FEDERAL RESERVE BANK OF NEW YORK

ANNUAL REPORT 1964

FEDERAL RESERVE BANK OF NEW YORK

March 1, 1965

To the Member Banks in the
Second Federal Reserve District:

I am pleased to present our Annual Report, reviewing economic and financial developments in 1964—the fiftieth year of this Bank's existence.

The United States economy achieved a substantial further advance in 1964, thus extending the expansion through the fourth consecutive year. Prices continued to be generally stable, although at the year end there was concern about the possible development of inflationary pressures. The United States balance-of-payments deficit, while slightly reduced, remained much too large, as a sharp increase in private capital outflows offset most of the increase in the trade surplus. Monetary policy was essentially easy. The discount rate increase in November, following the rise in the British bank rate, was undertaken to head off intensified capital outflows and any possible swing of speculative pressures toward the dollar. The sterling crisis demonstrated both the interdependence of the international financial system and the effectiveness of international cooperation in dealing with speculative attacks. For the monetary and fiscal authorities, and for the nation as a whole, the year 1965 presents the twin challenges of achieving continued expansion with price stability and a major reduction in the balance-of-payments deficit. President Johnson, in his Balance of Payments Message of February 10, has emphasized the urgency of the payments problem and has, at the same time, announced a broad program of corrective measures.

Alfred Hayes

ALFRED HAYES
President

Federal Reserve Bank

of New York

FIFTIETH ANNUAL REPORT

For the Year

Ended

December 31, 1964

Second Federal Reserve District

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Fiftieth Annual Report
Federal Reserve Bank of New York

Progress in 1964 and the Challenge of the Future

During 1964 the United States economy showed solid progress on the domestic front. Rapid growth in economic activity continued without significant loss of momentum throughout the year—thus extending the sustained upswing of the economy to a near record of almost four years. On the other hand, the United States balance-of-payments deficit, though slightly smaller than in 1963, remained much too large, and presented, as in other recent years, a serious problem. Monetary policy, while seeking to protect the international position of the dollar, continued to provide for the growth of money and credit needed by an expanding economy.

The tax cut enacted shortly after the year opened was without precedent for a period when the Federal budget was in deficit, and represented a skillful and imaginative use of fiscal policy. It was undoubtedly a key factor in the strong performance of the domestic economy, adding substantially to after-tax incomes and providing a psychological boost to the economy generally. It was significant that personal consumption outlays rose almost half again as fast as in the preceding year, that corporate profits climbed sharply, and that business investment in plant and equipment registered the largest gain since the mid-1950's.

The tax cut was primarily designed to stimulate the economy so as to bring about a fuller utilization of both human and physical resources. There were also well-recognized, but by no means excessive, risks that the economy might expand too rapidly, thus bringing about a resurgence of inflationary pressures. These risks were worth taking.

In the event, the advance in economic activity was sufficiently large to bring a significant part of the economy's unemployed resources into active use. However, new resources were themselves growing rapidly, and tended to slow the advance toward full utilization. Thus, while manufacturing output rose very substantially over the year, the cumulative effects of investment in plant and equipment led to a rise in capacity that almost kept pace with increasing output. Similarly, although employment rose rapidly, the advance did not match the increase in real output—since productivity growth, in part related to investment in plant and equipment, was also rapid. Also, a part of the increase in employment served to provide jobs for a growing labor force, so that the effect on pre-existing unemployment was somewhat diluted. However, by the end of the year the over-all unemployment rate had declined to 5 per cent, significantly below the 5½ per cent to 5¾ per cent rates that had generally prevailed from early 1962 through early 1964. In effect, during the year, unemployment declined about one half of the way back toward the 4¼ per cent rate characteristic of the boom years of the mid-1950's.

The inflow of new resources and the rapid increase in productivity, in conjunction with reasonable restraint in most wage settlements and competition from abroad, helped to prevent a run-up in prices. Over-all price indexes continued to show the same remarkable stability as in the previous three years. Consumer prices increased by about the same amount in 1964 as in 1963 and 1962. And changes in the industrial wholesale price index remained negligible despite some upward tilt at the year end. But announcements of price increases did become more prevalent as the year progressed, thus raising questions—made the more insistent by the outcome of wage negotiations in the auto industry—as to whether the record of price stability could be maintained in 1965.

The maintenance of reasonable price stability has always been of importance to the domestic economy, both because inflation creates inequitable hardships for those who live on fixed incomes, and also because it can too easily result in a boom accompanied by distortions, the outcome of which is likely to be recession or even depression. To these domestic considerations have been added in recent years the increased exposure of the United States economy to foreign competition and the resulting need to protect and improve the position of United States products in markets both at home and abroad. With a balance-of-payments deficit on regular transactions ranging from $3 billion to almost $4 billion in each of the years from 1958 through 1964, the United States was—and is—in no position to tolerate general price advances that would weaken its international payments position. Thus, in measuring the performance of the economy, price stability must be given heavy weight.

In 1964, the United States balance-of-payments deficit on regular transactions amounted to $3.0 billion, only slightly less than the $3.3 billion deficit of 1963. The decrease was more than accounted for by a rise in the merchandise trade surplus from $5 billion to $6½ billion, which in turn was attributable to a sharp growth in exports of a wide variety of manufactured goods. The strong export performance partly reflected the relative stability of prices in this country over a long period—as compared with rapid increases in many industrial countries abroad. It was also influenced by the high levels of economic activity in most other major countries and by the increased export consciousness of United States business. The effects of the larger export surplus, and of gains on some other accounts, in improving the United States balance of payments were, however, almost offset by increased capital outflows. Under the influence of the interest equalization tax, the outflows associated with the flotation of foreign securities in the New York market did decline. But there was an unusually sharp rise in bank lending to foreigners, as well as in corporate placements of short-term funds abroad, and direct investment in foreign countries increased again.

These evolving domestic and balance-of-payments developments provided the major part of the setting in which decisions with respect to monetary policy were made. And the actual outcome was in turn influenced by monetary policy.

Throughout the year monetary policy continued to be essentially easy—as had been true in the three preceding years. Total bank credit rose by 8 per cent, just as in 1963, and nonbank holdings of liquid assets also increased substantially. The money supply—narrowly defined to include currency outside banks and privately held checking deposits—rose by 4 per cent, matching the increase in the previous year. Thus, the move to a somewhat less easy policy back in mid-1963, signaled at that time by the rise in the discount rate to 3½ per cent, had little discernible effect on the actual rate of increase in bank credit, nonbank liquidity, and the money supply. There was, however, a further shift in the composition of bank portfolios during 1964. With business loan demands somewhat stronger, reflecting primarily the brisker pace of economic activity, banks found it necessary to finance additional loans by reducing their holdings of Treasury securities and by slowing their acquisitions of other securities. Despite this shift to a more heavily loaned-up position, the willingness of banks to make additional loans remained high.

Toward the end of the year, the monetary authorities were confronted with the sterling crisis. On November 23, the British bank rate was jumped from 5 per cent to 7 per cent. Almost immediately, Federal Reserve discount rates were raised from 3½ per cent to 4 per cent, and a simultaneous adjustment was made in ceilings on time deposit interest rates. Essentially, the Federal Reserve actions were precautionary in character and sought to head off any possible swing of speculative pressures toward the dollar. These actions took into account both the sizable United States payments deficit and the fact that the British and American rate increases, in combination, might well have the effect of improving the balance-of-payments position of both countries vis-à-vis the surplus countries of Continental Europe—where interest rates had moved up during the year. Domestically, the United States economy appeared to be strong enough to absorb easily the resulting adjustments in market rates of interest. At the same time the policy of maintaining the ready availability of credit, to sustain further expansion in economic activity, was reaffirmed.

The sterling crisis was a vivid reminder of the interdependent character of the international financial system. It served to emphasize the sizable volume of speculative capital flows that can develop when confidence in a key currency begins to ebb away. The massive availability of credits under the defensive arrangements that have been developed in recent years, and the speed with which they can be mobilized, were also demonstrated. In this respect, short-term credits advanced by central banks provided a flexible means of dampening day-to-day pressures. When the crisis deepened, the major industrial countries quickly mobilized an unprecedentedly large $3 billion to back up Britain's determination to defend the pound sterling. At almost the same time a $1 billion drawing from the International Monetary Fund—the first involving the General Arrangements to Borrow ratified in 1962—enabled the British to pay off outstanding short-term credits from central banks. These actions clearly indicated the strength and unanimity of the view that speculative attacks could not be permitted to topple sterling and disrupt the international financial system. The whole episode reemphasized the important role which international credit facilities now play in supplementing "owned" international currency reserves—a role that will be further expanded if the proposed increase in the International Monetary Fund quotas is adopted. Although the measures undertaken to defend sterling against speculative attack served their immediate purpose, Britain still had the problem of carrying through longer run adjustments that would bring its international payments into equilibrium.

The dollar, to an even greater extent than the pound sterling, is a key currency, used extensively as a vehicle in financing trade and payments and held by many countries as a part of their international currency reserves. Thus, any threat to sterling created a risk that speculative pressures might turn against the dollar, particularly in the context of the cumulative record of substantial United States balance-of-payments deficits over a seven-year period. There was a direct lesson in the British experience for the United States: namely, that continued efforts to reduce the United States balance-of-payments deficit are essential.

In the light of the sterling crisis, it became more clearly recognized that no Governmental policies, including monetary policy, could be formulated without regard to the urgent problem of reducing the United States payments deficit. In this respect, continuing Governmental efforts to economize on military expenditures abroad and foreign aid (to the extent that such economies are consistent with our international obligations), to encourage and strengthen the export drive, and to maintain a vigorous but noninflationary economy at home were all essential. As to monetary policy, the November rise in the Federal Reserve discount rate put the world on notice that monetary policy was not so closely bound by immediate domestic considerations as to be paralyzed in the face of any potential external threat. Since the payments deficit was still large as 1964 ended, and since the ready availability of bank credit to foreign borrowers was an important contributing factor to the deficit, it was apparent that for the period immediately ahead monetary policy might have to pay increased attention to international considerations.

The rapidity with which the Federal Reserve discount rate could be changed in response to the sterling crisis depended importantly upon the strength of the domestic economy, itself influenced by the stimulus provided by the tax cut early in the year. The possibility that, for balance-of-payments reasons, monetary policy might for some period be flexible only in one direction—that is, in the direction of less easy credit—suggests that continued rapid growth of the domestic economy may more than ever depend upon an imaginative use of other Governmental policies.

The further extension of the relatively steady and sustained growth achieved in the past four years will be a major challenge in 1965 and in subsequent years. Only with substantial growth can the economy absorb into employment a labor force that is likely to be increasing more rapidly than earlier. In addition, the country faces the continuing problem of existing unemployment. In many cases, retraining and better education will be vital in cutting into this problem. There is also a generally recognized need, reflected in the Civil Rights Act of 1964, for the end of discriminatory practices that in effect create artificial pockets of unemployment and poverty. However, retraining and educational programs and the end of discriminatory practices can all come to naught if the economy grows too slowly to provide the necessary additional jobs.

The effectiveness of the 1964 tax cut illustrates one way in which fiscal policy can provide a stimulus to economic growth. There are, of course, always risks of overstimulation. These are particularly acute in the case of fiscal policy—since, under present procedures, over-all fiscal changes are generally made only once a year and cannot easily be reversed if unforeseen developments occur. In this respect, the more open-minded climate of opinion on tax policy, and on the Federal budget generally, that seems to have developed in the last year or so may turn out to be one of the most important developments of recent years. Hopefully, this may lead to a reexamination of present legislative procedures with a view to making fiscal policy more flexible.

The further extension of sustained growth, as well as the effort to reduce the balance-of-payments deficit, depends importantly on the continuation of a reasonable degree of price stability. This requires not only the avoidance of excessive stimulation from the demand side, but also the avoidance of those cost-push pressures which arise when various groups of income recipients increase their demands for income to an exorbitant extent. In pinpointing this problem, the wage-price guideposts, first spelled out by the Council of Economic Advisers in its January 1962 *Annual Report,* are playing a valuable part in educating the public to the need to avoid wage increases that are in excess of the over-all national average rise in productivity. They also indicate why developments in the auto industry during 1964 were disturbing. Large profits in the auto industry might have been an occasion for price reductions. Instead they contributed to wage settlements that were out of line with the guideposts. Clearly, it would have been in the public interest if large profits had resulted in price reductions rather than in excessive wage increases that build higher costs into the entire price structure. The spread of such a wage pattern to industries with less favorable profit positions could unhinge prices, and weaken—or eliminate—the contribution that price stability has been making both to domestic growth and to the reduction of our balance-of-payments deficit.

In the coming year the flexible adaptation of domestic and international policy measures to current and prospective developments, many still at best only dimly discernible, will again be necessary. While the goals of national economic policy—maximum sustainable economic growth, a reasonable degree of price stability, and the defense of the dollar—remain the same from year to year, the actual measures adopted must be designed to meet specific situations.

The year 1965 and those beyond present both a challenge and an opportunity. The role of flexible and imaginative public policies in helping to bring about the sustained economic advance of recent years certainly suggests that opportunities for further improvement in economic performance should not be underestimated. Such an improvement must include real progress on the balance-of-payments front. In meeting these problems, monetary policy will have an important contribution to make, as it did during 1964.

