

*Annual
Statement* | *for
1965*

FEDERAL RESERVE BANK OF DALLAS

FEDERAL RESERVE BANK OF DALLAS

To the Member Banks in the
Eleventh Federal Reserve District:

The Statement of Condition and the earnings and expenses of the Federal Reserve Bank of Dallas for the year 1965, with comparative figures for 1964, are shown herein. Lists of the directors and officers of the Bank and its branches as of January 1, 1966, are also included.

A review of economic and financial developments in the Nation and the District during 1965 is being presented in the January 1966 Annual Report Issue of the *Business Review* of this Bank.

Additional copies of these publications may be obtained upon request to the Research Department, Federal Reserve Bank of Dallas, 400 South Akard Street (mailing address: Station K, Dallas, Texas 75222).

Sincerely yours,



WATROUS H. IRONS
President

Statement of Condition

	Dec. 31, 1965	Dec. 31, 1964
ASSETS		
Gold certificate account	\$ 367,907,289	\$ 647,555,676
Redemption fund for Federal Reserve notes	56,691,801	51,174,531
Total gold certificate reserves	424,599,090	698,730,207
Federal Reserve notes of other Banks	47,262,200	31,003,050
Other cash	6,546,798	4,203,532
Discounts and advances	22,024,000	21,810,000
U.S. Government securities:		
Bills	374,626,000	225,598,000
Certificates	—	—
Notes	1,022,083,000	940,099,000
Bonds	269,636,000	196,865,000
Total U.S. Government securities	1,666,345,000	1,362,562,000
Total loans and securities	1,688,369,000	1,384,372,000
Cash items in process of collection	464,980,479	489,178,791
Bank premises	10,513,931	11,202,982
Other assets	49,104,064	26,403,980
TOTAL ASSETS	<u>2,691,375,562</u>	<u>2,645,094,542</u>
LIABILITIES		
Federal Reserve notes in actual circulation	1,193,940,804	1,088,625,921
Deposits:		
Member bank — reserve accounts	1,034,443,622	1,050,702,507
U.S. Treasurer — general account	21,204,504	47,510,309
Foreign	8,700,000	12,540,000
Other	5,970,581	4,922,766
Total deposits	1,070,318,707	1,115,675,582
Deferred availability cash items	355,703,182	345,011,129
Other liabilities	7,476,769	34,610,610
TOTAL LIABILITIES	<u>2,627,439,462</u>	<u>2,583,923,242</u>
CAPITAL ACCOUNTS		
Capital paid in	31,968,050	30,585,650
Surplus	31,968,050	30,585,650
TOTAL CAPITAL ACCOUNTS	<u>63,936,100</u>	<u>61,171,300</u>
TOTAL LIABILITIES AND CAPITAL ACCOUNTS	<u>\$2,691,375,562</u>	<u>\$2,645,094,542</u>

Earnings and Expenses

	1965	1964
CURRENT EARNINGS		
Discounts and advances	\$ 1,062,969	\$ 965,397
U.S. Government securities	62,144,870	51,185,796
Foreign currencies	809,956	363,107
All other	31,407	24,917
TOTAL CURRENT EARNINGS	64,049,202	52,539,217
CURRENT EXPENSES		
Current operating expenses	9,991,494	9,569,964
Assessment for expenses of Board of Governors	501,096	498,300
Federal Reserve currency:		
Original cost, including shipping charges	1,153,992	758,624
Cost of redemption, including shipping charges	48,538	43,806
Total	11,695,120	10,870,694
Less reimbursement for certain fiscal agency and other expenses	840,387	828,499
NET EXPENSES	10,854,733	10,042,195
PROFIT AND LOSS		
Current net earnings	53,194,469	42,497,022
Additions to current net earnings:		
Profit on sales of U.S. Government securities (net)	—	24,030
All other	71,537	16,458
Total additions	71,537	40,488
Deductions from current net earnings:		
Loss on sales of U.S. Government securities (net)	329	—
All other	49,113	10,588
Total deductions	49,442	10,588
Net additions	22,095	29,900
Net earnings before payments to U.S. Treasury	53,216,564	42,526,922
Dividends paid	1,891,621	1,797,729
Payments to U.S. Treasury (interest on F.R. notes)	49,942,543	66,913,343
Transferred to surplus	1,382,400	-26,184,150
Surplus, January 1	30,585,650	56,769,800
Surplus, December 31	31,968,050	30,585,650

Directors

FEDERAL RESERVE BANK OF DALLAS

CARL J. THOMSEN	<i>(Chairman and Federal Reserve Agent)</i> , Senior Vice President, Texas Instruments Incorporated, Dallas, Texas
MAX LEVINE	<i>(Deputy Chairman)</i> , Chairman of the Board, Foley's, Houston, Texas
D. A. HULCY	Chairman of the Board, Lone Star Gas Company, Dallas, Texas
MURRAY KYGER	Chairman of the Board, The First National Bank of Fort Worth, Fort Worth, Texas
J. EDD McLAUGHLIN	President, Security State Bank & Trust Company, Ralls, Texas
J. B. PERRY, JR.	President and General Manager, Perry Brothers, Inc., Lufkin, Texas
KENNETH S. PITZER	President and Professor of Chemistry, Rice University, Houston, Texas
RALPH A. PORTER	President, The State National Bank of Denison, Denison, Texas
H. B. ZACHRY	Chairman of the Board, H. B. Zachry Company, San Antonio, Texas

EL PASO BRANCH

GORDON W. FOSTER	Chairman of the Board, Shop Rite Foods, Inc., El Paso, Texas
ROBERT W. HEYER	President, Southern Arizona Bank & Trust Company, Tucson, Arizona
ROBERT F. LOCKHART	Vice President, The State National Bank of El Paso, El Paso, Texas
C. ROBERT McNALLY, JR.	Rancher, Roswell, New Mexico
JOSEPH M. RAY	President, Texas Western College, El Paso, Texas
DICK ROGERS	President, First National Bank in Alpine, Alpine, Texas
JOE B. SISLER	President, The Clovis National Bank, Clovis, New Mexico

HOUSTON BRANCH

DONALD B. CAMPBELL	Works Manager, Sabine River Works, E. I. du Pont de Nemours & Company, Orange, Texas
HENRY B. CLAY	President, First Bank & Trust, Bryan, Texas
J. A. ELKINS, JR.	Chairman of the Board, First City National Bank of Houston, Houston, Texas
JOHN E. GRAY	President, First Security National Bank of Beaumont, Beaumont, Texas
EDGAR H. HUDGINS	Ranching — Partner in Hudgins Division of J. D. Hudgins, Hungerford, Texas
A. G. McNEESE, JR.	President, Bank of the Southwest National Association, Houston, Houston, Texas
GEO. T. MORSE, JR.	President and General Manager, Peden Iron & Steel Company, Houston, Texas

SAN ANTONIO BRANCH

JAMES T. DENTON, JR.	President, Corpus Christi Bank and Trust, Corpus Christi, Texas
G. C. HAGELSTEIN	President and General Manager, Union Stock Yards San Antonio, San Antonio, Texas
HAROLD D. HERNDON	Independent Oil Operator, San Antonio, Texas
MAX A. MANDEL	President, The Laredo National Bank, Laredo, Texas
FRANCIS B. MAY	Chairman of Department of General Business and Professor of Business Administration, The University of Texas, Austin, Texas
FORREST M. SMITH	President, National Bank of Commerce of San Antonio, San Antonio, Texas
J. R. THORNTON	Chairman of the Board and President, State Bank and Trust Company, San Marcos, Texas

