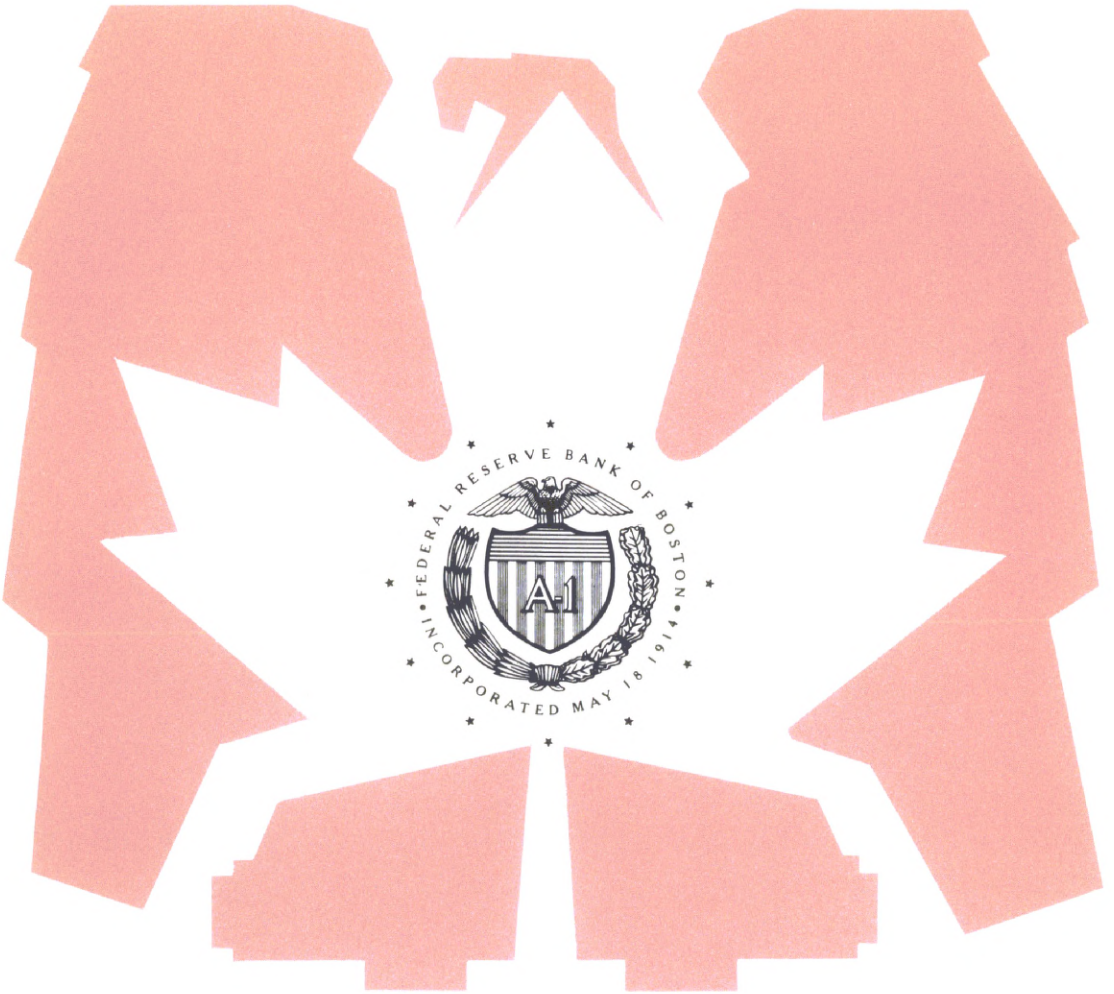
Canada and the United States: Their Economic Relationship

Federal Reserve Bank of Boston Annual Report 1965



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Federal Reserve Bank of Boston Annual Report 1965

To the Member Banks

It gives me pleasure to submit the 1965 Annual Report of the Federal Reserve Bank of Boston.

The year was one of continuing expansion for both the regional and national economies, and it topped a half decade of unprecedented peacetime growth. For New England, 1965 set new highs in nonagricultural employment, in per capita income, in department store sales, in commercial bank deposits, in business loans, and in member bank collective net earnings after taxes and dividends. The assets of the Federal Reserve Bank of Boston at the year's end stood at a record $3.5 billion, and its $68 million of earnings before payments to the U.S. Treasury set another record.

The notable performance of the nation's economy took place within a framework of increasingly complex and difficult problems in international monetary matters. Continuing disequilibrium in the country's balance of payments led in the spring of 1965 to the establishment of the voluntary foreign credit restraint program which is described in the Summary of Principal Changes.

About one-third of all United States private investments abroad — nearly $25 billion — is in Canada. To discuss the economic relationship of these North American neighbors, as well as other aspects of international finance, Louis Rasminsky, Governor of the Bank of Canada, met with member bankers in October 1965 at the 41st Annual Meeting of Stockholders of the Federal Reserve Bank of Boston. We are happy to include a major portion of Governor Rasminsky's address in this Annual Report.

The report also summarizes the Bank's operations. For the increasing efficiency of these operations, and for the assistance of our officers and staff in helping improve the Bank's contribution to New England's economic progress, I extend my own thanks and those of our directors. Our thanks go also to New England's bankers and business leaders for their generous cooperation.