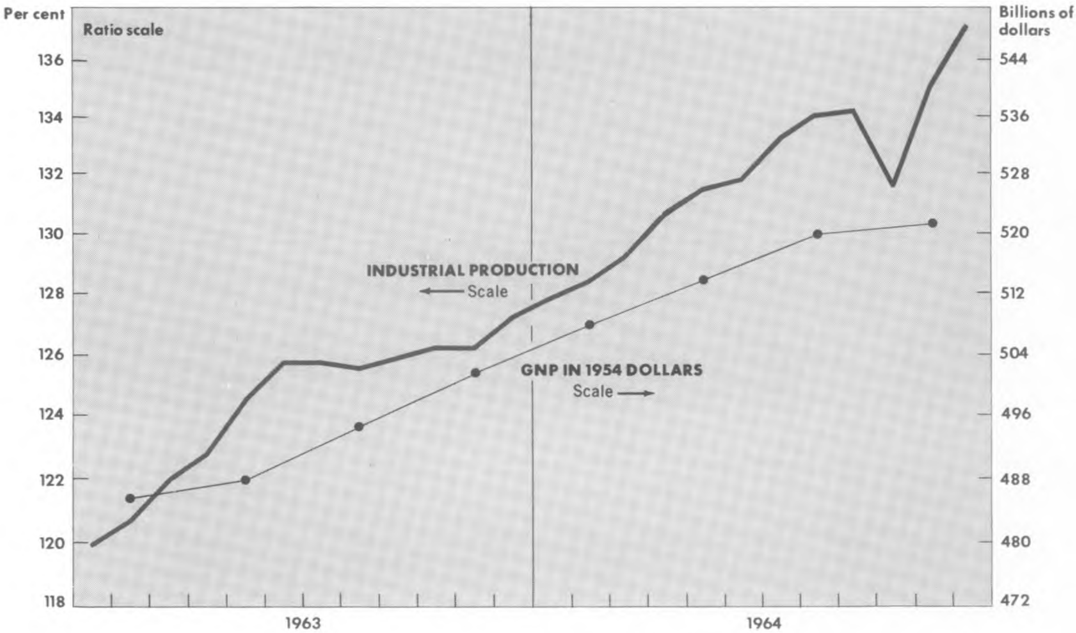
THE UNITED STATES ECONOMY AND FINANCIAL MARKETS IN 1964

Business Conditions: A Year of Achievement

From the very beginning 1964 gave promise of being a banner year for the domestic economy. Strong confidence in the outlook for the economy had become increasingly widespread among consumers, businessmen, and economic analysts as the economy built up increased forward momentum in the latter months of 1963. The prevailing degree of optimism was further reinforced by the continued absence of significant imbalances, favorable prospects for a tax cut, and the continuity of administration provided by President Johnson following President Kennedy's assassination. Uncertainties over the precise timing of, and response to, the tax cut and worries about whether much further push could be forthcoming from spending for automobiles and residential construction after their strong performances in 1963 dampened little of this enthusiasm. Moreover, except for some initial (and probably unwarranted) disappointment on the part of those who expected an immediate surge in consumer spending subsequent to the early March reduction in the Federal withholding rate from 18 per cent to 14 per cent, this over-all tone of confidence continued throughout the year. Indeed, unfavorable news from South Vietnam, the usual unsettlements of a Presidential campaign, and the November crisis in the pound sterling had little impact on business expectations or performance. Increased concern, however, was being voiced toward the year end over the possibility of a renewal of wage and price inflation following the large wage settlement in the automobile industry and selective increases in steel prices.

The degree to which the economy in 1964 actually made good on its promising beginning is reflected in the fact that gross national product (GNP)—the total output of goods and services—amounted to $623 billion during the year, a gain of $39 billion over 1963. While a part of this increase in the market value of total output reflected a rising level of prices, the growth in real output was still substantial (see Chart 1). In the first three quarters of the year GNP valued at 1954 prices grew at an annual rate of 4.7 per cent and, though strikes in the automobile industry greatly affected figures for total output in October

GROSS NATIONAL PRODUCT AND INDUSTRIAL PRODUCTION. Both of these measures of economic activity showed steady and sizable gains in the first three quarters of 1964, but the automobile strikes temporarily depressed output in the fourth quarter of the year. Following these strikes, industrial production rebounded to a record high level.



GNP is expressed at annual rates and industrial production is expressed as percentages of the 1957-59 average. Data are seasonally adjusted.

CHART 1

and November, strength in other sectors enabled the economy to post still another gain in the final quarter of the year. Reflecting the general vigor of the economy, the automobile industry, despite the strikes, finally surpassed the previous record for total car and truck production set back in 1955, and steel ingot production reached a record tonnage 16 per cent above the year before.

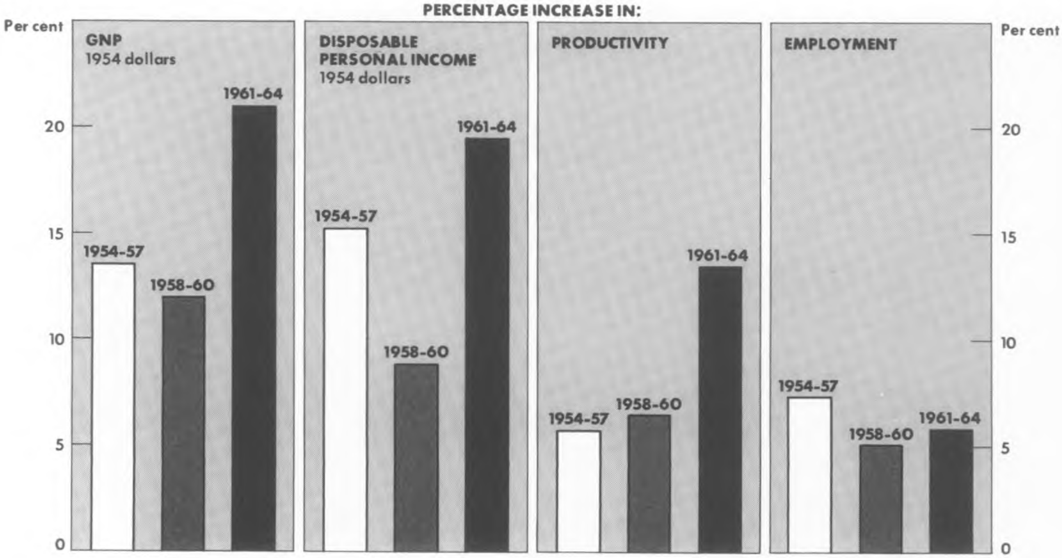
Economic expansion over the first nine months of the year—whether measured by GNP or industrial production—was remarkably steady. GNP, valued at current prices and expressed at annual rates, advanced by $10 billion in each of the first three quarters, and the index of industrial production showed unusually steady growth at an annual rate of 7.3 per cent. The automobile stoppages, which began in the final week of September, had a minor effect on total industrial production that month, but cut sharply into October output and were still being reflected in the November production total. By December, however, the automobile industry was back in full operation, and the production index rose to a record level closely in line with the growth trend of the pre-strike months.

The continued growth of the economy in 1964 carried real GNP to a level fully one-fifth above the cyclical trough in the first quarter of 1961. The upward pace of the current cyclical expansion has matched or bettered that of the two preceding business upswings over the comparable periods of duration. And yet—because the present expansion has remained so orderly, broadly based, and generally free from destabilizing speculative excess—it has gone beyond the length of the two earlier upswings and has resulted in a far larger over-all gain in output (see Chart 2). Incomes have likewise increased more in the current expansion than in the preceding two. Indeed, total disposable personal income (adjusted for price increases) has risen since early 1961 by almost 20 per cent, or more than double the increase during the previous expansion. With a major boost from the tax cut, real per capita disposable personal income rose by almost 5 per cent in 1964, which brought the total increase since early 1961 to 13 per cent and the annual average rate of gain to 3.3 per cent.

Over the long run, of course, rising incomes and standards of living must ultimately spring from increases in output per worker. Substantial gains in productivity have indeed been a major source of the rapid increases in real per capita income in the current expansion. Real GNP per person employed has since early 1961 grown at an average annual rate of 3.5 per cent, significantly above the average yearly growth in the two preceding expansions. Moreover, productivity continued to advance at a relatively rapid pace in 1964, contrary to the pattern of previous postwar expansions when productivity gains slowed markedly after the early years of the recovery.

While rising productivity is essential for domestic growth and for the improvement of our competitive position in world markets, it may of course also retard growth in employment. Part of the nation's continuing unemployment problem over the past several years undoubtedly is related to the unusually fast improvements in productivity coupled with large increases in the labor force. It should be emphasized, however, that even with rapid productivity gains unemployment becomes less of a problem if aggregate demand is increasing rapidly. In

ECONOMIC PROGRESS. Largely because of the exceptional length of the current expansion, most measures of growth have registered greater over-all advances than was the case in the two previous cyclical rises. Rapid gains in productivity during this business advance, however, have tended to moderate the gains in employment despite the substantial growth of gross national product.



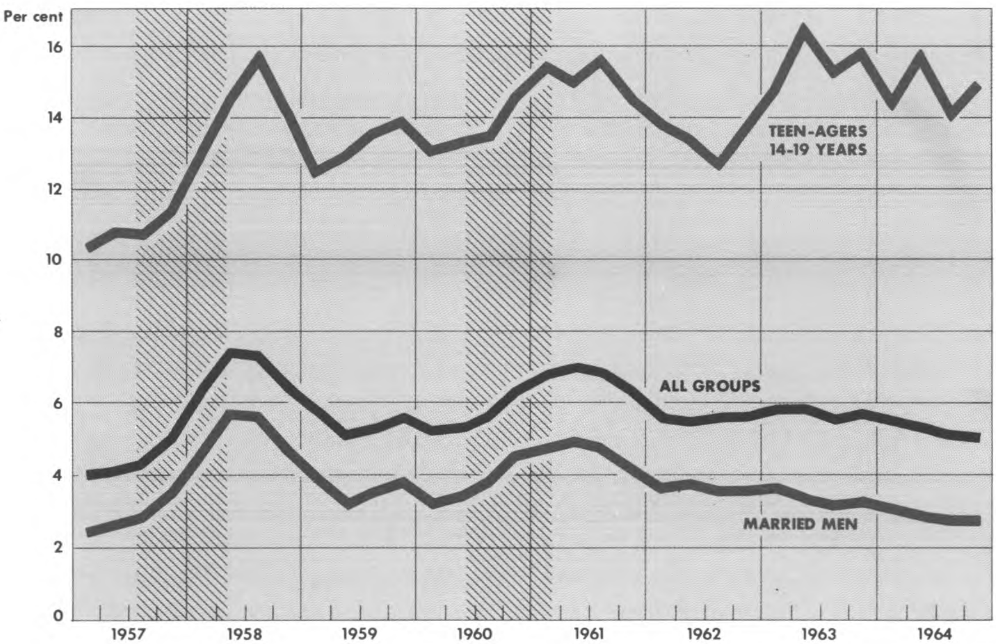
Productivity is measured by dividing GNP in 1954 dollars by total employment. Percentages shown are increases from troughs in general business activity, 1954-III and 1958-II, to the following business-cycle peaks, and from the trough in 1961-I to 1964-IV. All data are seasonally adjusted.

CHART 2

1964, for example, the strong rise in economic activity, stimulated by the tax cut and facilitated by monetary policy, resulted in an increase of almost 1.8 million in the number of Americans gainfully employed. This increase in jobs was sufficient to absorb all the growth in the labor force that occurred during the year, as well as to bring about a significant reduction in the excessively high level of unemployment (see Chart 3). As a result, unemployment in 1964 averaged less than 4 million persons for the first time in four years, and the average unemployment rate in the fourth quarter of the year fell to 5.0 per cent for the first time since 1957. The unemployment rate among married men was reduced to a seven-year low, and the rate among teen-agers remained about constant despite the rapid growth in the number of young people in the labor force. Moreover, with the new job opportunities well distributed across the country, the number of major areas in the Labor Department's category of "substantial unemployment" fell to twenty-nine by the end of 1964 from thirty-eight a year earlier.

But, in spite of these more favorable trends in employment and unemployment, there remains the challenge of creating new jobs for the substantial number of workers who are still out of work or who may be idled by future changes in technology, and for the large and increasing number of young people who enter the work force every day. With rapid changes in industrial technology, a greater

UNEMPLOYMENT. **Total unemployment declined in 1964, but remained high by historical standards. Teen-age unemployment continued to be particularly serious, but joblessness among married men was reduced to a seven-year low.**



All data are quarterly averages of seasonally adjusted monthly figures. Shaded areas denote periods of recession.

CHART 3

effort will be required to encourage both general education and suitable job training and retraining so that employees will be able to fill the jobs that do open up. And yet, progress along these lines will not suffice unless it is accompanied by rapid and balanced growth of job opportunities for all those appropriately trained.

Mainsprings of Progress in 1964

The Federal tax cut, which was designed in important part to stimulate consumer spending, appears to have been largely successful in achieving that objective. Consumers provided the major forward thrust to economic activity in 1964: the increase in their expenditures accounted for almost three fourths of the rise in GNP.

As expected in many quarters, there was some delay before consumers adjusted their spending habits to the higher level of take-home pay that began in early March. Consumption spending rose markedly in the first quarter of the year, probably in anticipation of the tax reduction. But spending lagged the rise of disposable income as the cut became fully effective in the second quarter, and consumer savings rose sharply. The moderate slowing at that time in the growth of outstanding instalment credit indicated that consumers initially used some of the tax cut both to reduce their debts and to buy more items for cash. Also, substantial additions to liquid assets were apparently made, as is suggested by the growth of savings deposits in the face of a very large ($1.2 billion) public common stock issue by the American Telephone and Telegraph Company. But by the third quarter of the year consumers had brought their spending into a more normal alignment with income. The savings-income ratio returned to a level close to that prevailing in 1963, and consumers began once again to make fairly extensive use of instalment credit. Personal saving did rise again to an unusually high rate in the fourth quarter of the year, but apparently this reflected largely the strike-caused shortage of new automobiles. Indications thus are that consumers adjusted their spending to the cut in personal taxes rather quickly, which was gratifying, but the very fact that the adjustment may well have been in good part completed by the end of 1964 raised some doubts that the tax cut would, by itself, have much further effect in stimulating consumption spending.