FEDERAL ADVISORY COUNCIL MEMBER

ROBERT H. STEWART, III	Chairman of the Board, First National Bank in Dallas, Dallas, Texas
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Officers

FEDERAL RESERVE BANK OF DALLAS

WATROUS H. IRONS, *President*

P. E. COLDWELL, *First Vice President*

ROY E. BOHNE, *Vice President*

JAMES L. CAUTHEN, *Vice President*

J. L. COOK, *Vice President*

RALPH T. GREEN, *Vice President*

CARL H. MOORE, *Vice President*

G. R. MURFF, *Vice President and
Secretary of the Board*

JAMES A. PARKER, *Vice President*

T. W. PLANT, *Vice President and Cashier*

W. M. PRITCHETT, *Vice President*

FREDRIC W. REED, *Vice President*

THOMAS R. SULLIVAN, *Vice President*

ARTHUR H. LANG, *General Auditor*

GEORGE F. RUDY, *General Counsel*

ROBERT H. BOYKIN, *Assistant Vice President
and Assistant Secretary of the Board*

J. Z. ROWE, *Director of Research*

JAMES O. RUSSELL, *Chief Examiner*

LEON W. COWAN, *Assistant Vice President*

TONY J. SALVAGGIO, *Assistant Vice President*

E. A. THAXTON, JR., *Assistant Vice President*

E. W. VORLOP, JR., *Assistant Vice President*

SIDNEY J. ALEXANDER, JR., *Assistant Cashier*

ROBERT A. BROWN, *Assistant Cashier*

RICHARD D. INGRAM, *Assistant Cashier*

HARRY E. ROBINSON, JR., *Assistant Cashier*

JESSE D. SANDERS, *Assistant Cashier*

GEORGE C. COCHRAN, III, *Assistant Counsel*

EL PASO BRANCH

FREDRIC W. REED, *Vice President in Charge*

T. C. ARNOLD, *Cashier*

FORREST E. COLEMAN, *Assistant Cashier*

HOUSTON BRANCH

J. L. COOK, *Vice President in Charge*

B. J. TROY, *Cashier*

ROY E. MALEY, *Assistant Cashier*

RASCO R. STORY, *Assistant Cashier*

SAN ANTONIO BRANCH

CARL H. MOORE, *Vice President in Charge*

A. E. MUNDT, *Cashier*

ALVIN E. RUSSELL, *Assistant Cashier*

FREDERICK J. SCHMID, *Assistant Cashier*



business review



january 1966

FEDERAL RESERVE
BANK OF DALLAS

Annual Report Issue

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strong expansion in 1965

The Nation's economy maintained a strong expansionary stance in 1965, propelled to successive new highs by increased demands in most major markets. The character of the expansion changed somewhat as the year progressed. While the upward climb was rather uneven in the first half of the year, the pace of the advance became more uniform in the last 6 months since the effects of work stoppages — actual and threatened — in a number of key industries began to wane.

In addition, the early-season concern over a possible slowing of the business upturn in the second half was replaced by a threat of inflation late in the year. A number of basic industries operated at or near capacity, skilled labor became harder to find, delivery schedules lengthened, and order backlogs rose. The closer approach to capacity usage of resources, both human and material, brought a new set of challenges to the economic scene and cast in a new light some long-standing problems associated with the underutilization of resources.

● Changes in the gross national product reflected *economic developments* last year. The value of final goods and services produced in the Nation during 1965 totaled approximately \$675 billion, or 7.5 percent higher than a year earlier — a gain that somewhat exceeded the performance of the economy in 1964. The private sectors of the economy provided the main upward thrust of demand, with personal consump-

tion outlays and private domestic investment accounting for almost nine-tenths of the increase. State and local government spending remained on an uptrend, while Federal expenditures began to move ahead at an accelerating rate in the last half of the year, reflecting the growing U.S. commitment in Viet-Nam. Although the volume of U.S. foreign trade increased, the surplus on goods and services account declined from the exceptionally high 1964 level.

● The strength of the domestic economy was also reflected in *financial developments* during 1965. There was a strong demand for credit at the Nation's commercial banks, the money supply expanded materially, and the public made further substantial additions to its already large holdings of financial savings. Moreover, after advancing moderately during the July-November period, interest rates rose rather sharply in early December in response to the upward adjustment from 4 percent to 4½ percent in the discount rate of the Federal Reserve banks.

Monetary policy became less stimulative in March, and the reduced level of reserve availability which prevailed thereafter was reflected in net borrowed reserves in most weeks. Although the U.S. balance-of-payments position showed notable improvement after the January-March quarter, international financial developments continued to be an important factor in domestic financial markets and in national economic policy considerations.

economic developments

Among the four major markets for final products — investment, consumer, government, and foreign — gross private domestic investment exhibited the greatest relative strength last year by advancing almost 13 percent to approximately \$105 billion. Business investment in plant and equipment and in larger inventories accounted for nearly all of the increase, since the value of residential construction was little changed from 1964.

Business capital spending approached boom proportions in 1965, with every major line of commercial enterprise adding to the heavy demands for structures and equipment. Contributing to the continued uptrend of fixed investment were such factors as record profits, increased depreciation allowances, higher operating rates, and the expectation of further strong sales gains. In the last quarter of the year, the rising calls for defense goods were a factor in boosting investment outlays in some industries above the levels anticipated earlier in the year.

Whereas the transportation industries paced the strong expansion in investment spending in 1964, the manufacturing sector reported the largest relative and absolute gains last year. The fabricators of durable goods and the pro-

ducers of nondurables each raised capital outlays by close to \$2 billion. Over half of the increase in the durable goods industries came from stepped-up outlays by the makers of nonelectrical machinery and of motor vehicles and parts, while about the same proportion of the enlarged investment in the nondurable goods industries was provided by the producers of chemicals and of petroleum products.

Business investment in inventories advanced approximately \$7.4 billion in 1965, compared with a gain of \$4.8 billion in the previous year. Although the accumulation of stocks during 1965 was the largest for any year since 1951, inventories — except in the case of steel — generally remained in a favorable relation to sales, with the overall stock-sales ratio for manufacturing and trade holding close to the level of 1964 and remaining fractionally lower than in 1963. The threatened steel strikes, first on May 1 and then on September 1, caused durable goods producers to inventory sizable tonnages of the metal during the first 8 months of the year. After the labor agreement in the steel industry was reached in early September, the liquidation of excess steel holdings began, thereby sharply reducing the rate of business inventory accumulation in the fourth quarter.

Spending for residential structures in 1965 was little changed from the previous year, despite a reduction in the number of new private houses started. The decline in housing starts was concentrated in multifamily units and was offset by higher unit values, which partly reflected increased construction costs.

Personal consumption expenditures, another major market for final goods and services which offered a pacesetting lift to the economic expansion in 1965, rose slightly over 7 percent to about \$429 billion. This increase represented the largest part of the overall gain in GNP. Consumers sharply increased their spending for a broad range of durables, nondurables, and services.

PLANT AND EQUIPMENT OUTLAYS

United States

(Dollar amounts in billions)

Industry group	1965 ¹	1964	Percent increase
Manufacturing	\$22.5	\$18.6	21
Durable goods	11.3	9.4	20
Nondurable goods	11.2	9.2	22
Mining	1.3	1.2	9
Transportation	4.5	3.8	19
Public utilities	6.8	6.2	10
Commercial and other ²	16.7	15.1	10
All industries	\$51.8	\$44.9	15

¹ Based upon anticipated expenditures as reported by business in late October and in November 1965.

² Includes trade, service, finance, communications, and construction.