January 15, 1966

George H Ellis
President

Canada and the United States: Their Economic Relationship

Louis Rasminsky, Governor of the Bank of Canada

History has intimately linked the Canadian and American economies. Canadians are never likely to lose sight of the important influence that economic and financial developments in the United States have had—and continue to have—on our own well-being. Indeed, one of the basic preoccupations of Canadian economic policy is how to foster and develop these relationships to the advantage of both countries, while retaining the strong sense of national identity and separateness which we cherish.

There is, of course, a vast difference in the economic size of the two countries—we are about one-tenth your size in terms of population and one-fourteenth in terms of Gross National Product—so we are less important to you than you are to us. But Canada is nevertheless your largest foreign customer, taking close to 20 percent of your non-military exports of goods and services, and about one-third of all U. S. private investments abroad—nearly $25 billion—is in Canada.

I know that you in New England are particularly interested in and knowledgeable about Canadian affairs, so I am going to take your familiarity with the general background of our relationship for granted and make some comments about recent economic and financial developments in Canada. I shall point out a few of the many similarities in the way events have evolved in our two countries, some of the major points of concern which we share and, perhaps even more importantly, where these concerns diverge.

Over the past few years there have in fact been striking similarities in the performance of the economies of Canada and the United States. Since early 1961 we have both enjoyed a period of economic expansion which, whether measured in terms of duration, of sustained growth, or of freedom from inflationary side effects, has been unequalled since the Second World War. At the start of this expansion we, like you, had a disturbingly large excess of unused resources; the Canadian unemployment rate was at a post-war high of 7.5 percent. Since then our progress has been impressive.

Between the first half of 1961 and the first half of 1965, our gross national product, at market prices, has increased at an annual average rate of 8.3 percent compared to a rate of 6.7 percent in the United States. Excluding the effect of price increases, our growth in real terms over this period has been a little over 6 percent annually in Canada, compared to a little over 5 percent in the United States, while the output of manufacturing industries in both countries has increased by about 7.5 percent per annum.

This expansion has resulted in a growth in employment appreciably greater than the growth in the labour force. By comparison with most other developed countries, we in Canada have been experiencing, and will continue for some time to experience, a particularly rapid growth in the labour force. In the early post-war years this was due primarily to our relatively high rate of net immigration, but at the present time it reflects mainly the very high birth rates which we had in Canada in the years immediately after the war. Consequently, over the past four years our civilian labour force has increased on average over 2 percent per annum compared with a growth of only 1.25 percent in the United States. However, employment in Canada has also increased very rapidly—by over 3 percent annually, compared to just under 2 percent in the United States. This high rate of growth in employment over the past four years has reduced unemployment in Canada below 4 percent, to a level which is the lowest we have had since early 1957—and about .5 percent less than the present rate in the United States.

The good performance of the Canadian economy over the past four years owes much, of course, to the strength of the expansion in the United States and to the generally favourable international economic environment. Growth tends to breed growth in a relatively new and dynamic economy like Canada, and rapidly expanding markets have provided opportunities for the efficient production of new goods and services.

I think an important contribution to the expansion was made by the substantial reduction in Canada's large balance of payments deficit on current account which occurred between 1960 and 1964. The benefits of the new fixed rate of 92.5 cents U. S. adopted for the Canadian dollar in 1962 were considerably strengthened by the maintenance of a relatively good cost and price performance in the period immediately following the exchange rate adjustment.

I would like to think that monetary policy in Canada has played

a constructive role in facilitating the expansion, as I believe it has in the United States. Using the broad definition of money supply which we commonly use in Canada, that is, currency and total bank deposits, the annual growth rate over the past four years has been 7.5-8 percent, about the same as in the United States. The growth in bank loans in both countries has been equally impressive over the past four years. Except at the time of the exchange crisis in 1962, the Bank of Canada has taken the view that an appreciable tightening of credit conditions was not appropriate so long as there were significant amounts of unused resources in the economy.

Economic Pressures and Imbalances

During the past year or so, even though the Canadian economy has advanced more rapidly, the degree of monetary expansion has been somewhat greater in Canada than it has been in the United States. I believe that this has been in a significant though unmeasurable degree due to the steps taken by the United States to improve its balance of payments, which have resulted in some shift from American to Canadian sources of credit. The demand for credit in Canada has been such that, notwithstanding the large expansion in the money supply that has occurred in the past year, there has been some rise in the interest rates.

In both our countries the same sort of questions about the economic outlook inevitably arise at the present time. With the absorption of most or virtually all of the slack which existed in our economies four years ago, are we likely to see a recurrence of some of the pressures and imbalances which arose in earlier periods of strong economic expansion?

Taking the period since 1961 as a whole, the expansion in Canada has been remarkably free of inflationary pressure. The rise in consumer prices over the four-year period from the first half of 1961 to the first half of 1965 was 1.6 percent per annum compared to 1.3 percent in the United States—a price performance which, though less than perfect, is still very much better than has been achieved by any of the other industrial countries during this period.