Spending on new plant and equipment facilities also provided a strong stimulus to economic activity in 1964. Businesses in virtually all major industry groups modernized existing facilities and added new capacity in response to generally rising sales and profits. Though surveys of business plans taken in late 1963 had pointed to only a moderate increase in capital spending, the steadily improving business outlook induced upward revisions in these plans, and by the final quarter of 1964 plant and equipment spending was running at a rate 13 per cent higher than in the closing quarter of 1963. Capital expenditures in the automobile, steel, and capital goods producing industries were particularly large, reflecting strong—and in some cases record—demand and profits in these sectors.

Expansion and modernization of industrial capacity took place in 1964 on a substantial scale, despite the fact that utilization of existing capacity was pressing on practical limits in only a few areas. Some key industries did appear to be operating near the normal limits of their capacity in the latter part of the year—notably, aluminum, textiles, automobiles, heavy equipment, and some segments of the steel industry. Yet, a McGraw-Hill survey indicated that manufacturers in September were on average still operating at only 86 per cent of capacity, and other similar measures suggested much the same conclusion. This was 6 percentage points below what manufacturers have termed their preferred rate, and only slightly higher than the rate of capacity utilization a year earlier when sales were running much lower. Although there were some indications that capacity utilization increased somewhat toward the year end, the additions to manufacturing facilities in the past year were sufficient to maintain a substantial margin of unutilized capacity in many industries and to prevent bottlenecks from developing in others.

The continued existence of some excess capacity in manufacturing may well have played an important role in minimizing destabilizing factors in the fourth year of the economic advance. Ample capacity helped to maintain short delivery times on new orders and to foster keenly competitive pricing. Thus, speculative inventory buying was again largely absent, and additions to business inventories were moderate and smaller than in 1963—despite stockpiling of steel late in 1964 as a precaution against a possible industry strike in the spring of 1965. Net inventory accumulation in manufacturing amounted to only $2.6 billion, with the result that the ratio of inventories to sales for manufacturers as a group declined further to near-record lows.

The substantial rise in profits and in depreciation allowances permitted corporations and other businesses to finance their increased capital expenditures with relatively modest recourse to outside financing. Bond financing, in particular, was unusually moderate given the substantial rise in fixed investment. Gross new bond issues (placed both publicly and privately) by nonfinancial corporations—the group responsible for most capital spending—actually fell 8 per cent short of 1963. Furthermore, although the total volume of funds raised through new stock issues advanced markedly from the low volume of the previous year, the rise was due almost entirely to the large issue marketed in the spring by the American Telephone and Telegraph Company and can, therefore, hardly be considered as reflecting a widespread rise in the demand for outside equity capital.

As against these relatively unchanged demands in the corporate securities markets, bank borrowing by business increased substantially. Total commercial and industrial loans advanced by almost 11 per cent. This was still a moderate rate of increase by comparison with some earlier periods of rapid business expansion, such as 1955 and 1956; yet it represented a significant change from the three prior years of the current expansion when the increases had been on the order of 4 per cent to 9 per cent. Part of the rise this year reflected greater bank lending to foreign businesses, but domestic loan demand also strengthened. Term borrowing continued at a high level, which suggested that businesses were using much of these funds to finance longer term working capital needs and to provide transitional financing of increased capital expenditures. Their decision to use bank credit to satisfy much of these needs, rather than to tap the long-term capital markets, may have reflected anticipations that internally generated funds would continue to grow rapidly and help provide for repayment of these bank loans.

The increases in consumer and business spending were far more than sufficient to offset some decline that developed in residential construction activity during 1964. Signs of weakness in this sector of the construction industry had become visible early in the year when housing starts dropped, and by the spring months outlays for residential construction began to recede. The downturn in residential building activity continued throughout the remainder of the year, and in the fourth quarter outlays were 7 per cent below the peak first-quarter level. However, construction industry analysts remained optimistic, as the continued advance in other construction helped to ameliorate the effects of the decline in residential building. Moreover, some of the leading indicators of housing construction showed signs of stabilizing toward the year end. Many observers voiced confidence that housing demand would soon catch up with the moderate amount of overbuilding—especially in apartment houses—that had occasioned the weakening in housing starts. This view found additional support from trends in the mortgage market where terms and credit availability remained favorable to both builders and ultimate buyers of residential property. Indeed, the heavy deposit flows this past year into savings institutions and commercial banks again resulted in aggressive competition among these lenders for mortgage investments, and while interest rates and other mortgage terms remained unchanged on average, some scattered rate reductions occurred late in the year, especially in the Northeast. The construction industry also found cause for optimism in the impending sharp jump over the coming years in the marriageable age group, resulting from the high postwar birth rate.

The Federal Government's most significant contribution to the economic advance of 1964 was undoubtedly the tax cut. This cut, undertaken in the face of an existing deficit, represented a new departure in fiscal policy, and was judged more likely to achieve an eventual budget balance at a satisfactory employment level and growth rate than any of a number of possible alternatives. Economic developments, as they unfolded during the year, suggested that this judgment was likely to prove correct and that further tax cuts—such as the reduction now proposed for excise levies—might well provide the marginal stimulus, should it be needed, to carry the economy through a fifth consecutive year of expansion. Meanwhile, Federal Government expenditures on goods and services were again kept under close control. Their $0.4 billion advance exerted little economic push in 1964, and some cutbacks in defense spending fell with considerable impact on a few industries and regions. The aerospace industry on the West Coast was particularly hard hit.

The long-term rise in the spending of state and local governments continued during the year just ended. Their purchases rose by $4.7 billion, or 7.8 per cent, during the year. The faster growth of state and local spending than that of the Federal Government has been a striking feature of the public sector in recent years. The demand for schools, hospitals, water supplies, and many other facilities traditionally supplied by these local governments has grown with the population boom. Meanwhile, the tax revenues of these governmental entities have continued to fall short of spending. The appropriate method of financing public activities at the non-Federal level in the face of this shift in the type of governmental services demanded has become one of the nation's pressing problems.

PRICE STABILITY: GROWING CONCERN LATE IN THE YEAR. In terms of over-the-year changes in the broader price indexes, the price record in 1964 was one of a general continuation of the reasonable stability that had characterized the preceding six years. Prices paid by consumers at retail actually rose slightly less than in the previous year, while advances in industrial wholesale prices did little more than to extend the slight uptrend that commenced in early 1963 (see Chart 4). A sharp upward movement did occur, however, in the prices of some industrial raw materials. This trend reflected both the worldwide increase in the raw materials consumption of industrial countries and some supply difficulties—including political disturbances—in primary-producing countries, especially those that produce nonferrous metals

PRICES. Both consumer and industrial wholesale prices remained reasonably stable during 1964. Toward the year end, however, specific price changes throughout the economy tended to be more frequently on the upside.

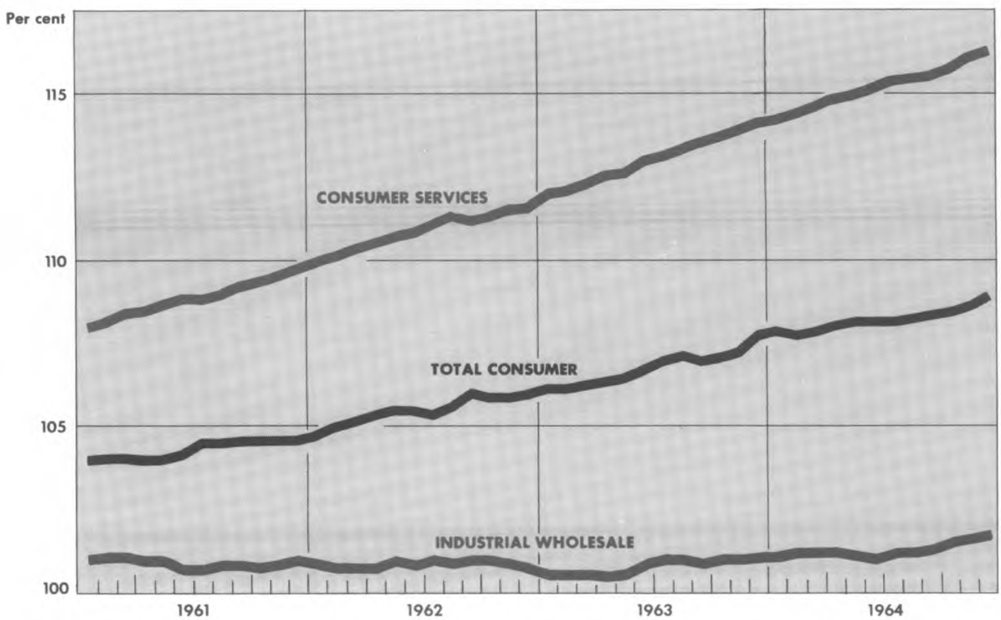


CHART 4

1957-59=100 for each index.

such as copper, lead, and tin. But supply conditions in these markets were showing some improvement toward the year end, and prices were tending to recede somewhat.

A major factor contributing to the general stability of finished goods prices this year was the large further gains in productivity mentioned earlier. In manufacturing, for instance, output per man-hour increased by more than 4 per cent during 1964, exceeding the gain in money wages and fringe benefits paid to manufacturing employees. Consequently, labor costs per unit of output declined over the year as massive injections of new and highly efficient capital equipment helped to advance worker productivity.

Despite the still generally favorable trends in the indexes of prices and wages in 1964 as a whole, developments in the final months of the year brought concern about whether stability could be maintained in the future. To be sure, occasional price declines and cancellation of announced increases continued to underscore the presence of strong competition in many markets—e.g., prices of electronic computers and color television sets fell, and higher quotes on aluminum siding were rescinded. But the business news seemed to be increasingly filled with reports of actual price increases and rumors of more in the offing. The steel industry continued to raise prices on a selective basis and, in December, advanced the quotation on galvanized sheet by 2 to 3 per cent. Prices of aluminum ingots and some fabricated products were upped in November, and as the new year began sulfuric acid—the most widely used industrial chemical—increased in cost.

The developing concern over future price stability was given additional impetus by the large wage settlement in the automobile industry. This settlement, reflecting the union's desire to capture what it considered to be a fair portion of the industry's high profits, substantially exceeded the Administration's wage guideposts and raised fears that rising labor costs would also contribute to inflationary tendencies. Though the automobile companies absorbed the higher labor costs without raising their prices, it was generally recognized that a spreading of this wage pattern to other, less profitable, industries would put considerable upward pressure on prices. And by the year's end, many observers felt that the chances of such a spreading, at least to the steel industry, had been enhanced as a result of the selective steel price increases announced in the final weeks of the year.

But, despite the several unfavorable developments during the year, it was far from clear that the economy had broken out of the pattern of reasonable price stability. The continued large increases in productivity, a persisting high rate of unemployment, considerable excess capacity in industry, and import competition all remained strong forces tending to restrain inflationary price and wage decisions. Nonetheless, it seemed apparent at the year end that upward price pressures had become stronger than heretofore and that developments on this front would require careful watching in the months ahead. It is thus to be hoped that pleas for continued restraint in wage and price decisions on the part of unions and managements will not go unheeded, so that the balance that has characterized the growth of economic activity over the past several years will not come to an end. More rapid increases in wages and prices could endanger the chances for further extension of the current business upswing and hinder efforts to reduce the nation's balance-of-payments deficit.

Monetary Policy in 1964: Continued Support of Growth

Monetary policy in 1964 continued to encourage domestic economic growth. The policy framework, to be sure, did undergo a change of emphasis late in the summer as the Federal Reserve began to supply reserves somewhat more reluctantly, and again in late November as defensive measures were taken immediately following the rise in the British bank rate. Both these moves, however, were motivated predominantly by the need to preserve the international position of the dollar, and credit to domestic borrowers remained readily available. Thus, the Federal Reserve System in 1964, as in the previous years of the current business expansion, facilitated a high rate of growth in bank credit and the money supply, and the banking system continued to play a key role in promoting the smooth flow of record amounts of funds through the financial markets.

The basic posture of policy for much of 1964 was actually established in July of 1963 when the Federal Reserve Banks increased the discount rate from 3 per cent to 3½ per cent and when 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 (including negotiable certificates of deposit) with maturities from ninety days to one year. From that time on, also, new reserves were supplied to the banking system a little more reluctantly than before, with the result that net free reserves averaged in the neighborhood of $100 million as excess reserves declined and member banks found it necessary to resort to more frequent borrowing from the Federal Reserve Banks. The money and credit markets quickly adjusted to the mid-1963 shift in monetary policy.

As the year 1964 opened, the Treasury conducted an advance refunding in an atmosphere of general confidence in the tenability of existing rate levels. Around mid-February, however, market participants became more cautious, feeling that the passage of the Federal income tax cut and a possible rise in the British bank rate (which materialized on February 27) might lead to a shift in monetary policy away from ease. Expectations of tighter credit conditions began to weaken following the tax cut, however, as it became apparent that earlier fears of a possible "overheating" of the economy had not been justified. The continued orderly advance of the economy, it was soon realized, was unlikely to result in either sharply increased credit demands or further major credit policy moves. Interest rates on intermediate and longer maturities receded through April and May, and market conditions remained generally unchanged thereafter until the late summer when the Federal Reserve shifted its policy stance slightly with a view to stiffening domestic short-term rates. The System allowed average free reserves to decline slightly and a firmer tone to develop in the money market. The ample flow of savings into the long-term markets prevented any spillover of this modest move into the capital market, where funds continued to be readily available to borrowers.