SOURCES: Securities and Exchange Commission.
U.S. Department of Commerce.

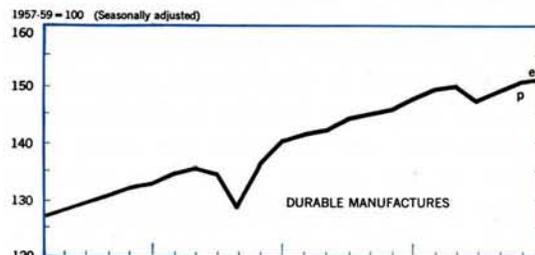
Consumer outlays for durable goods spurted close to 11 percent over the record level of 1964, with higher automobile sales accounting for a significant proportion of the gain. Automobile sales in 1965 totaled approximately 9.3 million units, or about 15 percent more than a year earlier. Part of this marked advance, however, reflects the effects of strikes in the automobile industry in the fall of 1964, which forced thousands of consumers to defer their new-car purchases until early 1965. The carry-over in sales may have been on the order of 250,000 units.

Although not a pacesetter in 1965, government purchases of goods and services provided strong support to the overall advance by climbing 5 percent to approximately \$135 billion. Not surprisingly, state and local government expenditures continued a long-standing uptrend and rose slightly over 8 percent. This relative gain was in line with the advance in 1964, despite a moderate reduction in the rate of expansion in outlays for new public facilities.

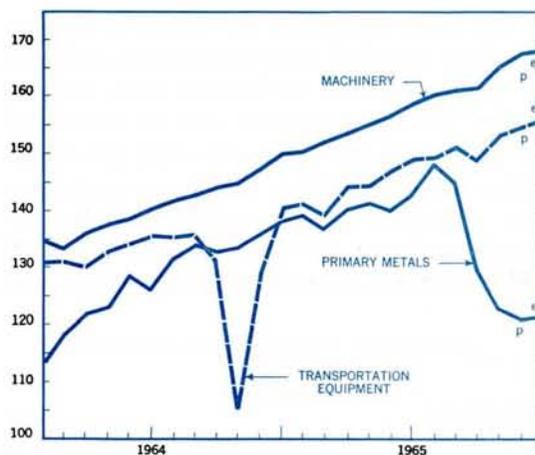
While Federal purchases recorded the largest increases — both relative and absolute — since 1962, the advances were fairly modest as such purchases edged upward a little over \$1 billion in 1965, or about 2 percent. During the first half of the year, defense spending, on an adjusted annual-rate basis, was below the 1964 total. The pace of defense outlays about matched the 1964 level in the July-September period and, then, moved ahead strongly in the final months of 1965, reflecting both a military pay raise and larger outlays for defense goods. Despite added spending for the Great Society programs and a pay increase for civilian employees late in the year, Federal outlays for nondefense purposes climbed only about 8 percent, the smallest relative gain since 1959.

The U.S. balance of trade with foreigners was a negative factor in the economic expansion last year, since net exports totaled about \$1 billion below 1964. The continued strong

The larger output of durables in the Nation last year contributed markedly to the growth of industrial production . . .



as a number of durable goods industries experienced significant gains.



p — Preliminary.
e — Estimated.
SOURCES: Board of Governors, Federal Reserve System.
Federal Reserve Bank of Dallas.

growth of the domestic economy kept imports in a rising phase during 1965. Moreover, the threatened steel strike led to a significant increase in imports of the metal during the year. While exports of goods and services also rose, they increased less than imports. This development partly reflected a slowing in the rates of industrial expansion in a number of foreign countries, particularly Great Britain, France, and Japan — all of which are important trading partners of the United States.

To provide the primary energy, materials, and products needed for the economic expansion

sion last year, the Nation's mines, factories, and utilities boosted the volume of industrial output approximately 7.8 percent. While all major industry groups experienced output gains in 1965, manufacturers of durable goods were the hardest pressed to meet market demands. In fact, the 10-percent increase in durable manufactures last year accounted for nearly two-thirds of the overall advance in industrial output in the Nation. The machinery, transportation equipment, primary metal, and fabricated metal products industries all made significant contributions to the larger outturn of hard goods during the year.

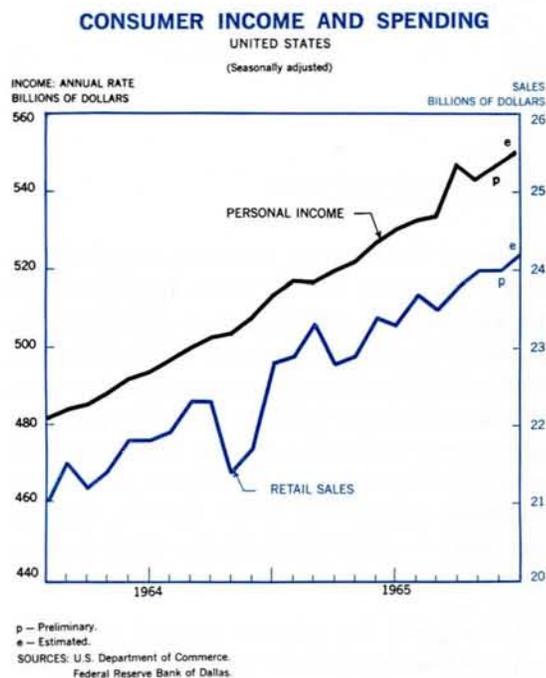
The sharp increase in the output of machinery, both electrical and nonelectrical, reflected the greater demand by business firms for producers' durable equipment and by consumers for household appliances, especially color television sets. In addition, machinery production was stimulated in the second half by the growing demand for defense goods, a growth which stemmed from the escalation of the war

in Viet-Nam. Larger calls for transportation equipment came from the Nation's airlines and railroads. Both truck and automobile production last year established records. U.S. car makers assembled approximately 9.3 million units, which represents an increase of about 19 percent over 1964 and is well above the previous high of 7.9 million cars turned out in 1955.

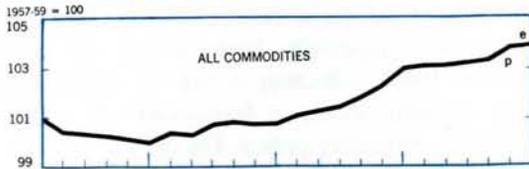
Many of the primary metal industries operated at or near capacity during much of 1965. The producers of the big-volume nonferrous metals — aluminum, lead, copper, and zinc — were under pressure throughout the year to provide the industrial sector with its needs for these metals. In the case of copper, demand tended to outrun supply; as a result, the production of some types of wire and brass mill products was constrained near the end of the year. Steel production in 1965 totaled approximately 130 million tons, up slightly from the previous high set in 1964. Of course, part of the output in 1965 was inventoried.

The robust expansion of the economy last year was reflected in significant gains in employment and income. Although the civilian labor force increased about 1.3 million persons, the number of civilians employed rose even more. Consequently, the average rate of joblessness for the year was reduced to 4.6 percent of the work force, down from 5.2 percent in 1964. Much of the reduction in the unemployment rate occurred in the last half of 1965 — an improvement that was evident from declines in the jobless rates for all major classes of workers. The total number of persons added to payrolls increased about 2.3 million over 1964, with sizable gains reported for manufacturing (especially durables), trade, and state and local government.

