31	Class	Group
GEORGE CHAMPION Chairman of the Board, The Chase Manhattan Bank, New York, N. Y.	1964	A	1
RALPH H. RUE Chairman of the Board, The Schenectady Trust Company, Schenectady, N. Y.	1965	A	2
ROBERT H. FEARON President, The Oneida Valley National Bank of Oneida, Oneida, N. Y.	1966	A	3
B. EARL PUCKETT Former Chairman of the Board, Allied Stores Corporation, New York, N. Y.	1964	B	1
KENNETH H. HANNAN Executive Vice President, Union Carbide Corporation, New York, N. Y.	1965	B	2
ALBERT L. NICKERSON Chairman of the Board, Socony Mobil Oil Company, Inc., New York, N. Y.	1966	B	3
PHILIP D. REED, *Chairman, and Federal Reserve Agent* Former Chairman of the Board, General Electric Company, New York, N. Y.	1965	C	
JAMES DECAMP WISE, *Deputy Chairman* Former Chairman of the Board, Bigelow-Sanford, Inc., New York, N. Y.	1964	C	
EVERETT N. CASE President, Alfred P. Sloan Foundation, New York, N. Y.	1966	C	

DIRECTORS — BUFFALO BRANCH

WHITWORTH FERGUSON, *Chairman* President, Ferguson Electric Construction Co., Inc., Buffalo, N. Y.	1964
ELMER B. MILLIMAN President, Central Trust Company Rochester N. Y., Rochester, N. Y.	1964
ANSON F. SHERMAN President, The Citizens Central Bank, Arcade, N. Y.	1964
MAURICE R. FORMAN President, B. Forman Co., Rochester, N. Y.	1965
ARTHUR S. HAMLIN President, The Canandaigua National Bank and Trust Company, Canandaigua, N. Y.	1965
THOMAS E. LAMONT Farmer, Albion, Orleans County, N. Y.	1966
CHARLES W. MILLARD, JR. Chairman of the Board and President, Manufacturers and Traders Trust Company, Buffalo, N. Y.	1966

MEMBER OF FEDERAL ADVISORY COUNCIL — 1964

WILLIAM H. MOORE Chairman of the Board, Bankers Trust Company, New York, N. Y.	1964

Officers of the Federal Reserve Bank of New York

ALFRED HAYES, *President*
WILLIAM F. TREIBER, *First Vice President*

HAROLD A. BILBY, *Vice President*
JOHN J. CLARKE, *Vice President, and General Counsel*
CHARLES A. COOMBS, *Vice President*
HOWARD D. CROSSE, *Vice President*
GEORGE GARVY, *Economic Adviser*
MARCUS A. HARRIS, *Vice President*
ALAN R. HOLMES, *Vice President*
ROBERT G. ROUSE, *Vice President, and Senior Adviser*
WALTER H. ROZELL, JR., *Vice President*
HORACE L. SANFORD, *Vice President*
ROBERT W. STONE, *Vice President*
THOMAS O. WAAGE, *Vice President*

EDWARD G. GUY, *Assistant General Counsel*
THOMAS C. SLOANE, *Assistant General Counsel*

WILLIAM H. BRAUN, JR., *Assistant Vice President*
FELIX T. DAVIS, *Assistant Vice President*
PETER FOUSEK, *Assistant Vice President*
PETER P. LANG, *Adviser*
ROBERT G. LINK, *Adviser*
ANGUS A. MACINNES, JR., *Assistant Vice President*
SPENCER S. MARSH, JR., *Assistant Vice President*
FRED W. PIDERIT, JR., *Assistant Vice President*
LAWRENCE E. QUACKENBUSH, *Assistant Vice President*
THOMAS J. ROCHE, *Senior Foreign Exchange Officer*
FRANK W. SCHIFF, *Assistant Vice President*
FREDERICK L. SMEDLEY, *Assistant Vice President*
PETER D. STERNLIGHT, *Assistant Vice President*
HAROLD M. WESSEL, *Assistant Vice President*

GERALD E. BEACH, *Manager, Security Custody Department*
MARTIN W. BERGIN, *Manager, Public Information Department*
ERNEST E. BLANCHETTE, *Manager, Bank Relations Department*
A. THOMAS COMBADER, *Manager, Building Operating Department*
ROBERT L. COOPER, *Manager, Acceptance Department*
ROBERT J. CROWLEY, *Assistant Counsel*
RICHARD A. DEBS, *Assistant Counsel*
KARL L. EGE, *Manager, Collection Department*
MARTIN FRENCH, *Manager, Cash Custody Department*
FRED H. KLOPSTOCK, *Manager, Research Department*
ROBERT LINDSAY, *Senior Economist*
BRUCE K. MACLAURY, *Manager, Foreign Department*
WILLIAM E. MARPLE, *Manager, Credit and Discount Department*
MADELINE H. MCWHINNEY, *Manager, Market Statistics Department*
PAUL MEEK, *Manager, Securities Department*
DONALD C. NILES, *Manager, Accounting Department*
ARTHUR H. NOA, *Manager, Service Department*
JAMES H. OLTMAN, *Assistant Counsel*
JOHN F. PIERCE, *Chief Examiner*
EVERETT B. POST, *Manager, Planning Department*
CHARLES R. PRICHER, *Manager, Personnel Department*
JOHN P. RINGEN, *Manager, Bank Examinations Department*
EDWIN S. ROTHMAN, *Manager, Foreign Department*
WALTER S. RUSHMORE, *Manager, Savings Bond Department*
FRANCIS H. SCHOTT, *Manager, Research Department*
WILLIAM M. SCHULTZ, *Manager, Personnel Department*
KENNETH E. SMALL, *Manager, Cash Department*
GEORGE C. SMITH, *Manager, Check Department*
ALOYSIUS J. STANTON, *Manager, Check Department*
ROBERT C. THOMAN, *Manager, Government Bond and Safekeeping Department, and Assistant Secretary*
THOMAS M. TIMLEN, JR., *Secretary, and Assistant Counsel*
ROBERT YOUNG, JR., *Assistant Counsel*

JOHN P. JENSEN, *General Auditor*
LEONARD I. BENNETTS, *Assistant General Auditor*

OFFICERS — BUFFALO BRANCH

INSLEY B. SMITH, *Vice President*

GEORGE J. DOLL, *Assistant Vice President, and Cashier*

GERALD H. GREENE, *Assistant Cashier*

JOHN T. KEANE, *Assistant Cashier*

THE SECOND FEDERAL RESERVE DISTRICT