In November, the System found itself confronted with the need to take further action as the sterling crisis forced the Bank of England to raise its discount rate from 5 per cent to 7 per cent. Faced with the distinct possibility that higher interest rates abroad might further intensify the already large capital outflows from the United States, and with the additional possibility that speculative pressures against the pound might shift to the dollar, the System acted to increase domestic money market rates. On November 23, the day of the rise in the British bank rate, this Federal Reserve Bank and four others announced increases in their discount rates from 3½ per cent to 4 per cent, and the seven remaining Federal Reserve Banks completed similar action by November 30. The Board of Governors also took steps, through revisions in Regulation Q, to permit greater commercial bank competition in the international and domestic markets for time and savings deposits. On time deposits of thirty- to ninety-day maturity, the maximum interest rate payable by member banks was increased from 1 per cent to 4 per cent—a very sharp change which reflected the special need to permit banks to compete internationally in this important segment of the money market. Other deposit rate changes permitted through the revision in Regulation Q included an increase from 4 per cent to 4½ per cent in the maximum rate payable on time deposits (including certificates of deposit) of longer than ninety-day maturity, and an increase from 3½ per cent to 4 per cent in the maximum rate payable on savings deposits left with banks for less than one year.

Because of strong credit demand and the firm money market atmosphere thus created, the System in 1964 had somewhat less need than in the years just preceding to be concerned about the immediate impact of its day-to-day operations on short-term interest rates. Only during a few intervals were System actions and Treasury debt management operations specifically directed at shoring up short-term rates for balance-of-payments reasons. A portion of the year's reserve needs, as in the preceding years, was supplied through net purchases of Treasury coupon securities, including a few occasions when it was desired to minimize the impact of reserve injections on Treasury bill rates. Late in the year, after the rise in the discount rate to 4 per cent, the System made repurchase agreements with Government securities dealers at rates below the discount rate for the first time since March 1962. This action served to help counter seasonal pressures on rates.

The continued large flow of savings into commercial banks and the ready availability of reserves was reflected in a further substantial expansion of bank credit. Total commercial bank credit—including both loans and investments—expanded by an estimated $20.2 billion in 1964. This increase amounted to 8 per cent, equaling the average gains that occurred in the first three years of this business expansion.

As a counterpart to the past year's rapid bank credit expansion, commercial bank demand and time deposits rose sharply, and the money supply[1] increased sizably (see Chart 5). The rise in the money supply of 4 per cent matched the 1963 increase. On the other hand, bank time deposit growth, while amounting to nearly 13 per cent, was less than that of the three previous years. The slowing-down in what nevertheless remained a high rate of growth of time deposits may

[1] *The money supply is defined to include demand deposits at commercial banks other than those of the United States Treasury (and certain other net adjustments) plus currency held by the nonbank public.*

THE MONEY SUPPLY AND COMMERCIAL BANK TIME DEPOSITS. Each of these financial series continued to grow in 1964. While time deposit growth slowed, compared with the very rapid advance of the two previous years, the money supply expanded at about the same rate as in 1963.

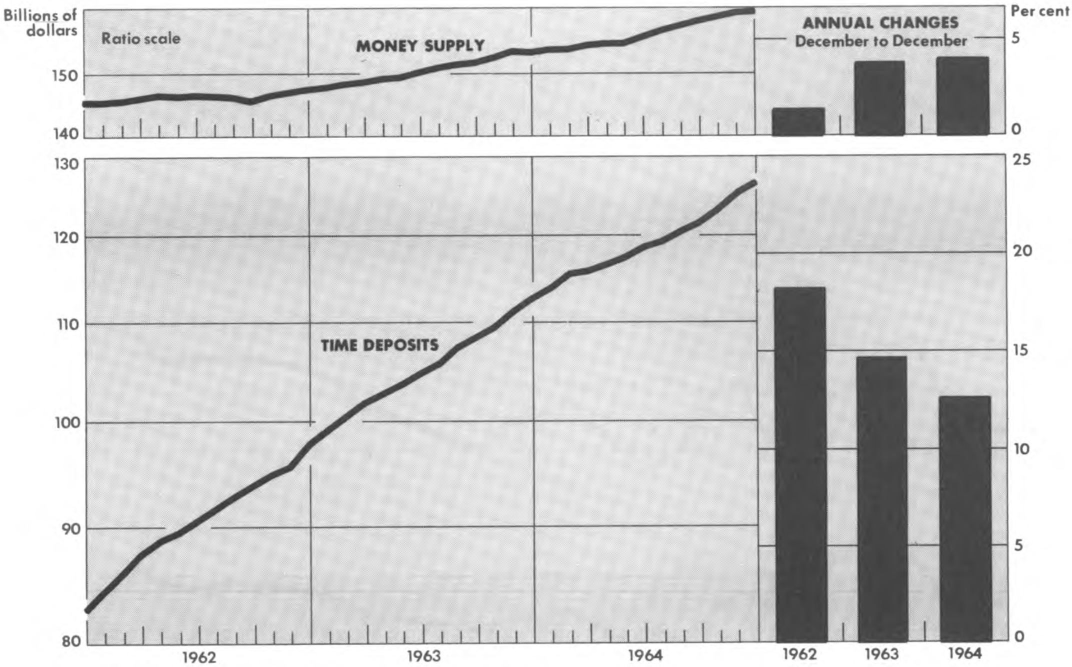


CHART 5

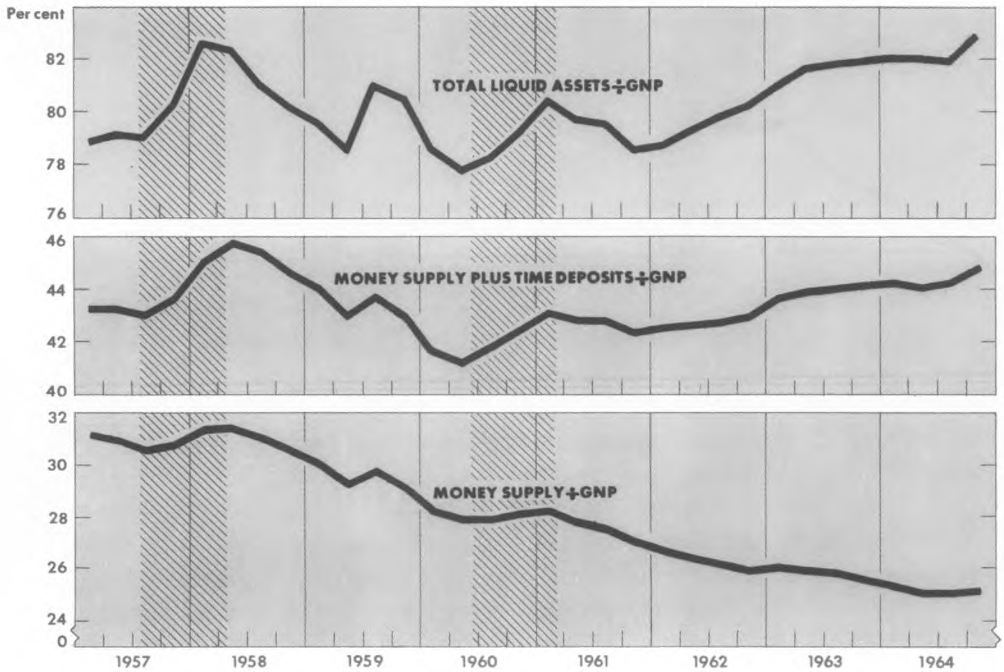
All data are seasonally adjusted.

have reflected in part a temporary deterioration in the competitiveness of commercial banks in the wake of rate increases at other savings institutions early in the year. Time deposit growth accelerated in the last quarter of the year.

The broader trends in the components of bank loans and investments in 1964 included a net decrease in the holdings of United States Government securities, a decline in purchases of "other securities" (mostly obligations of state and local governments), and an acceleration of the growth of many categories of loans, including business loans. The growth of business loans, at an estimated 11 per cent, was somewhat more rapid than in any previous year of the current expansion, although it fell far short of the years 1955-56 when the rise averaged 20 per cent.

The net effect of these bank portfolio changes was to reduce somewhat the

THE LIQUIDITY POSITION OF THE PUBLIC. **Measured relative to aggregate economic activity, the public's liquidity position remained generally unchanged over the year save for an increase in the fourth quarter when the automobile strikes limited the advance of gross national product. With the exception of the ratio of the money supply to GNP, which has been trending downward for a long time, these liquidity measures remained not only above the levels at the 1961 recession trough, but also well above the levels at the peak of economic activity in the preceding business cycle.**



The money supply--demand deposits and currency in the hands of the nonbank public--and the money supply plus time deposits at commercial banks are quarterly averages of daily figures. Total liquid assets held outside the banking system, which include the 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. Shaded areas denote periods of recession.

CHART 6

liquidity of commercial bank assets. With loans increasing more rapidly than investments, the average loan-deposit ratio for all commercial banks climbed to 59.5 per cent at the end of 1964 from 57.3 per cent a year earlier. The need for bank liquidity, however, may also have undergone some decline as time and savings deposits, which are less volatile than demand deposits, again accounted for a high proportion of the total deposit increase. Time and savings deposits amounted to 42.4 per cent of bank deposit liabilities at the end of 1964, significantly above the end-of-1963 level of 40.6 per cent.

The growth of deposits and other financial claims associated with the ample flow of credit to corporations and individuals through the banking system and financial intermediaries provided large additions to the liquidity of the nonfinancial sector. Nevertheless, because of the continued strong business advance, there was little further increase in the public's broadly measured liquidity position in relation to economic activity. The liquidity of the nonbank public can, of course, be measured in various ways, and no single measure is the right one for all purposes. But, after allowing for the fourth-quarter disturbance caused by the automobile strikes, it appears that all the principal liquidity ratios stabilized over the year (see Chart 6). Thus, the ratio of the money supply to GNP continued to decline slightly over the first half of 1964 but remained roughly unchanged thereafter as the money supply grew more rapidly. Among the broader measures of the nonbank public's liquidity, the ratio of the money supply plus bank time deposits to GNP edged up only very slightly during 1964 and that of total liquid assets to GNP remained virtually unchanged until the fourth quarter. (Total liquid assets are defined to include, along with the money supply and commercial bank time deposits, holdings of mutual savings bank deposits, savings and loan shares, savings bonds, and marketable United States Government securities maturing within one year.) This leveling-off in the principal liquidity ratios reflected a significant change from earlier years of this expansion when broadly measured liquidity grew rapidly, but the 1964 trends contrasted even more sharply with later years of earlier expansions when the broader liquidity ratios declined.

Monetary Policy in the Early Sixties—A Longer Look

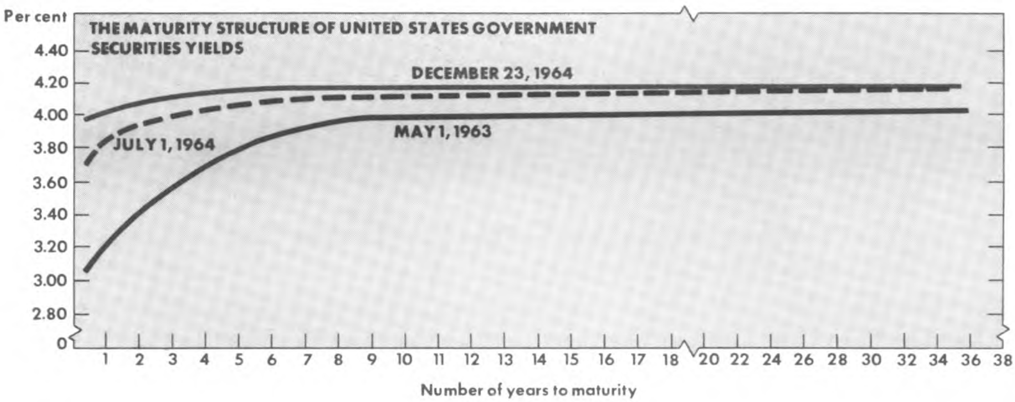
Monetary policy problems and actions in 1964 were basically similar to those of other recent years. What has been required of policy throughout has been an effective contribution to the financing of the economic expansion together with the achievement of a more competitive structure of money market rates internationally. Essentially, this has involved the gradual elevation since late 1960 of short-term interest rates—as similar rates in foreign financial centers rose—while encouraging the flow of funds into the domestic long-term markets. It may therefore be worthwhile to take a longer look at policy since the beginning of the expansion and to attempt a tentative if only partial evaluation of its effectiveness.

The efforts to shore up short-term rates have included some System purchases of Treasury coupon issues. But these purchases since the first half of 1961 have probably made only a relatively modest, although useful, contribution to the achievement of System objectives. Treasury debt management policies have also been helpful.

Among other System moves, the raising of the Federal Reserve discount rates in July 1963 and in November 1964 has been of fundamental importance in achieving the desired objectives, as has been the gradual and slight turn from supplying reserves very freely. Meanwhile, increases in the maximum interest rates payable on commercial bank time deposits have allowed the commercial banking system to pay interest on time deposits at rates in line with other, including international, short-term rates. Such deposits, including negotiable certificates of deposit, have in effect become another money market instrument, competing for—and absorbing large amounts of—short-term funds. This development, in turn, has been a key factor in sustaining short-term rates.

At the same time, the unprecedentedly large inflow of time and savings deposits at higher rates that has accompanied the raising of the ceilings on time deposit rates has led commercial banks to seek out more remunerative loans and investments to protect their profit margins. The sharp rise in bank lending to foreigners has been one of the less favorable consequences of this search for profitable outlets for funds. On the other hand, the banks have also purchased large amounts of mortgages and of state and municipal securities. This has helped channel record amounts of domestic savings into areas where the ready availability of funds at favorable rates can make a substantial contribution to spending on goods and services.