Over the past year, however, there has been a tendency for prices to rise rather more noticeably—Canadian consumer prices are currently about 2.5 percent higher than a year ago, while in the United States they have risen by 1.7 percent. In Canada there also seems to have been some recent deterioration in our unit labour costs (that is, in the increase in wage rates relative to productivity), in compari-

son to their behaviour in the first years of our expansion and in comparison to the continued good performance of costs relative to productivity in the United States.

Finally, though the expansion in Canada has been remarkably well balanced over most of its course to date (even residential building, which has been something of a weak spot in your own economy over the past year or two, has continued to grow strongly in Canada), the recent growth in one or two sectors of the economy, notably in business outlays on plant and equipment, has accelerated to a pace that cannot be regarded as sustainable over the longer run, and considerable pressure has also developed in the construction industry.

Balance of Payments Problems

I would like to turn now to the very important issues involved in the balance of payments relationship between our two countries. This is an area where the nature of our problems is somewhat different and where there is considerable danger of misunderstanding, yet one in which our ultimate objectives are wholly compatible.

The essential difference in the nature of our balance of payments problems can be stated quite simply. The United States customarily has a large net export surplus in its transactions in goods and services with other countries, but this surplus has not been large enough to cover the very substantial deficit arising from military and economic aid, from large investment abroad by private corporations, from heavy long-term borrowings by non-residents in your highly efficient capital market, and more recently from substantial short-term capital outflows as well. The result has been that, notwithstanding your large current account surplus, the flow of American dollars to foreigners has exceeded their usage of dollars, and you have had a deficit in your over-all balance of payments.

The Canadian balance of payments problem, on the other hand, is basically a current account problem. The Canadian economy has shown a persistent tendency to generate large deficits on goods and services account, especially at times when the domestic economy is running at high levels of employment and in periods of strong expansion. This in turn leads to a dependence on steady and sufficient inflows of capital to finance this deficit, if we are to avoid severe strains on our foreign exchange position. Our vulnerability to any drastic curtailment of this inflow was dramatically illustrated in 1962, when a sudden cessation of capital inflows produced a major

exchange crisis requiring vigorous monetary and fiscal measures to correct.

An upheaval in our exchange and financial markets, potentially as serious, was only narrowly averted in 1963, at the time of the first announcement in Washington of the interest equalization tax when, after urgent consultations with the Canadian authorities, the United States Administration gave an assurance that Canada would be granted the exemption now in effect.

As I mentioned before, there was an appreciable reduction in our current account deficit in the first several years of this economic expansion—from about $1.25 billion in 1960 to under $.5 billion in 1964. The fact that this reduction continued through the first three years of marked growth in the level of domestic economic activity was particularly gratifying, and it made an important contribution to the strength of the economy's performance.

However, for some time now it has been clear that this improving trend has ceased and that the more traditional tendency for imports to grow more rapidly than exports in a period of expansion has reasserted itself. In the first half of 1965 our current account deficit has been running at a seasonally adjusted rate of about $1 billion and we do not look for a level for the year as a whole that will be very different, despite the fact that we have recently negotiated a second large sale of wheat to the Soviet Union.

The deficit in our current account transactions is not evenly spread among our major trading partners. In our trade in goods and services with countries other than the United States we run a current account surplus which over the past five years has averaged about $500 million a year. The deficit in our current account is therefore more than wholly accounted for by our trade in goods and services with the United States. Since 1954 our net imports of goods and services from the United States have never fallen below $1 billion; in the past five years they have averaged close to $1,500 million, in 1964 they were $1,800 million, and this year our current account deficit with you is running at an even higher rate.

The problem of how to finance this large deficit in our goods and services transactions with the United States is one which is a constant source of concern to us in Canada. We do, to be sure, run a payments surplus with overseas countries. This surplus, together with newly-mined Canadian gold, has contributed to meeting our large trading deficit with you. To this extent, in fact, the United

States has been in an over-all surplus position in its current and capital transactions with Canada—to an aggregate amount of about $1.5 billion in the past five years on the basis of Canadian balance of payments statistics.

Since, however, our surplus in transactions with overseas countries is far from being adequate to cover the whole of our deficit with you, we must depend on capital inflows from the United States to finance the balance. There is no alternative source of capital on the scale required. Therefore, unless some major channels of access to U. S. capital markets were left open to us, the only policy choices remaining for Canada would be choices of the methods we would use to achieve the unavoidable curtailment of our imports of goods and services from the United States—and any choice along these lines would be as distasteful to us as it would be unhelpful to you in the solution of your balance of payments problem.

This has been the basic logic behind Canada's request for, and your Administration's agreement to, an exemption from the interest equalization tax for new issues of Canadian securities; and it is the reason for your Administration's concern that your guideline program should be administered in a way which recognizes the special circumstances of the financial relationship between our countries.

As a consequence of the guidelines implemented by the U. S. Administration earlier this year, the main channel of access to U. S. capital markets which remains open to us is the market for new long-term issues by Canadian borrowers. For our part we have, as you are aware, agreed not to encourage resort to this market on an excessive scale—that it, on a scale which would lead to a persistent tendency for our reserves to rise. It is, of course, not possible to predict precisely what scale of borrowing is necessary over any given period to keep our reserves more or less in balance, since so many other variables enter the accounts. Moreover, the magnitude of our external transactions and the marked seasonal variations in them naturally make it impossible at times to avoid appreciable short-term variations in the level of reserves.