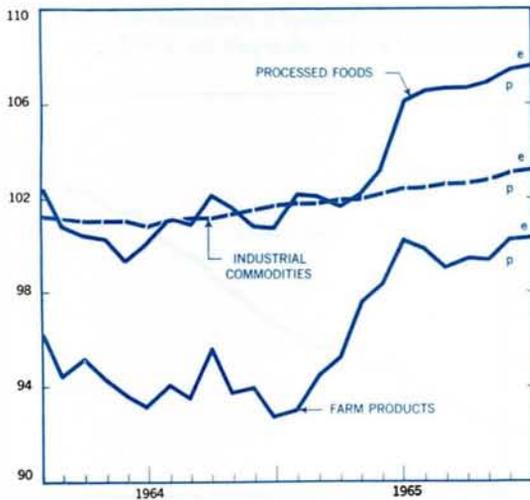
Buoyed by increased employment, higher wage rates, and significant amounts of overtime in some industries, personal income in the Nation advanced about 7.2 percent last year, or



Wholesale prices in the United States climbed upward in 1965 . . .



boosted in the first half of the year by higher quotations for agriculturally related commodities.



p — Preliminary.
e — Estimated.
SOURCES: U.S. Department of Labor,
Federal Reserve Bank of Dallas.

approximately \$36 billion. Most of the climb over the 1964 level of income stemmed from larger receipts for labor services, which rose about the same relative amount as overall personal income. Contributing to the higher total of wages and salaries last year were Federal pay raises for military personnel in September and for civilian employees in October. Moreover, new union contract settlements provided an upward bias to wage rates.

Other important increases in income were reported by farmers and recipients of transfer payments. Whereas farm income declined in 1964 from the prior year, such income spurted upward in 1965 under the combined impact of

higher prices for meat animals, fruits, and vegetables and the appreciably larger outturns of a number of important crops. Transfer payments were boosted significantly by the increased social security benefits which were paid in the last 4 months of the year, including a lump-sum retroactive disbursement of \$885 million in September.

Prices climbed more strongly in 1965 than in any year since the late fifties. Wholesale prices rose 1.9 percent; much of the gain was concentrated in the first 6 months, when costs of farm products and processed foods were trending sharply upward. Industrial commodity prices moved ahead somewhat more evenly over the year and averaged 1.3 percent higher than in 1964. The major impetus to higher costs for industrial commodities came from such diverse items as petroleum products, hides and skins, construction machinery, and nonferrous metals.

Consumer prices advanced 1.7 percent in 1965, an increase that is somewhat greater than the average gain of 1.2 percent shown for the preceding 4 years of the business expansion. As in prior years, the costs of medical care, public transportation, and homeownership trended upward. The really important difference in 1965, however, was the strong increase in food prices, particularly for meats and fresh vegetables.

financial developments

Loans at all commercial banks in the United States rose close to 15 percent during 1965 and, according to preliminary estimates, reached a seasonally adjusted level of approximately \$192 billion at the year-end. An especially strong demand by corporate and other business borrowers paced the advance. Business loans surged an estimated 19 percent, compared with the increase of nearly 12 percent in 1964, and accounted for about 45 percent of the total dollar expansion in loans.

Business recourse to commercial bank credit expanded during 1965 as internally generated

funds became inadequate, in contrast to the experience of other recent years, to meet working capital and other requirements. Moreover, greater reliance upon bank credit was fostered by the continued attractiveness of loan rates in relation to comparable market rates for business borrowing.

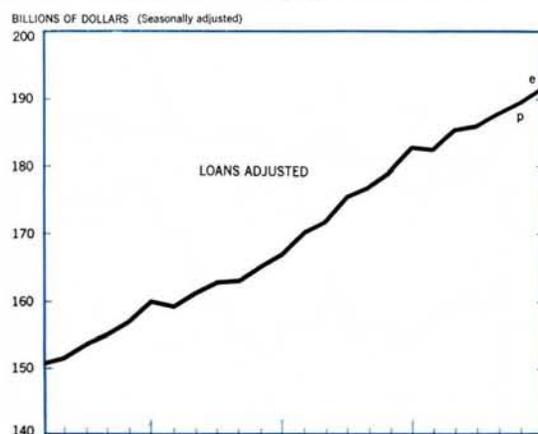
The advance in business loans was especially vigorous in the first half of the year, when borrowing from banks was stimulated by special factors associated with the dock strike, the threat of a strike in the steel industry, inventory building in the automobile industry, and anticipation of the extension of the interest equalization tax to bank loans made to foreigners. Although business loan expansion slowed during the second half of the year, partly as a result of the constraints of advanced loan ratios and reduced reserve availability, the July-December growth continued strong at about the year-earlier pace.

Consumer loans and real estate loans also contributed importantly to the advance in total loans last year. Consumer loans rose almost 15 percent, or at a substantially faster pace than in 1964. Consumers increased their borrowing at banks to finance purchases of durable goods — especially automobiles — and to provide for other personal outlays. Rapidly improving employment opportunities and high and rising levels of income enhanced both the willingness and the ability of consumers to add to their personal indebtedness. Real estate loans increased about 12 percent last year, or slightly more than in 1964.

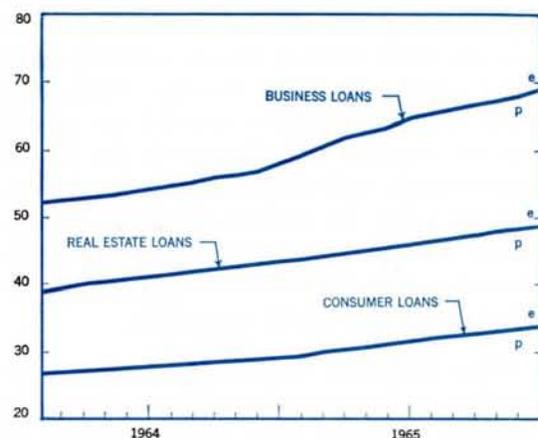
Last year, commercial banks reduced their holdings of U.S. Government securities by an estimated \$4.3 billion, or around 7 percent, and added to their investments in higher-earning non-Government securities — mainly state and local government and Federal agency issues — in the amount of about \$5.6 billion, or almost 15 percent. Although these changes represent a continuation of trends that began in 1962,

the adjustments in investment holdings last year were considerably sharper than those made in 1964. Bank sales and redemptions of Treasury issues were especially large during the first half of 1965, reflecting a rapidly expanding loan demand within a framework of a less expansive monetary policy. On the other hand, bank acquisitions of non-Government securities accelerated early in 1965 as time and savings deposits grew more rapidly.

Loans at the Nation's commercial banks continued to rise sharply in 1965 . . .



with business loans showing the greatest growth.



p — Preliminary.
e — Estimated.
SOURCES: Board of Governors, Federal Reserve System,
Federal Reserve Bank of Dallas.

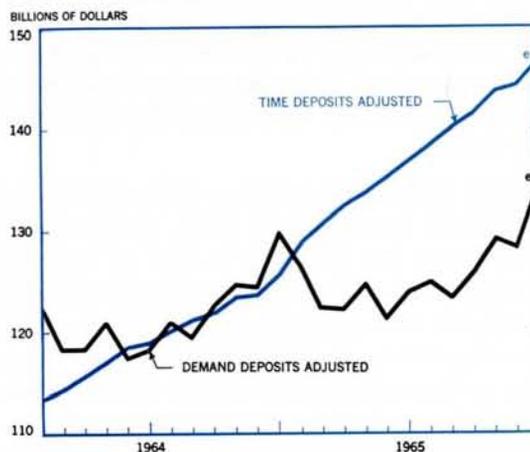
The liquidity positions of commercial banks receded further last year under the pressure of a mounting loan demand. By late summer, the loan-deposit ratio had increased 3.6 percentage points to a postwar high of 64.1. At the year-end, the ratio remained near this advanced level.