TRENDS IN THE MATURITY STRUCTURE AND LEVELS OF INTEREST RATES. Since the first half of 1963, interest rates have increased considerably in the money market, but little or not at all in the longer term area. Rates on long-term United States Government and corporate securities have moved up slightly, but rates on mortgages have held virtually constant. Moreover, yields on state and local government obligations have remained steady since mid-1963 and, like yields on mortgages, remain below their levels at the beginning of the current expansion.



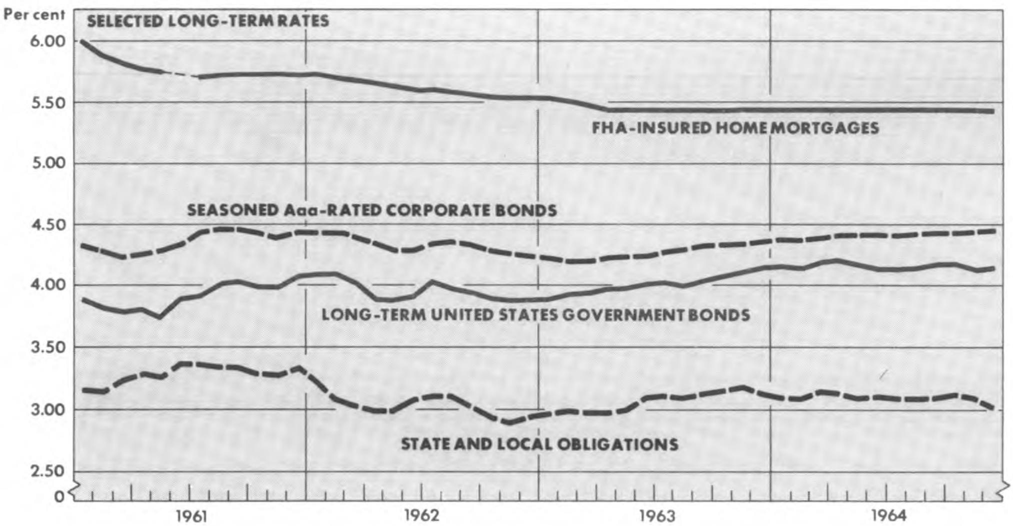


CHART 7

The yield-versus-maturity curves were developed at this Bank by drawing smooth lines through the scatter of actual market yields on United States Government obligations on the dates shown. The time series panel shows monthly average market rates for all series.

The effects of monetary and debt management policies aimed at lifting short-term interest rates without correspondingly increasing long-term rates are reflected in the behavior of the term structure of interest rates on United States Government obligations following the policy changes in July 1963 and again in the late summer and November of 1964 (see Chart 7). The effect of the July 1963 policy actions may be measured by the change in the interest rate relationships from early May 1963 to July 1964. During this period, ninety-day bill rates increased by roughly 58 basis points while rates on long-term United States Government securities moved up by only about 15 basis points. The policy actions of the last half of 1964 were associated with a further 38 basis-point rise in short-term rates from July 1, 1964 to the end of December, but with virtually no change in long-term rates.

The narrowing of the spread between short-term and long-term interest rates on United States Government securities, moreover, may understate the flattening of the yield curve for interest rates in general, as a substantial increase in the supply of long-term Treasury bonds, brought about by advance refunding operations, has tended to push their yields up. Thus, Government bond yields have not been representative of most other long-term rates, which have either held stable or increased considerably less. Indeed, rates on high-grade corporate bonds remained virtually unchanged between early 1961 and late 1964 (see Chart 7). Moreover, rates on state and municipal securities actually moved down slightly, as did mortgage rates, reflecting in part greater bank participation in these markets. In contrast, sharp rises in long-term rates took place during the business expansions of the 1950's.

In summary, financial developments during the current expansion suggest that Federal Reserve policy has successfully promoted greater firmness in the money markets without interfering with favorable borrowing conditions in the longer term credit markets, which have basically been generated by a growing volume of savings. It has thus been possible for monetary policy to contribute, to some extent, toward the solution of the balance-of-payments problem while actively continuing to foster economic growth. Clearly, however, there are limits to this process, given both the relationship between short-term and long-term rates that has developed and the fact that ready credit availability has contributed to sizable capital outflows.

THE INTERNATIONAL ECONOMY IN 1964

The year 1964 was one of progress for the world economy, mixed with ample reminders of the numerous challenges at hand. The stability of the international monetary system was put to severe tests, and these tests were met. The United States balance-of-payments deficit remained too large. Moreover, advance toward self-sustaining growth in the less developed countries was still difficult to achieve despite more progress in some cases than in other recent years.

Drastic external adjustments were required in some countries. The United Kingdom took stern action late in the year to deal with a serious crisis. With the help of massive credits made available by central banks, the United States Government, and international agencies, the attack on sterling was halted and Britain was thus given time to solve its underlying payments problems. Similarly, international cooperation helped stop a speculative attack on the Italian lira early in the year. Both cases demonstrated the determination and ability of major countries to defend the international monetary system.

Existing financial arrangements among nations were further developed during the year. In particular, the International Monetary Fund (IMF) was put to unprecedented use by major industrial countries. In the meantime, the whole international monetary mechanism was undergoing searching scrutiny to assess its present status and to weigh its future needs.

Economic activity in the developed nations advanced further, with many countries reaching record levels of production, income, employment, and trade. In a number of cases the pace of growth proved again incompatible with price stability, and restraining measures were required. Many underdeveloped countries also were able to show modest economic progress; in several cases, this improvement stemmed from effective adjustments of policy to the requirements of growth with stability. Some recent economic developments in the Communist part of the world—such as increased East-West trade and greater attention to consumers' needs within the Soviet bloc—may turn out to be of long-lasting importance, although they are not specifically covered in this *Report.*

The United States Payments Balance— The Problem Remains

The 1964 United States balance-of-payments deficit continued to be large at $3.0 billion, as against $3.3 billion in 1963, and it was clear that major efforts would still be needed to bring about the required external balance.[2] The substantial improvement which began in mid-1963 continued only into early 1964; thereafter the deficit widened again, especially in the fourth quarter (see Chart 8), as enlarged capital outflows reduced the effect on the over-all deficit of the progress achieved in several other important balance-of-payments sectors.

An improvement of about $2 billion in the current account was one of the bright spots of the past year. A part of this better performance can be traced to such items as rising earnings on earlier direct investments abroad; repatriations of these earnings apparently passed the $3.5 billion mark in 1964. The main factor, however, was a larger merchandise trade surplus which rose by $1.5 billion to $6.5 billion. (As in 1963, about $2.8 billion of our exports represented shipments under Government aid programs.) The increase in commercial exports was substantial and outpaced the rise in imports, although imports grew at a more rapid rate than GNP in 1964.

The broadly based expansion of exports has indeed been one of the encouraging developments of the 1960's. Capital goods exports have shown an impressive rise, particularly to the major European countries and to our two largest customers—Canada and Japan. Exports of industrial materials and manufactured consumer goods have also advanced, although not so sharply. Agricultural ex-

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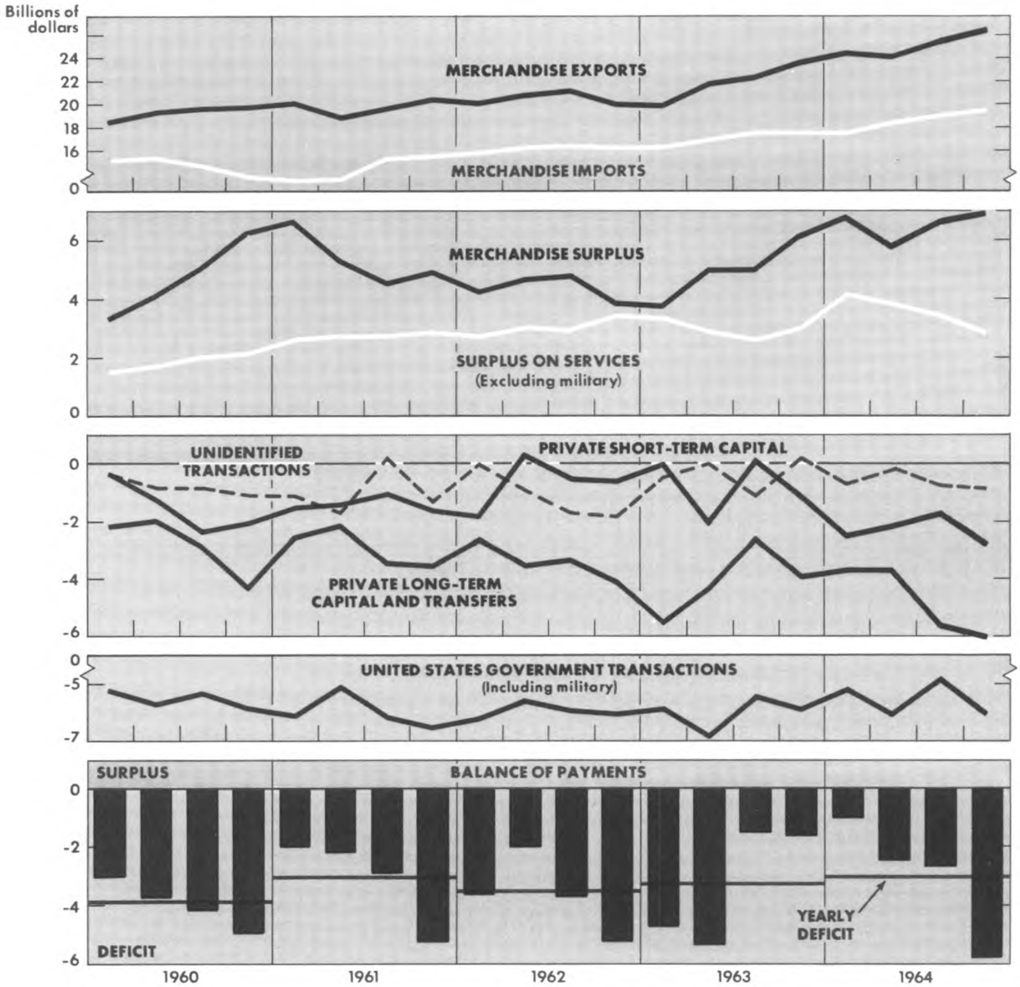
2 *In the official accounts presented by the Department of Commerce, three distinct over-all balances are presented. The deficit on regular transactions (as noted above at $3.0 billion in 1964 and $3.3 billion in 1963) includes "above the line" all foreign transactions of United States residents plus all transactions arising from the regular foreign activities of the United States Government, notably foreign aid and military expenditures. This definition provides the broadest measure of the over-all balance-of-payments problem and is the one used in the discussion in this Report. In recent years, the United States Government has negotiated with other industrial nations a series of special transactions, such as debt and military prepayments and sales of nonmarketable Treasury debt obligations, which effectively help finance the deficit on regular transactions. Two alternative measures of the deficit—which include some or all of these Government transactions "above the line" as inflows of foreign capital—are also presented in the official 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 institutions that the holder can convert into cash at relatively short notice. Since special transactions were smaller in 1964 than in 1963, the deficit on regular and all special transactions was $2.4 billion in 1964 as against $1.9 billion the year before. The deficit on regular and all special transactions except convertible, nonmarketable Treasury bonds was $2.8 billion in 1964 and $2.6 billion in 1963.*

MAJOR COMPONENTS OF THE UNITED STATES BALANCE OF PAYMENTS. **The United States balance on regular transactions showed a slight improvement in 1964 over the previous year. This reflected a larger trade surplus — as exports increased sharply — and a reduction in Government expenditures abroad. These improvements, however, were almost entirely offset by increased private capital outflows.**



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. Quarterly data are at seasonally adjusted annual rates.

CHART 8

ports, while still growing in absolute terms, have declined in relative importance, especially shipments to the European countries where barriers against agricultural imports have limited the opportunities for expanding export sales. An increased share of total United States exports now goes to the rapidly growing industrial nations. The countries of the European Economic Community (EEC) and Japan together have recently accounted for over one fourth of total United States exports, as against about one fifth of exports in the late 1950's. Countries of the Western Hemisphere, which were the destination of nearly half of United States exports in the late 1950's, now take only slightly more than one third.

Although the advance in United States exports in considerable part reflects a high level of business activity and rising income levels abroad, it is also virtually certain that the competitive position of American producers has gradually improved. While wage increases in many key competitor countries have clearly outstripped productivity gains in recent years, this has not been the case in the United States. Partly for this reason, the United States has had relatively stable prices in recent years, particularly in comparison with other industrial countries. Moreover, American businessmen have become somewhat more export conscious, and therefore more alert to sales opportunities abroad. Government and trade association export drives, as well as improved export financing facilities, have been of considerable help.

The net outflow of private long-term capital from the United States increased in 1964. Term loans to foreigners by United States banks, which had already risen considerably in 1963, registered another substantial increase after mid-1964. (The interest equalization tax on purchases of certain foreign securities was not applied to such lending in 1964, although the President had been given the authority to extend the tax to bank loans of more than one year.) The volume of new foreign issues placed in the New York market dwindled following the proposal of the interest equalization tax in July 1963 and remained low for much of 1964. With the enactment of the tax in September 1964, however, the market for new issues exempt from the tax quickly became very active, with Canadian borrowers accounting for the bulk of such issues. New direct investments reached their highest level since 1957; as in other recent years, Western Europe, especially the Common Market countries, was the major recipient of such investments.

Recorded short-term outflows were also larger during 1964. A notable reduction in such outflows had followed the July 1963 measures, when (along with the interest equalization tax proposal) increases in Federal Reserve discount rates and Regulation Q ceilings took place. By early 1964, however, commercial bank credits to foreigners had taken an upward turn. Europe, Latin America, and Japan obtained substantial credits, and increased outflows into deposits with Canadian banks also developed at various times during the year. The Federal Reserve moves in the late summer and in November, and subsequent moderate increases in money market rates here, were of course closely related to the problem of short-term outflows. Comparable rates had moved upward in a number of foreign countries during the year (see Chart 9).