Recently, for example, our reserves have been augmented by a large sale of wheat to the Soviet Union, which, incidentally, is bringing Soviet gold into the Western world to the advantage of all the major countries in the international monetary system. But looking ahead, I see no reason for supposing that the current rate of Canadian borrowing in the American capital market is in excess of what we

need to maintain an over-all balance in our international payments over a reasonable period of time.

I would not wish to imply that I am happy about the size of our over-all current account deficit and the present degree of our dependence upon net inflows of capital. On the contrary, I share the view of many Canadians that a major objective of our economic policy should be the reduction and eventual elimination of this deficit. This objective, however, if we are to reach it through constructive measures which increase the efficiency and competitiveness of Canadian industry and not through harsh disruptive measures, is one which it will take time to achieve.

Meanwhile, Canada must continue to rely upon a sizeable net inflow of capital from the United States to cover that part of our goods and services deficit with the United States which we are unable to finance from our over-all surplus with the rest of the world.

Mutual Understanding and Cooperation

For the foreseeable future, these aspects of our bi-lateral relationship are going to require the closest consultation between us if mutual understanding of each other's problems is to prevail and to produce constructive and imaginative solutions to any difficulties that may arise from time to time.

For your part, you in this country have demonstrated this understanding in granting the partial exemption of Canada from the interest equalization tax and in some recognition of Canada's special position under the guidelines.

For our part, we have tried to be as helpful as we can to you in the achievement of your balance of payments objectives. I think that I can fairly claim that in its monetary policy the Bank of Canada, while naturally directed towards meeting the requirements of the Canadian economy, has not been unmindful of your own balance of payments position. Moreover, in addition to the Canadian commitment not to encourage a persistent growth in our exchange reserves, Canada has tried in more specific ways to be as helpful as our circumstances have permitted.

For example, we hold a relatively high proportion of our foreign reserves in U. S. dollars (and a relatively low proportion in gold) and on several occasions when we knew it would facilitate your exchange management we have converted ordinary U. S. government securities into special securities of longer than conventional term.

Another example is that when your guideline program was put into effect early this year the Canadian Government requested our banks to conduct their foreign currency operations in a way that would reinforce and not prejudice the effects of your program. I might add that their wholehearted compliance with this request has been an important source of the improvement which has occurred in the short-term capital flows in your balance of payments.

I think that these examples of cooperative action illustrate the value that both of our countries can derive from the sort of close consultation we have been maintaining over the last few years. But I think they have an even wider significance than this. It is essential to the smooth and efficient working of the international monetary system that countries acknowledge a responsibility to cooperate with each other in initiating and carrying out constructive policies to effect adjustments of international payments positions when these are required. As the Canada-U. S. example shows, responsibility devolves on both sides—i. e., on those whose payments show a tendency to surplus as well as upon those which experience deficits.

In any new steps we may take to safeguard the continued sound operation of the international monetary system we should seize every opportunity to strengthen the means of promoting consultation and cooperation on the adjustment of payments imbalances, while making sure that adequate international liquidity is available for the temporary financing of such imbalances. Before I conclude these remarks, I should like to make a few further observations on these extremely important matters about which there has been so much discussion recently.

International Monetary Improvements

In the first place, I think it is important not to lose sight of the considerable progress which has already been made over the last twenty years in improving and strengthening the international monetary system. I would attribute this improvement first to the creation and increasingly important role of the International Monetary Fund, and secondly to the greatly increased opportunities for close consultation and full exchanges of information provided by the Fund, the OECD, and other agencies.

By and large, the major objectives sought at Bretton Woods —exchange stability, currency convertibility, and non-discrimination in transactions among the major trading nations of the world—have been achieved; and these have been achieved without sacrifice of the

major domestic economic objectives of sustained growth and high levels of employment—indeed, I believe they have furthered the attainment of these objectives.

It is true that some weaknesses in the system have recently developed, to which we are rightly directing our attention. However, I think that it is unnecessary—as well as impractical—to contemplate reforms so drastic that the many good characteristics of the present system would be lost. This is equally true both of proposals which envisage a return to something much closer to the classic gold standard system and of proposals which would substantially reduce the role now played by the two main reserve currencies.

The signs of strain which lately appeared in the system came about primarily because the deficits of the reserve currency countries were increasingly matched by offsetting surpluses in the hands of a relatively small number of continental European countries—who, faced with inflationary tendencies in their domestic economies, found these accretions to their reserves more and more unwelcome. They began to question a system which permitted the reserve currency countries to run large persistent deficits in their balance of payments, and such questioning led to a gradual diminution of confidence in the reserve currencies.

When the pound came under serious pressure a year ago, as a result of domestic as well as external strains, this situation became potentially very serious. Fortunately, as you know, the various measures taken since that time by your government and by the British authorities to improve the balance of payments positions of the two countries, together with the massive international assistance mustered in support of the pound, have produced a noticeable improvement.

The determination of both countries to eliminate their payments deficits in the near future is helping to restore the confidence in the dollar and the pound which is vital for the operation of the international monetary system. But at the same time, of course, the prospect of the reserve currencies coming into balance raises questions about whether in the period ahead sufficient liquidity will be generated to support the continued growth of world trade.