Commercial banks experienced an accelerated inflow of time and savings deposits during 1965. In December, these deposits (excluding interbank deposits) averaged, after seasonal adjustment, nearly 17 percent higher than a year earlier. In 1964, time deposits expanded 12.8 percent. The rapid inflow of time deposits last year was associated, in part, with the higher rates offered by banks after the permissive rate ceilings were raised, effective late in 1964, to 4 percent on all savings deposits and 4½ percent on time deposits held 90 days or more. Inflows in January and February were at near-record rates. Although a slackening occurred after this initial surge, banks continued to bid aggressively for and to attract these funds in subsequent months.

Reserve positions of member banks became less easy in 1965. During the first half of the year, reserve availability receded rather sharply under the influence of a strong loan demand and a less expansive monetary policy. The shrinkage in excess reserves and expansion in member bank borrowing at the Federal Reserve banks during January-June were reflected in average net borrowed reserves of \$185 million in June, in contrast to net free reserves of \$168 million in December 1964. Net borrowed reserves were slightly less deep during July-October. A sharp, further improvement in reserve availability occurred, especially during December, as System open market operations provided large amounts of reserves.

The Nation's money supply (demand deposits adjusted plus currency in the hands of the public) rose sharply in 1965, expanding almost 5 percent. The growth in the money supply last

Time deposits at all commercial banks in the United States maintained their rapid growth...



e - Estimated.
 SOURCES: Board of Governors, Federal Reserve System.
 Federal Reserve Bank of Dallas.

year exceeded the rate recorded for any other year since 1951. The expansion was especially rapid during the second half of 1965; during the July-December period, the money supply advanced almost 7 percent on an annual-rate basis, compared with an increase of 2.6 percent in the first half. Growth in the stock of money was also accompanied by a further rise in the rate of use of money, as indicated by the turnover of demand deposits at commercial banks.

Liquid assets held by the public continued to rise sharply during 1965, principally reflecting increases in the money supply and time deposits of commercial banks. In the first 9 months, liquid asset holdings advanced at an annual rate that was slightly higher than the pace of 7.1 percent recorded for all of 1964. The net inflow of funds to savings and loan associations during the first 10 months of 1965 totaled \$5.9 billion, or markedly less than the \$8.0 billion in the comparable 1964 period. Savings inflows to mutual savings banks also slowed and were \$2.7 billion in January-October, compared with \$3.3 billion during the first 10 months of 1964. The reduced rate of

net savings flows to savings and loan associations was associated, in part, with the fact that maximum interest rates paid by these institutions were not appreciably higher in 1965 than in the preceding 2 years. On the other hand, rates offered on time and savings deposits by commercial banks were higher last year than in 1964.

The volume of mortgage debt outstanding continued to expand in 1965, rising slightly more than \$30 billion to a level of approximately \$342 billion. On a seasonally adjusted basis, the rate of expansion through the third quarter of the year held at a level slightly below the peak reached in the second half of 1964, when the net increase in multifamily and commercial mortgage debt was at a high. With little or no upturn in residential construction during the year, the growth in debt on 1- to 4-family properties was virtually unchanged from the pace of the second quarter of 1964. Although mortgage funds were in relatively plentiful supply in 1965, a slightly firmer tone developed in mortgage markets, especially during the final months of the year. Acquisitions of mortgages by savings and loan associations continued to moderate in line with altered competitive and regulatory influences.

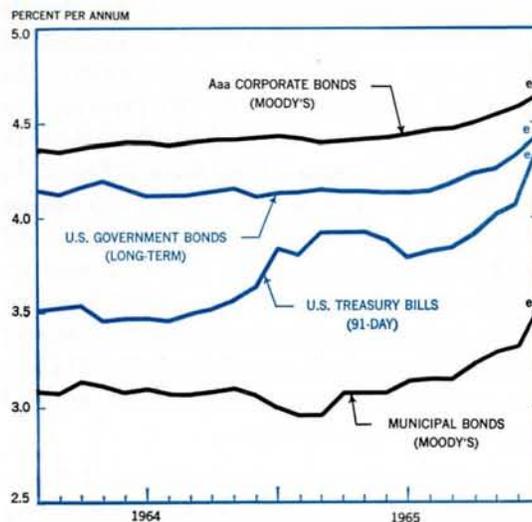
State and local governments borrowed a total of about \$10.4 billion of new funds in the capital market during 1965, or about \$200 million more than the advanced volume reported for 1964. As in past years, this debt financing primarily reflected outlays for educational facilities and public improvements, as well as less than adequate tax revenues. Commercial banks continued to be heavy purchasers of municipal obligations; however, they tended to moderate net additions to portfolios after midyear under the pressures of tightened liquidity positions and other demands for credit.

Corporate borrowing in the capital market increased substantially last year. New security offerings for cash totaled about \$15.2 billion,

up almost \$2.2 billion over the 1964 volume. Corporate debt financing expanded sharply — approximately 31 percent — as both public offerings and private placements rose. Stock issues reaching the market declined about 30 percent from the high level reported for 1964. Heavy corporate financing requirements in 1965 were related, in part, to the high and rising level of outlays for plant and equipment.

Net demands by the U.S. Treasury on credit markets were substantially lighter in 1965 than in the previous year. Unexpectedly large tax receipts and small cash payments in the first 6 months permitted both debt repayment and a large buildup in the Treasury's cash balance. Debt retirement was accomplished mainly by the repayment of maturing Tax Anticipation bills in March and June. In the second half of the year, the Treasury sold \$6.5 billion of tax bills in October and November to meet seasonal needs for cash. At the year-end, the marketable public debt was \$214.6 billion, reflecting an increase of \$2.1 billion over December 31, 1964.

After midyear, interest rates advanced appreciably . . .



e — Estimated.
 SOURCES: Board of Governors, Federal Reserve System.
 Federal Reserve Bank of Dallas.

In early January 1965, the Treasury again employed the advance refunding technique to achieve a more even distribution of the Federal debt and to lengthen its average maturity. Holders of eight outstanding issues of notes and bonds maturing from February 15, 1965, to November 15, 1967, were offered in exchange two issues of new bonds maturing in 1970 and 1974 and an additional amount of the 4¼-percent bonds maturing on August 15, 1992. Issues eligible for the exchange were outstanding in the amount of about \$33.1 billion, with public holdings totaling \$22.1 billion. Investors holding \$9.7 billion of the eligible issues elected to make the exchange. Other refunding operations during 1965 involved Treasury notes maturing on May 15, August 13, and November 15, which were refinanced by offerings of notes and bonds maturing in 15 months to 9 years.

Interest rates in money and capital markets rose appreciably during 1965. Although rates in some sectors of these markets began to firm in the first 6 months of the year, the increases accelerated in the second half and became general by early December. The upward movement in interest rates during the year was in response to a number of factors — including the broadly based and continuing expansion of the domestic economy, heavy borrowing demands from both the private and the public sectors, uncertainties associated with international developments, and official policy actions in the field of money and credit. At the year-end, most short- and long-term interest rates were close to the advanced levels reached in late 1959.

In the first 2 months of 1965, market rates on 3- and 6-month Treasury bills rose modestly — by 9 and 6 basis points, respectively; but by June, yields had receded to levels slightly below those prevailing in December 1964. In the case of Federal funds, however, the rate continued upward through May but receded slightly in June to a level that was 19 basis

points above the average for the last month of 1964. Most other money market rates climbed during the first quarter and generally held at these higher levels until early December. In the second half of the year, rates on Treasury bills and Federal funds rose, on balance, through November. Yields in that month averaged 4.08 percent for the 3-month bill, 4.24 percent for the 6-month bill, and 4.10 percent for Federal funds, with all being substantially above their December 1964 levels.