SHORT-TERM INTEREST RATES IN SELECTED COUNTRIES. Short-term rates in most leading countries rose considerably, as monetary policy was used to counter inflationary pressures. United States short-term interest rates were steady until late November, when they rose moderately after the Federal Reserve acted to prevent an increased outflow of short-term funds in connection with the wider interest differentials that had developed and threatened to increase. Canadian rate movements roughly paralleled those in the United States, reflecting the close ties between the two money markets.

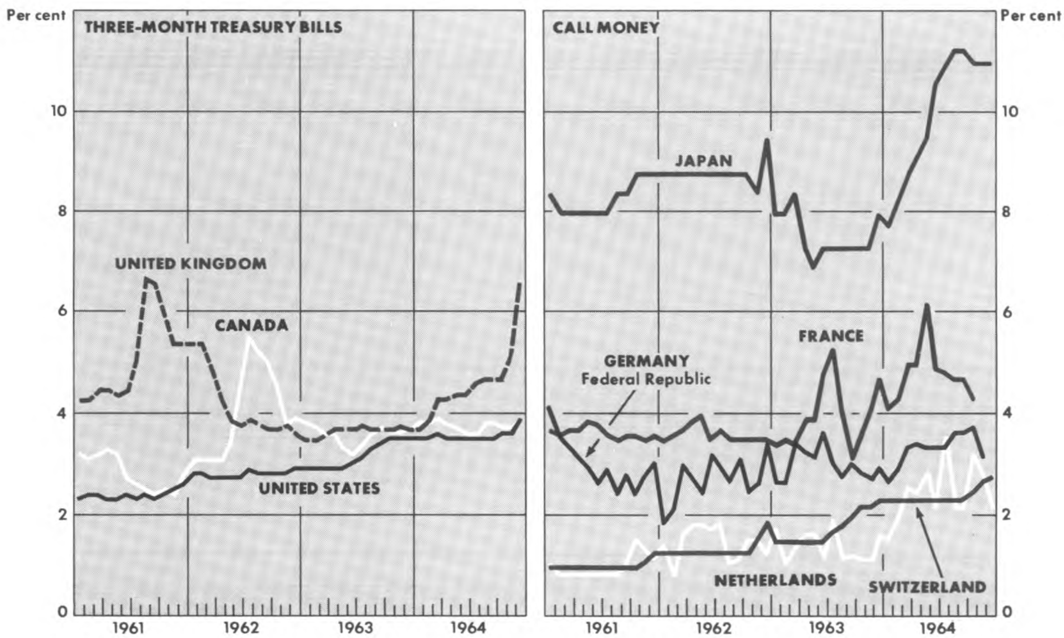


CHART 9

Net outpayments in connection with United States military transactions were somewhat smaller in 1964, and there was a diminished outflow of Government capital, including reduced outlays under assistance programs. However, the postponement of a regular British debt repayment of $138 million, scheduled for December, was among the adverse developments for the United States over-all payments balance in the fourth quarter.

The 1964 deficit on regular transactions was financed primarily by increases in United States liquid dollar liabilities and to some extent also by reductions in United States monetary reserves. As compared with other recent years, a greater share of dollar accruals to foreigners in 1964 remained in private hands. Contributing factors were a higher level of interest rates here, more active competition for deposits by American banks through their branches abroad, and the larger volume of world trade and other private payments. Underdeveloped countries, whose needs for working balances of convertible currencies are especially pressing, experienced a modest improvement in their payments positions and thus were able to add to their dollar holdings during the year. On the other hand, official gains in dollar reserves among major industrial countries were generally not so large as in the earlier 1960's. The special Governmental transactions that assist in offsetting the United States deficit on regular transactions were smaller than in other recent years.

For the first time, the United States financed part of its deficit with foreign currencies drawn from the IMF, although technical considerations prompted the Fund drawings.[3] United States drawings in 1964 totaled $525 million. Since other countries drew dollars during the year and thereby reduced the repurchase obligation of the United States, our net obligation to the IMF from all transactions was only $262 million at the year end.

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[3] *During much of the postwar period the United States had been a creditor with the IMF, since other countries had borrowed dollars from the Fund (on a net basis) and had reduced the Fund's holdings of dollars to below the initial 75 per cent of the United States quota. In the late 1950's and early 1960's, however, there were net dollar repayments to the Fund, and its dollar balances gradually returned to 75 per cent. (IMF holdings of a currency may not exceed that limit without a country's drawing from the Fund and thus taking on a repayment obligation to the Fund.) Since the dollar is widely used by foreign monetary authorities as a reserve currency, the United States Treasury arranged a stand-by with the Fund in July 1963, which permits the drawing of convertible currencies when needed for United States sales to countries that would wish to use dollars to make their IMF repayments. The drawing of these currencies from the Fund has no effect on the United States payments balance: the initial increase in United States holdings of foreign currencies is offset by an equivalent decrease in claims (i.e., drawing rights) on the Fund. The subsequent sales of currencies drawn by the United States help to finance the deficit since these sales absorb foreign-held dollars.*

Monetary gold holdings of the United States declined by $125 million in 1964. Other sources of supply, such as increased new production and exceptionally large Russian sales, helped satisfy the foreign demand for monetary gold. Estimated official gold reserves in the Free World increased by about $700 million through the third quarter of 1964, as against an increase of about $800 million for the year 1963.

International Financial Cooperation— Stiff Tests Passed Successfully

In a year in which the monetary authorities continued and deepened their studies of the international financial system, cooperation among the major industrial nations under existing arrangements quelled large-scale attacks against two major currencies, the Italian lira and the pound sterling. In the Italian case, the lira had come under increasingly heavy selling pressure during the winter of 1963-64 as the result of a widening payments deficit on current account, capital outflows, and repayments of foreign indebtedness by Italian commercial banks. To deal with the situation, the Italian authorities initiated various corrective policy measures (described in the next section) which were expected to take effect over a period of months. Meanwhile, the Bank of Italy suffered heavy reserve losses in supporting the lira. On March 14, the Italian authorities announced an aid package of about $1 billion from the United States Government, the Federal Reserve, and European central banks. In addition, the Italians shortly drew $225 million from the IMF. This support proved sufficient to stop the run on the lira, capital inflows (including reflows) quickly developed, and the effect of the basic stabilization measures soon became apparent. The Italian payments balance then swung into surplus, allowing Italy to reconstitute its foreign exchange holdings to mid-1963 levels and to repay credits made available under the assistance package.

Several factors were at the root of the sterling crisis, which reached its height in November. Throughout the year substantially higher (and partly anticipatory) imports, coupled with lagging exports and heavier outflows of capital, had led to a sharply widened payments deficit. These factors, along with uncertainties over the British election to be held in October, resulted in a weakening of sterling in the exchange markets. When the Labor Government assumed office, it took a series of actions calculated to shore up the balance of payments and to strengthen sterling (see next section). The discussions in Britain and abroad that followed these actions included sharp questioning as to the adequacy of the corrective measures. Thus, further uncertainties developed in the exchange market, which in turn generated speculative sales of sterling. In this context, the increase in Britain's bank rate—by 2 percentage points to 7 per cent on November 23—gave only momentary relief.

International cooperation measured up to the challenge. A massive package of $3 billion in short-term credit facilities from the United States Government, the Federal Reserve, and ten other central banks, along with the Bank for International Settlements, was put together in a few hours and announced on November 25. A drawing of $1 billion on the IMF at about the same time enabled Britain to repay previous central bank credits. The full package of $4 billion was the largest in the history of international financial assistance. By its very size it was intended to erase any residual doubt over the firm determination of monetary authorities to stifle disruptive forces in the exchange markets for major currencies. The package gradually achieved its goal of halting the attack, while Britain took a firm grasp on the job of resolving its underlying payments problem. Indeed, around the turn of the year, there was already a growing awareness in the financial markets the world over that the steps taken by the British authorities in the closing months of 1964 added up to a much stronger program in defense of sterling than had at first been recognized.

Many other aspects of growing cooperative international action in 1964 deserve to be noted. The IMF was used more than ever before by major industrial countries; as mentioned, Italy, Britain, and the United States drew on the Fund. Britain was the first country for which a part of the currencies needed was supplied to the IMF through the supplementary facilities made available by the General Arrangements to Borrow of the Group of Ten.[4]

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[4] *The original agreement, in effect since 1962, was among the ten major industrial countries that held the bulk of national gold and convertible currency reserves. In view of the potentially heavy demands upon the IMF for convertible currencies, each of these countries has agreed to make available, upon request by the Fund, up to a specified amount of its own currency for medium-term credits to other members of the Group. Out of the over-all credit facility of $6 billion, the United States pledged $2 billion. In 1964, Switzerland, which is not a member of the Fund, agreed to associate itself with the Arrangements, thus adding $200 million equivalent to the facility.*

The network of Federal Reserve swap facilities was increased further, to a total of $2,350 million. The increases included one of $250 million (to $750 million) in the arrangement with the Bank of England and one of $50 million (to $100 million) with the National Bank of Belgium. In another active year, the Federal Reserve carried out official transactions in nine of the eleven currencies covered by the swap arrangements. The United States Treasury also undertook substantial foreign exchange operations. In addition, the Treasury issued $356 million (net) of foreign currency bonds in 1964. Outstanding obligations under such borrowing totaled $1,086 million at the year end.[5]

Looking beyond immediate problems, the major nations studied and discussed basic questions concerning the functioning of the present international monetary system. The regular exchange of ideas continued at the ministerial meetings of the Group of Ten and of their deputies, the Organization for Economic Cooperation and Development, and the Bank for International Settlements. Moreover, two authoritative studies of the monetary system were prepared in advance of the IMF's annual meeting in Tokyo in September. These studies—one written under the auspices of the Group of Ten and the other by the IMF itself—indicated general agreement on a wide range of fundamental issues. In particular, it was concluded that the present international monetary system, based on fixed exchange rates and the established price of gold, has proved its value as a firm basis on which to build. Furthermore, for the system as a whole, gold and convertible currency reserves are fully adequate for the present and are likely to be for the immediate future. Over time, the continuing growth of world trade and payments might call for greater amounts of international liquidity. Such a need may best be met for the time being by the expansion of existing credit facilities. While disagreement on specific issues did appear at the Tokyo meetings, support developed for a general 25 per cent increase in IMF quotas, with larger increases in certain cases, when present quotas are reviewed in 1965. It is clear that any radical departures from the current system—such as the immediate establishment of a new form of reserve asset—are far from likely. Instead, the evolutionary approach will undoubtedly continue.

[5] *Included in these Treasury operations were new issues of $404 million of mark-denominated bonds to Germany, $82 million of Swiss franc bonds to Switzerland, and $70 million of Swiss franc bonds to the Bank for International Settlements. The Treasury also redeemed for the Bank of Italy $200 million equivalent of previously issued lira-denominated bonds.*

The Industrial Economies— Keeping Growth on an Even Keel

In general, the industrial economies continued to grow in 1964, with many countries reaching record levels of production and income. (See Chart 10 for industrial production and consumer price indexes of major countries.) Except for Italy, unemployment rates held at generally low levels, and labor scarcities intensified in some areas. Disposable incomes continued to rise, and larger consumption was a major factor in the over-all expansion in most countries. The Japanese economy, in particular, continued its impressive postwar advance. Along with the United States, Germany was an important beneficiary of the increased world demand for goods and services. The German export surplus was again sizable, although it narrowed as the year progressed.

Private investment was also growing, but not generally at so brisk a pace as in previous years. In some European countries, businessmen were faced with declining profit margins, which reflected both increasing international competition among producers and rising production costs in economies operating close to full capacity. By reducing incentives for new investment, inflationary pressures—which were present in many industrial countries abroad—became a possible force for curbing, if not reversing, the current expansion.

Against this background, several governments found it necessary to adopt a variety of anti-inflationary measures or to intensify earlier action. Nearly all governments made serious efforts to trim over-all budget deficits. Specific measures—such as purchase taxes—were often employed to curb demand for particular products, especially imports. Monetary policy also tended to be more restrictive. Many central banks raised their discount rates during the year, including those of Belgium, Canada, Japan, the Netherlands, Sweden, Switzerland, and the United Kingdom. Central banks also moved to curb excessive increases in bank credit through changes in borrowing and lending ceilings. For example, along with other measures taken by the Netherlands in 1963-64, ceilings were placed on increases in bank credit. When these ceilings were persistently exceeded early in 1964, the banks were required to make noninterest-bearing deposits at the central bank equal to the amounts by which they had exceeded the ceilings. In several countries—Germany, Switzerland, France, and occasionally in Belgium and the Netherlands—sizable inflows of funds from abroad tended to add to domestic liquidity, and measures were again taken in 1964 to reduce these inflows and to moderate their effects on the domestic economy.