After the meetings of the International Monetary Fund and World Bank in Washington last month, I am reasonably confident that we are making good progress in the search for ways to overcome this problem. As was observed at these meetings, it should

not be beyond the wit of man to devise a system of liquidity creation less dependent upon levels of gold production and the balance of payments positions of one or two countries. On the other hand, there is no point in minimizing the complexity of some of the issues involved or the difficulties which may be encountered in reaching a consensus.

Among the more contentious issues to be settled first are the questions of whether some new form of international liquidity should be created and, if so, how many countries should participate in its creation—and whether or not a new system of liquidity creation will operate within or outside the framework of the International Monetary Fund.

With regard to participation, it would be my hope that even if initial participation in any such scheme is quite limited, it will be possible to leave the door open for other qualified countries to join as time goes on. We, in Canada, also believe that new machinery for supplementing existing forms of international liquidity should be managed within the general framework of the International Monetary Fund and not by a rival international monetary authority.

To conclude, I feel that there are solid grounds for optimism with regard to each of the questions that I have attempted to touch upon in my remarks today.

In each case, of course, such optimism will be justified only if we continue to direct our efforts along appropriate lines. In the case of our domestic economies, we must not allow ourselves to be lulled by our successes over the past four years into forgetting the important part that the avoidance of imbalances and of serious inflationary pressure has played in sustaining economic expansion in North America since 1961.

In the complex balance of payments relationships between our two countries, and in our exploration with other like-minded countries of ways in which we can further improve the international monetary system, the beginning of wisdom is to understand the facts, not only as they appear from one's own perspective but also from the point of view of others, and to seek constructively for the means by which objectives can be reconciled.

I hope that we in the central banks of Canada and the United States are playing our part in this process, both in the relations between our two countries and in the broader international sphere.

Comparative Statement of Condition

ASSETS	December 31, 1965	December 31, 1964
Gold Certificate Reserves	$ 801,268,563.80	$ 768,581,992.75
Federal Reserve Notes of Other Federal Reserve Banks	74,022,168.00	48,700,675.00
Other Cash	9,522,174.01	8,894,321.74
Discounts and Advances	1,927,000.00	18,790,000.00
U. S. Government Securities—System Account	2,096,777,000.00	1,911,003,000.00
Cash Items in Process of Collection	518,593,365.39	643,757,723.43
Bank Premises	2,873,167.45	2,981,377.85
Foreign Currencies	29,525,645.83	14,155,138.87
All Other	15,823,765.25	13,272,655.87
Total Assets	$3,550,332,849.73	$3,430,136,885.51

LIABILITIES		
Federal Reserve Notes (net)	$2,249,766,171.00	$2,083,514,114.00
Deposits:		
Member Bank Reserve Accounts	701,894,331.60	653,333,820.74
U. S. Treasurer—Collected Funds	48,210,404.48	54,790,728.09
Foreign	7,050,000.00	10,560,000.00
Other	6,482,090.78	5,281,174.65
Total Deposits	763,636,826.86	723,965,723.48
Deferred Availability Cash Items	474,262,002.02	542,283,828.56
Other Liabilities	9,470,049.85	30,670,419.47
Total Liabilities	$3,497,135,049.73	$3,380,434,085.51

CAPITAL ACCOUNTS		
Capital Paid In	$ 26,598,900.00	$ 24,851,400.00
Surplus	26,598,900.00	24,851,400.00
Total Capital Accounts	$ 53,197,800.00	$ 49,702,800.00
Total Liabilities and Capital Accounts	$3,550,332,849.73	$3,430,136,885.51

Comparative Statement of Earnings and Expenses

	1965	1964
Current Earnings:		
Advances to Member Banks	$ 694,594.39	$ 350,322.28
Foreign Loans on Gold	40,701.19	10,483.64
Invested Foreign Currency Balance	664,162.10	299,440.71
U. S. Government Securities—System Account	78,583,698.39	68,290,446.94
All Other	13,188.46	16,628.18
Total Current Earnings	79,996,344.53	68,967,321.75
Net Expenses	12,135,443.26	12,559,605.73
Current Net Earnings	67,860,901.27	56,407,716.02
Additions to Current Net Earnings:		
Profit on Sales of U. S. Government Securities (net)		32,238.00
All Other	47,943.42	34,508.95
Total Additions	47,943.42	66,746.95
Deductions from Current Net Earnings:		
Loss on Sales of U. S. Government Securities (net)	475.22	
All Other	5,386.07	5,280.68
Total Deductions	5,861.29	5,280.68
Net Addition	42,082.13	61,466.27
Net Earnings before Payments to U. S. Treasury	$67,902,983.40	$56,469,182.29
* * * *		
Dividends Paid	$ 1,546,585.23	$ 1,452,361.02
Payments to U. S. Treasury (Interest on F. R. Notes)	64,608,898.17	77,398,421.27
Transferred to Surplus (from Surplus)	1,747,500.00	(22,381,600.00)
	$67,902,983.40	$56,469,182.29