In capital markets, rates on corporate and municipal bonds began to rise in March; in November, yields on high-grade issues (Moody's Aaa bonds) reflected increases of 19 and 37 basis points, respectively, over the average levels prevailing during February. Yields on long-term Treasury bonds were virtually unchanged during January-July but advanced 19 basis points by November to 4.34 percent.

During December, interest rates in money and capital markets advanced sharply and generally, in response to the upward adjustment to 4½ percent in the discount rate of the Federal Reserve banks (effective on December 6 for two of the Reserve banks). Although reaction to the discount rate increase was immediate and sharp, the adjustments in prices and yields which occurred throughout the financial markets proceeded in an orderly manner.

By mid-December, yields on money market instruments reflected increases of ¼ to slightly more than ⅜ of a percentage point over the rates prevailing immediately before the increase in the discount rate. Market rates on Treasury issues maturing in 3 to 5 years advanced 29 basis points to 4.81 percent. In the capital markets, yields on high-grade corporate bonds advanced 11 basis points, while rates on long-term Government bonds and high-grade municipals gained 8 and 5 basis points, respectively. The prime rate charged by commercial banks to customers with the highest credit rating was

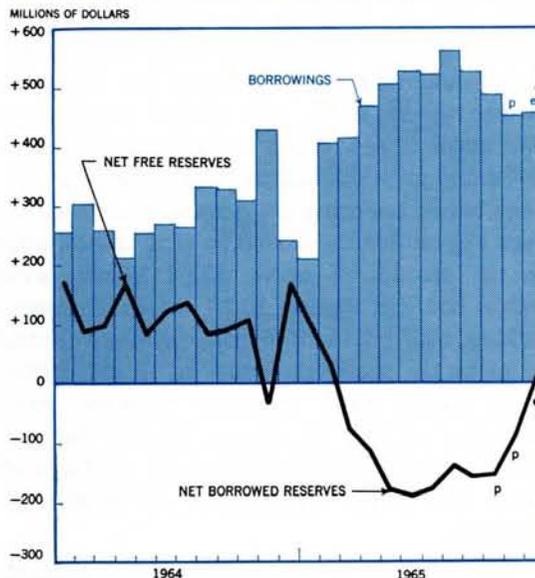
also advanced promptly by a number of banking institutions, with the rate rising from 4½ percent to 5 percent. Similar increases were announced subsequently by other major banks.

Federal Reserve operations during 1965 were conducted with a view to meeting the seasonal and sustainable growth requirements of the domestic economy, under conditions approaching full employment of human and physical resources, and to providing a monetary climate conducive to improvement in the Nation's persistently adverse balance-of-payments position. Although monetary policy became firmer after February and the discount rates of the Reserve banks were raised in December, the System was a net supplier of reserves in each quarter of the year. Reserves were supplied in amounts sufficient not only to offset the reserve-absorbing effects of a greatly enlarged outflow of monetary gold but also to support the bank credit and money requirements of an expanding economy.

Effective December 6, the Board of Governors of the Federal Reserve System announced that it had approved actions taken by the Federal Reserve Banks of New York and Chicago increasing the discount rates of those banks from 4 percent to 4½ percent. (Subsequently, the Board approved similar actions taken by each of the other Reserve banks.) Simultaneously, the Board increased, to 5½ percent, the maximum rates that member banks are permitted to pay their depositors on all time deposits, including certificates of deposit, having a maturity of 30 days or more. Previously, the maximum rates payable were 4 percent for time deposits and certificates with maturities of 30 to 89 days and 4½ percent for those having maturities of 90 days or more. No change was made in the maximum rate payable on savings deposits (4 percent).

In announcing its actions, the Board visualized that these steps should have the three-pronged impact of backing up the Govern-

Member bank borrowing at the Federal Reserve banks rose as pressures on reserve positions intensified . . .



p — Preliminary.
e — Estimated.
SOURCES: Board of Governors, Federal Reserve System,
Federal Reserve Bank of Dallas.

ment's efforts to prevent inflationary excesses from damaging an economy already carrying the added burden of military operations in Viet-Nam; bolstering the Government's programs to overcome persistent deficits in the U.S. balance of payments; and demonstrating anew the Nation's determination to maintain the international strength of the dollar.

balance of payments

The continuing adverse balance-of-payments position of the United States weighed heavily in the Nation's economic policy decisions in 1965. On February 10, the President of the United States announced a broad program of actions and proposed measures to improve the persistent deficits which have prevailed since 1958. The immediate objective and central focus of the President's program was to reduce net outflows of U.S. private capital from the extraordinarily high rates of 1964 to rates more in

line with previous experience and, in this way, bring about a substantial improvement in the Nation's payments position.

The program included a call on the Federal Reserve System—in cooperation with the Treasury—to work with all banks to limit lending to foreigners and a call on the U.S. Department of Commerce to work with corporations having business interests abroad to effectuate a reduction in their capital outflows. Other major features of the program included immediate action to impose the interest equalization tax on bank loans to foreigners (with maturities of 1 year or more); proposed legislation to continue the interest equalization tax through December 31, 1967, and to apply the tax, retroactive to February 10, 1965, to non-bank credits to foreigners (with maturities of 1 year or more); an intensified effort to reduce military expenditures abroad; continued action to minimize adverse balance-of-payments effects of foreign aid programs; and a more vigorous export promotion drive.

Under guidelines prepared by the Board of Governors to implement the President's Voluntary Foreign Credit Restraint Program, commercial banks were requested to limit the growth in their credits to foreigners during 1965 to 105 percent of the amount outstanding on December 31, 1964. It was visualized also that, within this limit, banks would give absolute priority to credits for financing exports from the United States. High but secondary priority was also recognized for nonexport loans to certain less-developed countries. Lenders were requested to avoid restrictive policies that would place an undue burden on Canada, Japan, and the United Kingdom. Similar guidelines were established for nonbank financial institutions.

Response to the credit restraint program was immediate and supported the more optimistic expectations. Largely as a result of this favorable response by U.S. banks and other lenders

and investors, there were net reflows from abroad, beginning in March and continuing through August, of both U.S. bank credits and liquid money market investments. In the first half of the year, the deficit on regular transactions was at a seasonally adjusted annual rate of \$1.3 billion, compared with a deficit of more than \$3 billion in each of the preceding 7 calendar years.

Although data with respect to the U.S. payments position are not available for all of 1965, the deficit on regular transactions may be about one-half as large as a year earlier. The substantial reduction in the deficit last year occurred, despite a narrowing in the trade surplus from the high level of 1964, mainly because of the improvement in capital outflow.

On December 6, the Board of Governors of the Federal Reserve System issued new guidelines for financial institutions to follow during 1966 in cooperating with the President's program to improve the Nation's balance of payments. Under the 1966 program, commercial banks are requested to restrain any expansion in foreign credits to such an extent that the amount outstanding does not exceed 109 percent of the amount outstanding on December 31, 1964. In order to spread throughout the year any outflow necessary to meet priority credit requirements, the Board has requested that the expansion be utilized at a rate of not more than 1 percent per calendar quarter. That is, the target is 106 percent of the 1964 base during the first quarter, 107 percent during the second quarter, 108 percent during the third quarter, and 109 percent for the remainder of the year. Special consideration for banks with small bases is expected to add about 1 percent to the total, bringing the possible expansion for 1966 for the banking system as a whole to about the same amount as that provided for 1965.