PRODUCTION AND PRICES IN SELECTED COUNTRIES. **Industrial production indexes showed a somewhat mixed pattern in 1964. Production in the United States continued its sustained advance. In a number of European countries, the growth was less rapid than in the previous year and in a few cases production declined. Consumer prices in the United States remained relatively stable. In several other countries inflationary pressures increased, although in some cases the upward drift of prices was slowed by effective stabilization efforts.**

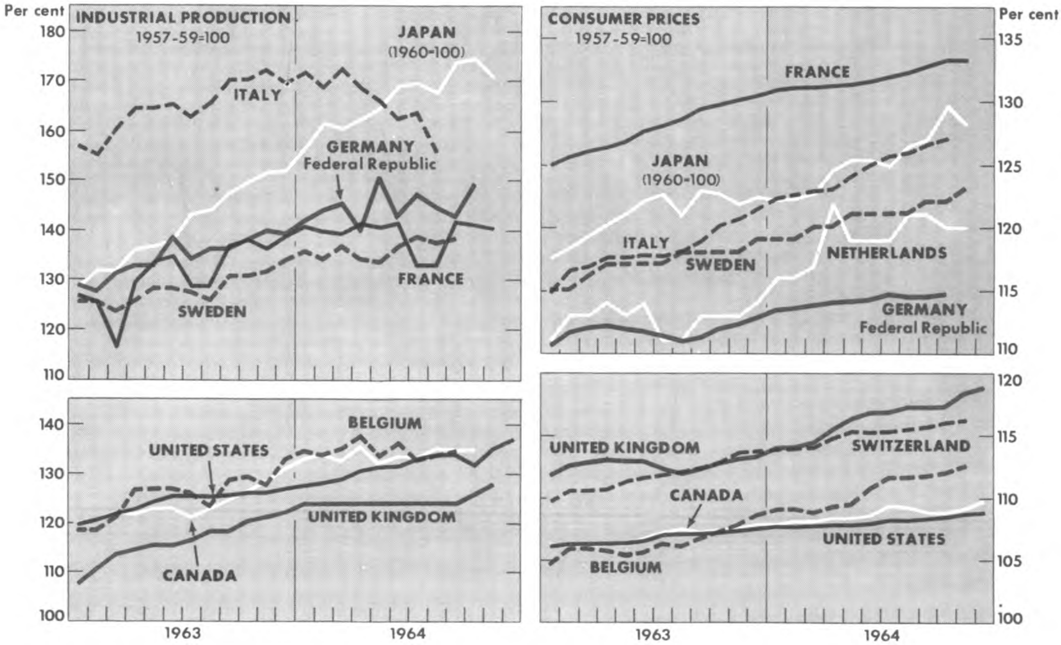

CHART 10

For clarity of presentation, the countries were arbitrarily separated into two panels. All data are seasonally adjusted.

Comprehensive stabilization plans were employed in countries where inflationary pressures were recognized as being particularly serious. For instance, the Italian program included a reduced government deficit, increased purchase taxes on certain consumer goods, several actions to limit foreign borrowings by Italian banks, and a generally more restrictive credit policy at home. Although production then declined, upward pressure on prices eased somewhat, the trade account improved sharply, and capital inflows—including foreign direct investment—resumed. Italy thus achieved a balance-of-payments surplus for the last three quarters of 1964. With the improvement in the external balance, the Italian authorities were able to begin relaxing some of the earlier measures. France, Switzerland, and the Netherlands also had stabilization measures in operation during the year, and in each case the rise in prices slackened although wage pressures tended to persist. In France, inflation curbs also halted the growth of production.

The British program, put into effect in the fourth quarter, included a 15 per cent surcharge on imports of most manufactured and semimanufactured goods as well as some rebates of indirect taxes on exports. In addition, the budget deficit, already running lower than had been expected, was to be further reduced through tax increases, some of which went into effect almost immediately. Moreover, besides the 2 percentage point hike in its rate, the Bank of England requested the commercial banks to slow the growth of bank lending while still making credit readily available for exports and productive domestic investment.

Capital markets, especially in Europe, showed further gradual development in 1964. New instruments and techniques were introduced and, with a larger volume of funds to be channeled between savers and investors, competition continued to stiffen among financial intermediaries, both domestically and internationally. Partly as a result of the United States interest equalization tax, more international securities issues were floated in European financial centers (especially in Britain and Germany). Most were denominated in dollars, but there were also quite a few issues in German marks.

Nevertheless, many official and institutional barriers to international capital movements remain. In fact, in several highly developed countries there was considerable questioning of the advisability of accepting, and possibly depending on, large-scale direct investments and inflows of short-term capital from outside sources, notably the United States. It was suggested that such inflows might lead to external control of important segments of industry and add to the problem of curbing excess domestic liquidity.

Important trade policy discussions took place during the year and will continue into 1965. In particular, the sixth round—the "Kennedy Round"—of multilateral negotiations by the contracting parties to the General Agreement on Tariffs and Trade opened officially in May 1964. As was to be expected, progress in the negotiations has been slow. In November, the contracting parties submitted lists of nonagricultural products on which tariff reductions would be considered, and the ensuing discussion took on a cautiously hopeful tone.

The Underdeveloped World— Modest Progress in Some Areas

The relations between the industrial and the less developed countries were thoroughly discussed in 1964. One important forum was a special United Nations Conference on Trade and Development held in Geneva from March to June, where representatives from 120 countries exchanged views and decided to establish an institution in which the discussion between the two groups of countries might continue. During the year, less developed countries did show some over-all improvement in their trade position. In large part, this reflected the rise in many commodity prices that had started in 1963 and continued in 1964. Last year's trend was highlighted by rising prices for nonferrous metals —tin and copper in particular—and by an additional firming of coffee prices. On the other hand, prices of several foodstuffs softened after an earlier advance; sugar, for example, slid further from its 1963 highs.

Meanwhile, sizable aid flows from the United States and other industrial countries as well as from international institutions continued. Lending by international agencies was broadened in scope, giving more attention to such fundamental needs as improved education and agriculture. On the resources side, the Inter-American Development Bank increased its capital stock and special funds by $1.3 billion, and the International Development Association (IDA) received an additional $753 million from a consortium of eighteen capital-exporting nations. Furthermore, the World Bank took the initiative in transferring $50 million of its earnings to the IDA.

On their own account, a larger number of underdeveloped countries in the Free World were making strong efforts toward more rapid economic growth. Progress was again recorded in such countries as Mexico, Peru, Taiwan, and quite possibly Nigeria, while a renewed rise in real growth occurred in Pakistan. Moreover, Brazil took determined steps to slow its inflationary spiral, and some of the newer African republics—Kenya and Uganda, in particular—have made a promising economic start under independence. On the other hand, many underdeveloped countries have still not adopted effective policies to overcome poverty and stagnation. Thus, ample seedbeds of political and economic instabilities continue to exist. Progress on these immense problems will require the combined efforts, public and private, of all nations of good will.

Unfinished Business

The world economy has moved into the mid-1960's at a fast pace—world merchandise trade alone increased by about 50 per cent between 1959 and 1964. Still, several key areas remain in which the international economy can be strengthened and in which added impetus to economic development can be provided. The Kennedy Round of tariff negotiations offers an important opportunity to increase trade even further, so as to attain a more efficient use of the world's vast, yet scarce, resources. Accelerated development of the European capital markets could prove instrumental in enlarging the flow of resources to the less developed countries, as well as in contributing to the reduction in existing payments imbalances.

The international movements of goods and capital of course also increases the scope for rapid transmission of economic disturbances from country to country. In view of this growing interdependence, the authorities of many nations have already established formal and informal means by which joint problems can be handled on a coordinated basis. The Group of Ten's continuing study of the international financial system is evidence of this coordinated approach, and should prove fruitful in identifying future sources of instability and in finding means of controlling them. Similarly, the proposed increase in IMF quotas represents an important step in the continuing adaptation of the structure of the international financial system to the requirements of expanding world trade and payments. Nevertheless, the events of 1964 clearly show not only that economic policy must be coordinated—among the major nations at least—but also that no nation can afford to ignore the responsibilities inherent in a world that is becoming more closely knit.

THIS BANK'S OPERATIONS

Volume and Trend of the Bank's Operations

DOMESTIC OPERATIONS. With the exception of coin activity, the Bank's operations, including those it carries out as agent of the Treasury, expanded appreciably during 1964.

The volume of checks processed rose substantially in 1964. For the year as a whole, this Bank handled 703 million checks (excluding United States Government checks and postal money orders). This was a rise of nearly 6 per cent over 1963. The dollar amount of checks processed in 1964 amounted to $443 billion—a growth of nearly 17 per cent over 1963. The substantial rise in the dollar volume was distributed about equally between checks drawn on this Bank and those drawn on commercial banks. Checks drawn on this Bank represent mainly interbank transfers of funds. These rose by about 27 per cent from the year before. The similar rise in the dollar amount of all other checks represented a 12 per cent increase.

The impressive rise in check volume was accompanied by a sizable rise in the use by this Bank of the Federal Reserve System's leased wire facilities. The dollar volume of wire transfers, other than Treasury transfers between Federal Reserve Districts, totaled $1,554 billion in 1964, an increase of 11 per cent over 1963. The number of transfers involved also rose 11 per cent.

Forward strides were made during the past year in the use of high-speed electronic equipment in the check collection function of this Bank. The number of checks processed on electronic equipment rose steadily—from about one seventh of all checks handled in December 1963 to nearly two thirds by December 1964. The rapid expansion in high-speed check processing operations necessitated almost continuous equipment changes throughout the year. The most significant change was the removal of the original pilot test equipment and the installation of seven new high-speed systems of enlarged capacity. Orders have also been placed for delivery of two additional high-speed systems in 1965.

Use of the Magnetic Ink Character Recognition (MICR) system was enhanced by continued progress in the proportion of checks preprinted in magnetic ink with the routing symbol-transit number of the drawee bank. A Febru-

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

Number of pieces handled (in thousands) ★	**1964**	**1963**
Currency received	1,426,131	1,351,268
Coin received†	556,807	1,601,876
Gold bars and bags of gold coin handled	203	177
Checks handled:		
United States Government checks	60,937	60,403
All other	703,430	665,207
Postal money orders handled	33,233	35,151
Collection items handled:		
United States Government coupons paid	4,007	4,124
Credits for direct sendings of collection items	325	315
All other	19,022	18,634
Issues, redemptions, exchanges by fiscal agency departments:		
United States savings bonds	29,719	29,327
All other obligations of the United States and Federal agencies	8,510	7,420
Obligations of the International Bank for Reconstruction and Development	98	36
Obligations of the Inter-American Development Bank	59	5
Participation certificates of the Federal National Mortgage Association	14	—
Safekeeping of securities:		
Pieces received and delivered	8,135	7,922
Coupons detached	6,445	6,020
Wire transfers of funds‡	924	833
Amounts handled (in millions of dollars)		
Discounts and advances§	11,686	14,547
Currency received	9,582	8,965
Coin received†	65	179
Gold bars and bags of gold coin handled	2,901	2,515
Checks handled:		
United States Government checks	23,629	23,367
All other	443,195	379,428
Postal money orders handled	618	643
Collection items handled:		
United States Government coupons paid	2,925	2,806
Credits for direct sendings of collection items	724	724
All other	3,656	3,038
Issues, redemptions, exchanges by fiscal agency departments:		
United States savings bonds	1,727	1,889
All other obligations of the United States and Federal agencies	590,742	546,146
Obligations of the International Bank for Reconstruction and Development	630	300
Obligations of the Inter-American Development Bank	209	12
Participation certificates of the Federal National Mortgage Association	786	—
Safekeeping of securities:		
Par value pieces received and delivered	717,402	713,535
Wire transfers of funds‡	1,554,372	1,400,795

★ Two or more checks, coupons, etc., handled as a single item are counted as one "piece".

† Excludes shipments of new coin from the Mint.

‡ Excludes Treasury transfers between Federal Reserve Districts.

§ The number of discounts and advances handled in 1964 was 1,248, compared with 1,369 in 1963.

ary 1964 survey showed that 94 per cent of the checks drawn on Second District banks and handled by this Bank were so preprinted.

The downward trend in coin receipts that started in 1962 accelerated sharply during 1964. To be sure, receipts of new coin by the Bank from the Mint reached an all-time high of about $43 million in 1964. This increase of $16 million (58 per cent) over 1963 reflected the Treasury's stepped-up coinage program. But at the same time, receipts of circulating coin (excluding shipments of new coin from the Mint) declined drastically: the dollar volume by 63 per cent to a new low of $65 million, and the number by 65 per cent. The corresponding declines in 1963 over 1962 were about 20 per cent each. For the second consecutive year, the shortage of coin necessitated a general rationing of shipments to banks. At various times during 1964, such shipments were reduced to a token one or two bags of certain denominations and had to be suspended completely on several occasions. In contrast, currency received by this Bank increased moderately during 1964. The number of items handled rose by about 6 per cent and the dollar volume by 7 per cent over 1963. The corresponding increases in 1963 over 1962 were about 1 per cent each.

Continued expansion in the Treasury's refunding and financing operations during 1964 resulted in another increase in this Bank's fiscal agency operations. The dollar volume of all Government obligations (other than United States savings bonds) processed by this Bank in 1964 was $591 billion—an increase of about 8 per cent over the 1963 volume. The number of pieces handled during 1964 was 8.5 million, 15 per cent more than in 1963. In contrast, issues, redemptions, and exchanges of savings bonds processed by this Bank declined by 9 per cent in 1964 to $1,727 million, offsetting about three quarters of the gain reported in 1963. The number of items handled nevertheless increased by 1 per cent.

The aggregate volume of Second District member bank borrowings during 1964 amounted to about $12 billion; it was 20 per cent less than during 1963, but more than twice that of either 1962 or 1961. The proportion of member banks that borrowed at least once during the year, calculated at 42 per cent, was slightly higher than that reported for 1963.

Public interest in the Federal Reserve was manifested in 1964 by the number of requests for tours of this Bank and for speeches and publications on the Bank's purposes and functions. In the course of the year 12,652 persons visited the Bank, 280 addresses were delivered by members of the Bank's staff to various business and educational groups, and 861,825 copies of this Bank's publications were distributed.

Despite the rise in the volume of operations of this Bank during 1964, average employment declined by about 1 per cent, which represents a reversal of a four-year upward trend. At the end of 1964, the Bank's officers and staff numbered 4,121, including 234 at the Buffalo Branch.