TRANSACTION	VOLUME IN PIECES OR UNITS (Daily Average)		VOLUME IN DOLLARS (Annual Total)	
	1965	1964	1965	1964
Discounts and Advances			$ 2,699,764,000	$ 1,406,625,000
Daily Average Outstanding			17,233,000	9,847,309
Purchases and Sales of U. S. Securities for Member Banks	12	13	428,834,650	456,045,100
Currency Sorted and Counted	1,315,414	1,269,032	2,418,706,765	2,188,915,606
Coin Counted and Wrapped	3,513,582	2,240,268	65,980,750	45,109,200
Check Collection	1,492,011	1,467,829	108,711,081,383	96,006,897,357
Noncash Collection:				
Notes, Drafts and Coupons (except U. S. Government)	5,075	4,981	756,750,638	404,784,246
Safekeeping of Securities:				
Pieces Received and Delivered	919	746	16,595,552,818	11,106,965,597
Coupons Detached	2,636	2,479	50,356,347	49,426,403
Transfer of Funds	818	706	168,587,789,069	140,617,869,064
Issues, Redemptions and Exchanges:				
U. S. Securities (Direct Obligations)	1,096	1,471	18,594,613,243	18,331,731,665
U. S. Savings Bonds	39,539	39,061	528,412,984	540,906,622
All Other	254	85	136,014,150	72,893,110
U. S. Government Coupons Paid (Direct Obligations)	2,331	2,351	209,525,594	211,095,511
Federal Taxes: Depository Receipts and Direct Remittances	3,482	3,518	2,440,284,769	2,377,404,940
Currency Verified and Destroyed	183,179	205,642	54,282,000	61,224,000
Deposits and Withdrawals—Treasury Tax and Loan Accounts	597	578	9,951,851,166	8,276,148,075

Summary of Principal Changes

Statement of Condition

At the end of 1965, total assets of this Bank stood at $3.5 billion, a record high. The increase this year was $120 million — about 3.5 percent — somewhat more moderate than the rise a year earlier. As usual, sizable fluctuations occurred during the year in both assets and liabilities.

Among the assets, gold certificates rose $33 million, a little more than 4 percent, reflecting a net favorable balance in the System interdistrict settlement fund. Treasury transfers of funds to New England — for debt, defense outlays, and other fiscal operations — more than offset outward movements to other districts on private financial and commercial accounts as well as the effects of this Bank's $185 million increase in the System Account holdings of U. S. government securities.

In addition to the increase in assets attributable to the somewhat larger amount of other Federal Reserve Banks' notes held, there was another doubling in the amount of foreign currencies held. This increase in our foreign currencies account reflects the Bank's share of the additions to the System's investment account which stemmed, in part, from the crisis in Sterling which developed during the summer. Activities under the reciprocal currency agreements — which were established in early 1962 between the System and foreign central banks to provide mutual credit facilities — have not only aided in the two Sterling crises, but have also played a role in offsetting temporary pressures on the key currencies, the dollar and the pound.

Discounts and advances dropped markedly on the last day of the year in spite of taut credit markets. The balance shown on the statement represents only this Bank's participations in the System's foreign loans on gold. System operations designed to aid market adjustments resulting from the increase to 4.5 percent in discount rates which the Reserve Banks posted early in December supplied substantial amounts of reserves which made possible elimination of member bank indebtedness. For the year as a whole, however, average daily borrowing at the discount window was almost double the amount in the year 1964.

The "cash items in process" figure fell about 20 percent despite another increase in both number and dollar volume of checks handled. Float, derived from "cash items" on the asset side and "deferred availability items" on the liability side of the statement, was less than half that of last year. This resulted from the combination of further improvement in high speed processing of checks, the increased number of checks received with amounts encoded, and an extension of early morning "sends" to a larger number of banks. Average daily "holdover" of checks for the year was only 16 thousand, down from 517 thousand and 176 thousand in 1963 and 1964, respectively.

Federal Reserve notes of this Bank in circulation posted another increase of 8 percent. This rise reflected not only the new record level of economic activity of the year, but also an increase of over 8 percent in vault cash at member banks. Further substantial progress was made in substituting Federal Reserve notes of $1 denomination for silver certificates.

Total deposits rose about 5 percent. The increase in member bank reserve accounts — reflecting higher levels of both demand and time deposits, in response to expansion of commercial bank credit — more than offset moderate declines in Treasury and other deposits. Treasury deposits were drawn down in the latter part of 1965 as Treasury spending accelerated — in part in response to outlays for the conflict in Viet Nam.

Paid-in capital rose almost 7 percent — moderately more than the customary amount — reflecting additions to membership and growth in the capital and surplus of member banks. A number of banks added a larger amount of new funds to their capital than in previous years through stock dividends, new issues, and transfers to surplus. Five new national banks were also established.

The Bank's gold reserve ratio (computed against note liability only, as authorized by an amendment to the Federal Reserve Act on March 3) stood at 35.6 percent, about 1 percentage point lower than the ratio for 1964, computed on the same basis. The ratio is in line with the gold ratio of the 12 Federal Reserve Banks combined. The change in the computation of the ratio, by elimination of deposits, was permitted by Congress to avoid breaching the limits set by the old method — with possible attendant stimulation of gold outflows and other disturbances. The nation's gold loss was substantial during the first half of the year, and this factor, along with continued increases in note circulation for this Bank — as well as the System as a whole — contributed to the decline in the ratio.