With respect to nonbank financial institutions, the 1966 guidelines have been made

broadly comparable with those for commercial banks. The priorities established by the 1965 guidelines remain in effect. The Department of Commerce has also issued new guidelines for U.S. commercial and industrial firms making direct investments abroad during 1966.

International financial developments during 1965 included a continued high level of cooperation among the central banks and treasuries of major industrial countries in matters of mutual interest. Currency swap agreements between the Federal Reserve System and foreign central banks — arrangements which have contributed significantly to international financial stability in recent years — were continued and refined. The United States, as the major reserve-currency country of the world, demonstrated its continued willingness last year to assist other important currency countries in countering speculative attacks or other seriously destabilizing movements affecting normal international financial transactions.

Developments in foreign exchange markets during 1965 were dominated, in the main, by speculative pressures focusing on the British pound. By mid-January, sterling began to show signs of recovery from the speculative onslaught of late 1964. In March, however, the market once again was beset by doubts as to whether the British Government's pledge to defend the sterling parity would be matched by effective measures. New complications arose as the U.S. Voluntary Foreign Credit Restraint Program led to some withdrawal of funds from London. New restraint measures contained in the Chancellor's budget message of April 6 and steps announced by the Bank of England, in late April and early May, to restrain bank credit expansion resulted in a strong upward movement in sterling; but publication of disappointing trade figures for April subjected the pound once again to downward pressures.

Against the background of market sentiment that a new sterling crisis would develop in the

autumn months, the British Government took further corrective action on July 27, announcing cutbacks and deferments in public spending programs and a further tightening of instalment credit. Favorable market reaction to these measures was quickly swamped, however, by the report, in early August, of larger than expected reserve losses; as a result, sterling was heavily offered in both spot and forward markets. On September 2, the British Government announced its intention to seek statutory authority to require notification and, if deemed appropriate, temporary deferment of wage and price increases. This basic policy went a long way toward relieving the market's apprehension regarding a progressive undermining of the sterling parity by wage and price inflation and tended to strengthen the pound.

On September 10, the Bank of England announced that new facilities for support of sterling had been provided by the U.S. monetary authorities, together with nearly all of the other central banks that had joined in the 1964 rescue operation. Immediately following this announcement, concerted market action was initiated, and the rate for spot sterling moved up. As short covering developed, further improvement in the rate occurred. These actions — coupled with earlier measures and improving market sentiment that the pound would be defended — imparted strength to sterling, which held during the remainder of the year.

district situation

The exuberance evident in the national economy in 1965 also was characteristic of economic developments in the southwestern states of Arizona, Louisiana, New Mexico, Oklahoma, and Texas. After reaching record levels in 1964, the broad indicators of economic activity in the Southwest in 1965 advanced significantly further. The region's factories, mines, oil fields, and farms all experienced production gains. Nonagricultural employment rose from the advanced 1964 level, farm and nonfarm incomes

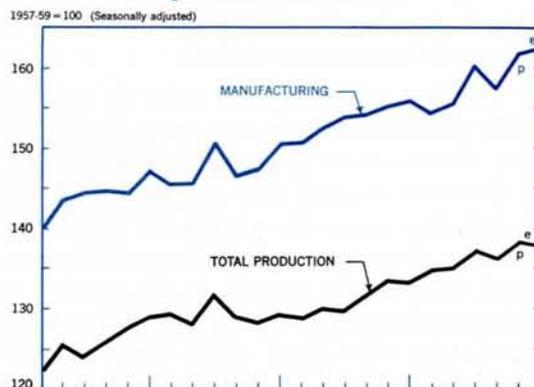
both increased, and consumer purchases rose sharply. The strength in southwestern economic sectors extended into the banking and financial area, as bank credit demands increased vigorously.

A feature of industrial activity in the Southwest last year was the continuation of a rather broadly based increase in the physical volume of output. Overall industrial production, as reflected in data for Texas, showed a gain of about 5 percent, a little less than the advance of almost 7 percent in the State in 1964. Output in each of the three broad categories — durable manufactures, nondurable manufactures, and mining — rose over the 1964 levels. Among the 21 industrial subcategories, only the petroleum refining and metal, stone, and earth minerals groups failed to exceed their 1964 production levels.

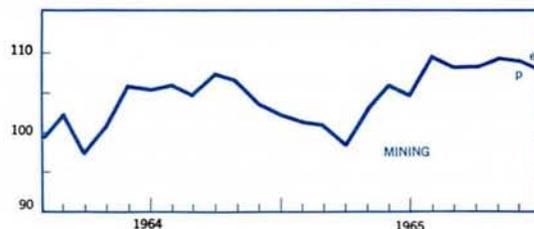
The major impetus to the expanding southwestern output of goods stemmed from increased activity in the manufacturing sector, since mining production advanced only slightly. As was the case in 1964, the most vigorous gains in manufacturing output last year were centered in durable goods manufacturing. Output of durables rose about 9 percent, a rate somewhat smaller than the nearly 12-percent rise in 1964. Industries producing machinery (particularly electrical components), primary metals, fabricated metal products, and transportation equipment experienced the largest relative gains in output last year. These same industries also had registered the strongest relative increases in 1964.

The production of nondurable goods by southwestern manufacturers in 1965 increased almost 6 percent, a rate likewise below the year-earlier gain (7 percent). As in the previous year, the 1965 increase in nondurable goods output was paced by increased production from the Southwest's growing textile and apparel industries and by further expansion in the manufacture of chemicals and allied prod-

Manufacturing continued to pace the rise in industrial production in Texas . . .

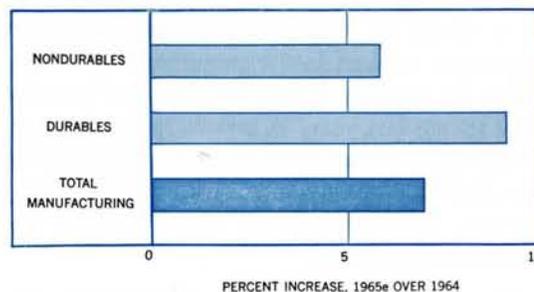


as the advance in mining output remained relatively modest.



p — Preliminary.
e — Estimated.

In manufacturing, production of durable goods showed the greatest expansion . . .



e — Partly estimated.

ucts. Moderating the growth in nondurable goods manufacturing in 1965 was the slight decline in output of refined petroleum products. Refining activity through August of last year remained below the levels in the comparable months in 1964 as refiners drew on stocks to

meet increasing consumption. In the fall of 1965, however, refining activity began to pick up in response to the rising needs for fuel oil in eastern and midwestern markets.

Somewhat paralleling the trend in refining, crude petroleum output was weak during the early months of the year but began to increase in mid-1965 to push total production for the year slightly above the year-earlier level. The weakness in southwestern drilling activity persisted, and, for the year, both the number of well completions and the footage drilled were below their 1964 totals. Gains in the production of both natural gas and natural gas liquids were major contributors to the rise in overall mining output last year. The use of these two products in space heating and other energy markets has continued to expand.