During 1964, this Bank transferred to (or set aside for) the United States Treasury $412 million as an interest charge levied by the Board of Governors under Section 16 of the Federal Reserve Act on Federal Reserve notes not covered by gold certificates. Of this amount, $286 million represented the Bank's net earnings after statutory dividend payments to member banks on outstanding Federal Reserve stock, and $126 million the amount of surplus in excess of paid-in capital pursuant to the decision of the Board of Governors to reduce the accumulated surplus of Federal Reserve Banks to the level of the capital actually paid in by the member banks instead of the subscribed capital. These transfers amounted to 5.2 per cent of the Bank's average Federal Reserve notes outstanding during 1964 (which can be broken down into transfers from current net earnings of 3.6 per cent and transfers from accumulated surplus of 1.6 per cent).

FOREIGN AND INTERNATIONAL OPERATIONS. Exchange operations by this Bank for System and Treasury account increased from last year's high level as a result of transactions for the Treasury in connection with United States drawings on the International Monetary Fund. In addition, 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 $2,350 million were in effect with the monetary authorities of eleven countries plus the Bank for International Settlements, while outstanding United States Treasury securities denominated in foreign currencies had risen to the equivalent of $1,086 million.

Gold, dollar balances, and other assets held for foreign and international account decreased slightly in 1964 to $28.2 billion at the year end. This was the first year-to-year decline in total foreign and international assets held at this Bank in seven years. Holdings for foreign accounts decreased by $413 million to a total of $20.3 billion; earmarked gold decreased by $235 million and United States Government securities by $286 million, whereas dollar deposits increased by $58 million and miscellaneous securities (including commercial paper and bankers' acceptances) rose by $50 million. The accounts of international organizations registered a nominal decrease—$30 million—to a total of $8.0 billion at the year end.

Gold operations were somewhat above the level of last year, reflecting an increase in purchases from and sales to the United States Treasury as well as an increase in exports. Requests for loans against gold under earmark continued to be rather small; three credit facilities aggregating $57 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, but at the year end only $30 million was outstanding.

Financial Statements

STATEMENT OF EARNINGS AND EXPENSES FOR THE CALENDAR YEARS 1964 AND 1963 (In thousands of dollars)

	1964	1963
Total current earnings	335,357	291,817
Net expenses	40,956	39,099
Current net earnings	294,401	252,718
Additions to current net earnings:		
Profit on sales of United States Government securities (net)	151	77
All other	76	113
Total additions	227	190
Deductions from current net earnings	6	11
Net additions	221	179
Net earnings available for distribution	**294,622**	**252,897**
Dividends paid	8,138	7,743
Payments to United States Treasury (interest on Federal Reserve notes)	412,485	232,650
Transferred to surplus	—126,001	12,504

SURPLUS ACCOUNT

	1964	1963
Surplus—beginning of year	263,215	250,711
Transferred from net earnings for year	0	12,504
Payments to United States Treasury (interest on Federal Reserve notes)	126,001	0
Surplus—end of year	**137,214**	**263,215**

STATEMENT OF CONDITION
(In thousands of dollars)

Assets	DEC. 31, 1964	DEC. 31, 1963
Gold certificate account	3,072,781	3,608,466
Redemption fund for Federal Reserve notes	355,066	334,006
Federal Reserve notes of other Banks	183,441	109,996
Other cash	32,083	31,676
Total cash	3,643,371	4,084,144
Discounts and advances	40,980	9,998
Acceptances	93,768	161,720
United States Government securities	9,285,737	8,707,557
Total loans and securities	9,420,485	8,879,275
Other assets:		
Cash items in process of collection	1,833,246	1,688,500
Bank premises	7,804	8,110
All other*	139,526	105,935
Total other assets	1,980,576	1,802,545
Total Assets	**15,044,432**	**14,765,964**

* Includes assets denominated in foreign currencies.

STATEMENT OF CONDITION
(In thousands of dollars)

Liabilities	**DEC. 31, 1964**	**DEC. 31, 1963**
Federal Reserve notes	8,253,863	7,939,568
Deposits:		
Member bank reserve accounts	4,829,799	4,994,535
United States Treasurer — general account	152,505	227,126
Foreign*	67,430	54,054
Other	180,824	167,741
Total deposits	5,230,558	5,443,456
Other liabilities:		
Deferred availability cash items	1,113,473	967,104
All other	172,110	21,014
Total other liabilities	1,285,583	988,118
Total Liabilities	**14,770,004**	**14,371,142**
Capital Accounts		
Capital paid in	137,214	131,607
Surplus	137,214	263,215
Total Capital Accounts	**274,428**	**394,822**
Total Liabilities and Capital Accounts	**15,044,432**	**14,765,964**
Contingent liability on acceptances purchased for foreign correspondents†	32,311	24,673
Ratio of gold certificate reserves to deposit and Federal Reserve note liabilities combined	25.4%	29.5%

* After deducting participations of other Federal Reserve Banks amounting to	161,480	116,960
† After deducting participations of other Federal Reserve Banks amounting to	90,135	67,179

Changes in Membership

During 1964 the total number of commercial banks in this District that are members of the Federal Reserve System declined from 426 to 418. The net decrease of eight banks was the result of the organization of twelve new national banks, the mergers of eighteen member banks with other members, and two member banks combined with nonmembers. The 418 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, 1964			DECEMBER 31, 1963		
Type of Bank	Members	Non-members	Per cent members	Members	Non-members	Per cent members
National banks★	294	0	100	296	0	100
State banks and trust companies	124	82	60	130	80	62
Total	**418**	**82**	**84**	**426**	**80**	**84**

★ Includes one national bank located in the Virgin Islands.

CHANGES IN FEDERAL RESERVE MEMBERSHIP IN SECOND DISTRICT DURING 1964

Total membership beginning of year	**426**
Increases:	
New national banks	12
Decreases:	
Member banks combined with other members	18
Member banks combined with nonmembers	2
Total membership at the year end	**418**

Changes in Directors and Officers

CHANGES IN DIRECTORS. In November 1964, member banks in Group 1 elected George A. Murphy a Class A director of the Federal Reserve Bank of New York for the term of three years beginning January 1, 1965. Mr. Murphy, Chairman of the Board of Irving Trust Company, New York, N. Y., succeeded George Champion, Chairman of the Board of The Chase Manhattan Bank, New York, N.Y., whose term expired December 31, 1964.

At the same time, member banks in Group 1 elected Arthur K. Watson a Class B director for the three-year term beginning January 1, 1965. Mr. Watson, Chairman of the Board of IBM World Trade Corporation, New York, N.Y., and Senior Vice President of International Business Machines Corporation, Armonk, N.Y., succeeded B. Earl Puckett, former Chairman of the Board of Allied Stores Corporation, New York, N.Y., whose term expired December 31, 1964.

Also in November 1964, 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 1965. 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 appointed Everett N. Case as *Deputy Chairman* for the year 1965. In this capacity, Mr. Case, President of the Alfred P. Sloan Foundation, New York, N. Y., succeeded James DeCamp Wise, former Chairman of the Board of Bigelow-Sanford, Inc., New York, N.Y., whose term as *Deputy Chairman* and as a Class C director expired December 31, 1964. Mr. Wise had served as a Class C director since January 1959 and as *Deputy Chairman* since January 1961.

In December 1964, the Board of Governors appointed Dr. James M. Hester a Class C director for the three-year term beginning January 1, 1965. Dr. Hester, President of New York University, New York, N.Y., succeeded Mr. Wise as a Class C director.

At the Buffalo Branch of the Federal Reserve Bank of New York, in November 1964, Maurice R. Forman, President of B. Forman Co., Rochester, N.Y., was designated by the Board of Directors of this Bank as *Chairman* of the Board of Directors of the Buffalo Branch for the year 1965. At the same time, the Board of Directors of this Bank appointed J. Wallace Ely and John D. Hamilton directors of the Buffalo Branch for three-year terms beginning January 1, 1965. Mr. Ely, President of Security Trust Company of Rochester, Rochester, N.Y., succeeded Elmer B. Milliman, President of Central Trust Company Rochester N.Y., Rochester, N.Y., whose term expired December 31, 1964. Mr. Hamilton, President of Chautauqua National Bank of Jamestown, Jamestown, N.Y., succeeded Anson F. Sherman, President of The Citizens Central Bank, Arcade, N.Y., whose term expired December 31, 1964. In December 1964, the Board of Governors of the Federal Reserve System appointed Robert S. Bennett a director of the Buffalo Branch for the three-year term beginning January 1, 1965. Mr. Bennett, General Manager of the Lackawanna Plant of Bethlehem Steel Corporation, Buffalo, N.Y., succeeded Whitworth Ferguson, President of Ferguson Electric Construction Co., Inc., Buffalo, N. Y., whose term expired December 31, 1964.

CHANGES IN OFFICERS. Since February 1964, two officers have retired and one officer has resigned:

Robert G. Rouse, Vice President and Senior Adviser, retired effective October 1, 1964. Mr. Rouse had joined the Bank's staff in July 1939 as an officer. From November 1939 until May 1962, he was Vice President in charge of the Open Market Operations function and Manager of the System Open Market Account. From May 1962 until his retirement, Mr. Rouse served as Vice President and Senior Adviser.

Harold M. Wessel, Assistant Vice President, retired effective March 1, 1965. Mr. Wessel had been a member of the Bank's staff since September 1917 and an officer since April 1945. From 1953 to 1963, Mr. Wessel served as Assistant Vice President of the Buffalo Branch.

Robert Lindsay, Senior Economist, resigned effective September 15, 1964 to accept appointment as Professor of Finance and Research Adviser to the Dean at the Graduate School of Business Administration of New York University.

The following additional changes in official staff, including the appointment of five new officers, have taken place since February 1964.

Edward J. Geng, formerly Special Assistant in the Securities Department, was appointed an officer with the title of Manager, effective July 2, 1964, and assigned to the Securities Department.

James H. Oltman, formerly Assistant Counsel, was appointed Manager, effective July 2, 1964, and assigned to the Bank Examinations Department. His appointment as Assistant Counsel terminated as of the same date.

Donald C. Niles, formerly Manager of the Accounting Department, was appointed Assistant Vice President, effective January 7, 1965, and assigned to the Accounting and Planning function, with responsibility for the newly established Computer Services Department.

Kenneth E. Small, formerly Manager of the Cash Department, was appointed Assistant Vice President, effective January 7, 1965, and assigned to the Cash and Collections function, with responsibility for the Cash, Cash Custody, and Collection Departments.

Louis J. Brendel, formerly Chief of the Computer Services Division, Accounting Department, was appointed Manager, effective January 7, 1965, and assigned to the Computer Services Department.

Richard G. Davis, formerly Special Assistant in the Research Department, was appointed Senior Economist, effective January 7, 1965.

Leonard Lapidus, formerly Chief of the Financial and Trade Statistics Division, Research Department, was appointed Manager, effective January 7, 1965, and assigned to the Personnel Department.

Robert Meyer, formerly an Attorney in the Legal Department, was appointed Assistant Counsel, effective January 7, 1965.

Everett B. Post, Manager, Planning Department, was assigned also to the Accounting Department, effective January 8, 1965.

Charles R. Pricher, Manager, formerly assigned to the Personnel Department, was assigned to the Cash Department, effective January 8, 1965.

MEMBER OF FEDERAL ADVISORY COUNCIL—1965. The Board of Directors of this Bank selected William H. Moore to serve during 1965, for the second successive year, 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.

Directors of the Federal Reserve Bank of New York

DIRECTORS	Term expires Dec. 31	Class	Group
GEORGE A. MURPHY Chairman of the Board, Irving Trust Company, New York, N. Y.	1967	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
ARTHUR K. WATSON Chairman of the Board, IBM World Trade Corporation, New York, N. Y., and Senior Vice President, International Business Machines Corporation, Armonk, N. Y.	1967	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	
EVERETT N. CASE, *Deputy Chairman* President, Alfred P. Sloan Foundation, New York, N. Y.	1966	C	
JAMES M. HESTER President, New York University, New York, N. Y.	1967	C	

DIRECTORS — BUFFALO BRANCH

MAURICE R. FORMAN, *Chairman* 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
ROBERT S. BENNETT General Manager, Lackawanna Plant, Bethlehem Steel Corporation, Buffalo, N. Y.	1967
J. WALLACE ELY President, Security Trust Company of Rochester, Rochester, N. Y.	1967
JOHN D. HAMILTON President, Chautauqua National Bank of Jamestown, Jamestown, N. Y.	1967

MEMBER OF FEDERAL ADVISORY COUNCIL — 1965

WILLIAM H. MOORE Chairman of the Board, Bankers Trust Company, New York, N. Y.	1965

Officers of the Federal Reserve Bank of New York

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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*
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ALAN R. HOLMES, *Vice President*
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HORACE L. SANFORD, *Vice President*
ROBERT W. STONE, *Vice President*
THOMAS O. WAAGE, *Vice President*

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THOMAS C. SLOANE, *Assistant General Counsel*

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ERNEST E. BLANCHETTE, *Manager, Bank Relations Department*
LOUIS J. BRENDEL, *Manager, Computer Services Department*
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ROBERT L. COOPER, *Manager, Acceptance Department*
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LEONARD LAPIDUS, *Manager, Personnel Department*
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*
ROBERT MEYER, *Assistant Counsel*
ARTHUR H. NOA, *Manager, Service Department*
JAMES H. OLTMAN, *Manager, Bank Examinations Department*
EVERETT B. POST, *Manager, Accounting Department, and Manager, Planning Department*
CHARLES R. PRICHER, *Manager, Cash 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*
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*

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

GERALD H. GREENE, *Assistant Cashier*

JOHN T. KEANE, *Assistant Cashier*


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ALBANY
ROCHESTER
BUFFALO
NEW YORK
ELMIRA
BINGHAMTON
POUGHKEEPSIE
JAMESTOWN
BRIDGEPORT
NEW YORK
NEWARK
NEW BRUNSWICK
VT.
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OHIO
HEAD OFFICE TERRITORY
BUFFALO BRANCH TERRITORY