Earnings and Expenses

Total current earnings of the Bank rose some 16 percent, or $11 million — about the same amount as in 1964. Earnings on U. S. securities accounted for the great bulk of the increase. Average holdings of these securities and average yields were higher than a year earlier — reflecting both the increased volume of the System's open market operations and the gradual and persistent firming of interest rates in response to tightening markets, particularly during the last half of the year. Earnings on both loans and advances and on invested foreign currency balances approximately doubled. Net expenses were decreased about 3.5 percent — some $400 thousand — although the volume of operations of the Bank continued to expand. Technological improvements in certain operations and more efficient use of automated equipment enabled us to operate with a smaller average number of employees.

Net earnings, after all adjustment, totaled $67.9 million — more than $11 million higher than in 1964. A little over $1.5 million was paid to member banks as their statutory 6 percent dividend on Federal Reserve Bank Stock. About $1.7 million was transferred to surplus — lifting the account to $26.6 million — to equal paid-in capital. All of the balance — about $64.6 million — was paid to the Treasury as an interest charge, levied by the Board of Governors, on Federal Reserve notes not secured by gold certificates under Section 16 of the Federal Reserve Act. In 1964, $22.4 million was transferred from surplus to be paid to the Treasury as a result of the decision of the Board of Governors to reduce the surplus level to that of paid-in capital rather than that of subscribed capital.

Foreign Credit Restraint Program

In February of 1965, President Johnson inaugurated a voluntary foreign credit restraint program designed to assist in remedying the critical balance of payments problem. In this program the Federal Reserve System is charged with aiding all commercial banks and nonbank financial institutions as they voluntarily cooperate in limiting the growth of foreign credit. Specifically, the Reserve Banks distribute and interpret restraint guidelines and collect, edit and consolidate periodic reports on foreign asset holdings of financial institutions in their respective districts.

The response to the program by the New England banking community and its nonbank financial institutions has been most gratifying. By November 30, 1965, only one of the 10 monthly reporting commercial banks with foreign assets of more than $500,000 was over its target — 105 percent of its foreign holdings on December 31, 1964 — and then by only 1 percent. For the group as a whole, foreign asset holdings at that date were 8 percent below the holdings of December 31, 1964. Similarly, on September 30, 1965, the last date for which data are available, only one of the eight smaller reporting banks was in excess of its target. The group as a whole reported foreign holdings were down 53 percent from the 1964 year end base.

In the nonbank financial institution group — the larger insurance companies, mutual funds, and pension and college endowment funds — the New England area constitutes a very significant segment of the national total, with 107 reporting institutions making up about one-fifth of all such reporting institutions in the nation. Their foreign asset holdings of $2.6 billion account for more than 20 percent of the national total. On September 30, 1965, the most recent date for which figures are available, the group as a whole reflected a decrease of 32.9 percent in liquid asset holdings, an increase of only 3.8 percent in intermediate-term foreign holdings, and an increase of 7.4 percent in long-term foreign holdings which are subject to no percentage increase restriction.

Volume of Operations

Nearly 384 million checks with a dollar value of $111 billion were processed by the Bank during 1965 — an increase in number of items of 1.2 percent and of 13.3 percent in dollar value, although there were three fewer business days than in 1964. The daily average volume for the year was 1,528,000 checks, including those presented in sealed envelopes. Amount encoded checks received for processing on electronic equipment increased from a daily average of 971,000 in January of 1965 to 1,124,000 in the following December. The total volume of checks handled during the year by high speed equipment was 313 million as compared with 229 million in 1964. The processing of government checks and postal money orders was converted to electronic equipment late in 1965, and the volume aggregates thereof are included in the total volume figures above. The expanding automation of the check collection process resulted in a decrease of department personnel from 480 to 372.

Payments and receipts of currency during 1965 increased 8 percent in dollar volume despite a decline in the number of $1 and $2 units processed, continuing the trend of movement from lower to higher denominations. Withdrawal of United States silver certificates continued, with $1 certificates representing only about 10 percent of the volume of $1 units handled during the year. The coin situation improved markedly during the last six months of 1965, with only half dollars in seriously short supply at year end. Armored car service for delivery and pickup of currency and coin was further extended, with 575 banking offices now receiving this service.

In the Fiscal Agency Department, the number of United States government bearer securities processed in 1965 was slightly below the level of the previous year but the dollar amount was considerably higher. In savings bonds there was a slight decrease in sales, although redemptions continue at about the 1964 level. Attempts by the Treasury Department to lengthen the maturity of the debt in refinancing operations were not successful, most of the new debt being in increased issues of the weekly bill offerings, special issues of Treasury bills, and other short-term issues.

Wire transfer of funds for member banks set a new record in 1965, increasing 16 percent in number and 20 percent in dollar value. During the year the daily average number of transfers was 818; the annual dollar value exceeded $168 billion. Much of the increase reflected more active trading in federal funds.