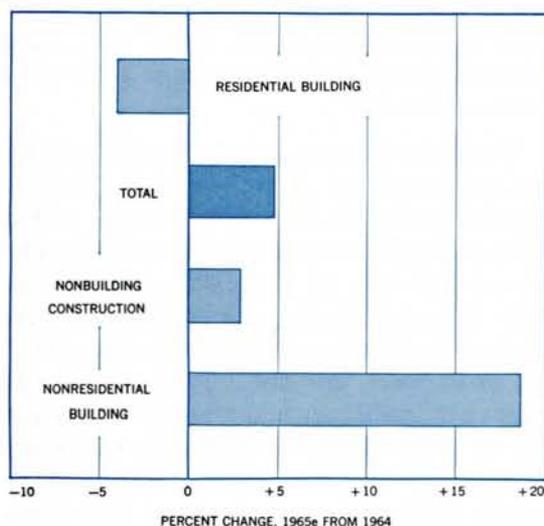
Although the number of southwesterners entering the labor market in 1965 rose significantly, job openings increased at a faster rate, and the number of unemployed workers and the unemployment rate declined. Nonagricultural employment rose about 3.8 percent as hirings in both the manufacturing and the nonmanufacturing sectors increased over their 1964 levels. On the other hand, the work force in agriculture continued its longtime downtrend as a result of mechanization and improved output per worker. In the manufacturing sector, hiring by durable goods makers was particularly strong last year; in nonmanufacturing, all of the categories of employment contributed to the year-to-year advance, with construction, services, government, and trade showing the largest relative gains.

The improvement in the Southwest's job picture and the concomitant reduction in unemployment have resulted in a tightening labor situation for skilled and experienced workers. The unemployment rate in the Southwest each month last year remained below the rate for the comparable month in 1964. The unemployment rate in the five southwestern states aver-

aged a little under 4.0 percent in 1965, compared with 4.4 percent in the previous year. In a few of the major southwestern metropolitan labor markets, the unemployment rate dipped to less than 3 percent of the civilian labor force in the latter months of 1965.

The stronger employment picture, together with the increasing level of output, resulted in a stretch-out in the length of the workweek, especially in manufacturing. In addition, average weekly earnings were higher in most major employment categories.

Residential building remained weak in the five southwestern states in 1965 . . .



• — Partly estimated.
 SOURCES: F. W. Dodge Corporation,
 Federal Reserve Bank of Dallas.

Construction activity in the five southwestern states reached a record during 1965, with the value of construction contracts totaling approximately \$5.3 billion — an amount exceeding the previous year's contracts by almost 5 percent. Despite the overall rise in the value of contracts, the performance of the various types of construction showed considerable differences. The downtrend in residential building that began in the latter part of 1964 continued last year, marking two successive years of decline.

The weakness in the residential sector remained largely centered in apartment construction. Contracts for single-family residences were well maintained, partly because of the higher average value for each unit.

The stellar performer last year was nonresidential building. Contracts for office buildings, educational structures, recreational facilities, and various kinds of commercial and industrial buildings were let at a brisk pace in 1965; as a result, the estimated total value of contracts for these types of structures was lifted nearly 19 percent over the 1964 total. This expansion reflects not only the continuing growth in the economy of the Southwest but also the participation of the region in the sharp upswing in capital spending that is under way in the Nation.

Nonbuilding construction (engineering and public works) also increased over the high 1964 level. The further expansion of sewerage and waterworks systems and public utilities facilities contributed to the climb. Contracts for additional segments of the interstate highway network and for urban streets also provided major support to nonbuilding construction.

Along with the other broad sectors, agriculture contributed strongly to the rise in southwestern economic activity. Crop and livestock production increased about one-tenth last year — the largest gain experienced in several years. Coupled with this larger output was a stronger price situation, especially for livestock; and overall prices received by southwestern farmers and ranchers averaged above those in 1964. As a consequence, gross income from marketings and Government payments advanced. Net farm income also increased last year, as production expenses rose only modestly.

In 1965, more southwesterners were working than ever before and receiving higher average pay, and the flow of personal income advanced

over 1964. This higher income, together with lower Federal income tax rates and the mid-1965 reduction in some excise taxes, provided the basis for a step-up in consumer purchasing. The southwesterner was an eager buyer, indeed, in 1965, and retail sales are estimated to have risen perhaps 9 percent over the high 1964 total.

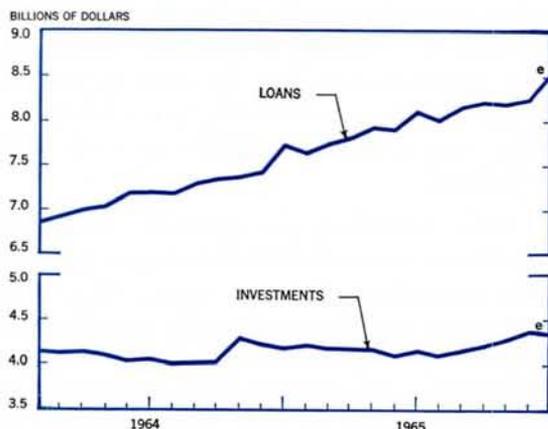
When individuals are optimistic concerning the future course of economic events and find their discretionary incomes higher, they often boost their purchases of durables. Automobiles, in particular, continued to capture the fancy of the buying public in 1965. Total registrations of new automobiles in four major markets in Texas — Dallas, Fort Worth, Houston, and San Antonio — last year rose about 12 percent above the previous record set in 1964. Although durable goods sales were the pacesetters, purchases of nondurable goods also increased.

Banking developments in the Southwest last year reflected many of the same influences at work nationally. Loans at all member banks in the Eleventh District at year-end, amounting to an estimated \$8.6 billion, advanced more than 10 percent over the high level a year earlier. The strength in loan demand was rather general among all the major categories of loans. In relative terms, real estate loans — a category which also turned in a strong performance during the previous year — showed the greatest expansion in 1965. Consumer-type loans rose modestly, but the gain failed to match the exceptional advance in 1964. Of all the loan categories, commercial and industrial loans, which account for almost one-half of total bank loans outstanding in the District, registered the largest dollar advance last year and increased considerably more than in 1964.

Member banks continued to rely heavily upon time and savings deposits to acquire earning assets, as demand deposits showed little growth. The inflow of time and savings deposits increased at a more rapid rate last year than in

MEMBER BANK LOANS AND INVESTMENTS

ELEVENTH FEDERAL RESERVE DISTRICT



e - Estimated.

1964, since banks sought to attract these deposits with new savings plans of various kinds tailored to fit the needs of savers. The supply of loanable funds did not advance rapidly enough, however, to prevent a further decline in bank liquidity. The loan-deposit ratio at District member banks rose from 55.4 at the end of 1964 to perhaps 57.5 at the end of last year. Loan-deposit ratios at both reserve city and country banks increased.

Investment decisions at member banks in 1965 were influenced by the desire to meet rising loan demands; realize higher earnings in order to offset rising costs, including interest payments on time and savings deposits; and provide secondary reserves and the collateral

needed for certain types of deposit accounts. Total investments expanded slightly last year. As in 1964, however, member banks reduced their holdings of U.S. Government securities and increased their acquisitions of non-Government obligations.

Participation of District banks in the Federal funds market increased further last year, with both purchases and sales of Federal funds rising over their 1964 totals. Although the differential between purchases and sales narrowed last year, Federal funds purchases exceeded sales by a substantial margin. Eleventh District member banks continued to utilize Reserve bank credit in 1965, but daily average borrowings for the year were little changed from the 1964 level.

Bank issuance of negotiable time certificates of deposit continued to grow in importance in 1965. Although somewhat below the level reached last summer, the amount of time certificates of deposit outstanding, in denominations of \$100,000 or more, at weekly reporting member banks in the District totaled \$979.3 million in mid-December 1965. This total is about 4 percent above the year-end 1964 figure. Survey data on the maturity distribution of CD's show that, last November, 63.4 percent of the dollar volume of outstanding CD's had maturities of 3 months or less, compared with 55.1 percent 9 months earlier. However, the proportion maturing within 6 months was smaller than in early 1965.