Continuing strong credit demand in 1965, under a monetary policy of somewhat less ease than in 1964, resulted in increased borrowing at the discount window for the fourth consecutive year. Daily average borrowings, which had expanded from a low of $3.8 million in 1961 to $9.8 million in

1964, rose to $17.2 million in 1965. The notes discounted for member banks in the First District climbed from $1.4 billion in 1964 to $2.7 billion in 1965. The decline in the number of First District banks using the discount window — from 130 in 1964 to 106 in 1965 — can be attributed primarily to use of federal funds by an increasing number of member banks. Apparently for the same reason, the dollar amount of borrowing was concentrated among a relatively small number of larger banks, some of which, in addition to buying and selling federal funds in the national market for their own account, furnished federal funds as a service to their correspondent country banks.

Over the year as a whole, the larger volume of work was carried on with a decrease in the number of employees. The staff averaged 1180 during 1965, of which 1121 were full-time employees and 59 were part-time employees.

Directors

Charles W. Cole of Amherst, Massachusetts, was appointed a Class C Director for a three-year term beginning January 1, 1966. Dr. Cole, a former teacher of economics and history at Amherst College and Columbia University, served as President of Amherst College from 1946 to 1960 and recently retired as United States Ambassador to Chile. He succeeds General James McCormack, Jr., who resigned as a Director to accept the position of Chairman and Executive Officer of Communications Satellite Corporation.

In the annual election of the Directors of the Bank, Lawrence H. Martin, President, The National Shawmut Bank of Boston, Boston, Massachusetts, was elected a Class A Director for a three-year term ending December 31, 1968. Mr. Martin succeeds Ostrom Enders, Chairman of the Hartford National Bank and Trust Company, Hartford, Connecticut, who served as a Director from 1963 through 1965.

John R. Newell, Vice Chairman of the Board, Bath Iron Works Corporation, Bath, Maine, was re-elected as Class B Director for a three-year term ending December 31, 1968.

Erwin D. Canham, Editor in Chief of *The Christian Science Monitor,* Boston, Massachusetts, was redesignated Chairman of the Board of Directors of the Bank and Federal Reserve Agent for 1966.

William Webster, Chairman and Chief Executive Officer, New England Electric System, Boston, Massachusetts, was redesignated Deputy Chairman of the Board of the Bank for 1966.

Member of Advisory Council

John Simmen, President, Industrial National Bank of Rhode Island, Providence, Rhode Island, was selected by the Board of Directors to serve as the member of the Federal Advisory Council to represent the First Federal Reserve District for 1966.

Officers

Donald A. Pelletier, Assistant General Auditor of the Bank, was appointed an officer of the Bank, effective October 1, 1965.

John A. Hayes, formerly a Bank Representative in the Bank Relations Department, was appointed Assistant Cashier, effective January 1, 1966.

DIRECTORS, January 1, 1966

ERWIN D. CANHAM, *Chairman of the Board and Federal Reserve Agent; Editor in Chief,* The Christian Science Monitor, Boston, Massachusetts

Appointed 1959

WILLIAM WEBSTER, *Deputy Chairman of the Board; Chairman of the Board,* New England Electric System, Boston, Massachusetts

Appointed 1961

JAMES R. CARTER, *President,* Nashua Corporation, Nashua, New Hampshire

Elected 1962

LAWRENCE H. MARTIN, *President,* The National Shawmut Bank of Boston, Boston, Massachusetts

Elected 1966

DARIUS M. KELLEY, *President,* The Orange National Bank, Orange, Massachusetts

Elected 1964

CHARLES W. COLE, Amherst, Massachusetts

Appointed 1966

JOHN R. NEWELL, *Vice Chairman,* Bath Iron Works Corporation, Bath, Maine

Elected 1963

WILLIAM R. ROBBINS, *Vice President for Finance,* United Aircraft Corporation, East Hartford, Connecticut

Elected 1960

WILLIAM I. TUCKER, *President,* Vermont National Bank, Brattleboro, Vermont

Elected 1965

MEMBER OF FEDERAL ADVISORY COUNCIL

JOHN SIMMEN, *President,* Industrial National Bank of Rhode Island

OFFICERS, January 1, 1966

George H. Ellis, *President*

Earle O. Latham, *First Vice President*

D. Harry Angney, *Vice President*

Ansgar R. Berge, *Vice President*

Robert W. Eisenmenger, *Vice President and Director of Research*

Luther M. Hoyle, Jr., *Vice President*

Oscar A. Schlaikjer, *Vice President and General Counsel*

Charles E. Turner, *Vice President*

G. Gordon Watts, *Vice President*

Parker B. Willis, *Vice President and Economic Adviser*

Stanley B. Lacks, *General Auditor*

Laurence H. Stone, *Secretary and Associate General Counsel*

Jarvis M. Thayer, Jr., *Cashier*

Paul S. Anderson, *Financial Economist*

Lee J. Aubrey, *Assistant Vice President*

Charles H. Brady, *Assistant Vice President*

Wallace Dickson, *Assistant Vice President*

Harry R. Mitiguy, *Assistant Vice President*

Loring C. Nye, *Assistant Vice President*

Eugene M. Tangney, *Assistant Vice President*

Richard A. Walker, *Assistant Vice President*

Daniel Aquilino, *Assistant Cashier*

John J. Barrett, *Assistant Cashier*

John A. Hayes, *Assistant Cashier*

Ripley M. Keating, *Assistant Cashier*

Donald A. Pelletier, *Assistant General Auditor*

Richard H. Radford, *Assistant Cashier*