FIFTY-THIRD

Annual Report

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1966

Digest of Principal Federal Reserve Policy Actions in 1966

Period	*Action*	*Purpose*
January	Reduced System holdings of U.S. Government securities, on balance, by about \$650 million. Member bank borrowings averaged about \$400 million.	To continue to moderate money and credit market adjustments to the December 1965 discount rate increase early in the month, and then to offset seasonal reflow of funds and maintain about the same money market conditions that had prevailed in early January.
February–early June	Limited the increase in System holdings of U.S. Government securities to about \$1.5 billion. Average member bank borrowings rose to nearly \$600 million.	To effect gradual reduction in net reserve availability and thereby to restrain the growth in the reserve base, bank credit, and the money supply.
June	Raised from 4 to 5 per cent the reserve requirements against time deposits, other than savings deposits, in excess of \$5 million at each member bank, effective July 14 and 21 for reserve city and country member banks, respectively, thereby increasing required reserves by about \$420 million.	To exercise a tempering influence on the issuance of time certificates of deposit by larger banks and to apply some additional restraint on the expansion of banks' loanable funds, thus reinforcing the operations of other instruments of monetary policy in containing inflationary pressures.
	Made shorter-term bank promissory notes and similar instruments issued after June 26, 1966, subject to regulations governing reserve requirements and payment of interest on deposits, effective September 1, 1966.	To prevent future use of these relatively new instruments as a means of circumventing statutory and regulatory requirements applicable to bank deposits.

DIGEST OF PRINCIPAL FEDERAL RESERVE POLICY ACTIONS IN 1966—Continued

Period	*Action*	*Purpose*
Early June–September	Limited the increase in System holdings of U.S. Government securities to about $800 million. Average member bank borrowings rose to $750 million.	To continue to restrain bank credit expansion while maintaining about the same state of net reserve availability and/or money market conditions and taking account, at various times, of scheduled financings by the Treasury, any unusual liquidity pressures, and any significant deviations of required reserves or bank credit from current expectations.
July	Lowered from 5½ to 5 per cent the maximum rate payable by member banks on new multiple-maturity time deposits of 90 days or more, and from 5½ to 4 per cent the maximum rate payable on such deposits with maturities of less than 90 days.	To help forestall excessive interest rate competition among financial institutions for consumer-type time deposits.
	Granted temporary authority to the Federal Reserve Banks to provide emergency credit facilities, under certain conditions, to nonmember depositary-type institutions, including mutual savings banks and savings and loan associations. No lending was necessary under this authority.	To assure that funds could be provided to assist in meeting unusual withdrawals that might develop at nonmember depositary institutions and to safeguard against the possibility of additional pressures on mortgage and securities markets resulting from such exceptional withdrawals.
August	Raised reserve requirements from 5 to 6 per cent against time deposits, other than savings deposits, in excess of $5 million at each member bank, effective September 8 and 15 for reserve city and country banks, respectively, thereby increasing required reserves by about $450 million.	To exert a tempering influence on the issuance of certificates of deposit by the larger banks and to apply some additional restraint upon the expansion of bank credit to businesses and other borrowers.
September	Requested member banks to moderate their rate of expansion of loans, particularly business loans; indicated that bank use of Reserve Bank discount facilities would be expected to be in a manner consistent with this objective; and noted the continuing availability of discount facilities to cushion deposit shrinkages.	To moderate excessive expansion of business loans at banks and at the same time to avoid additional pressure on financial markets resulting from further substantial liquidation by banks of municipal securities and other investments to obtain loanable funds; also to reaffirm availability of Federal Reserve credit assistance in case of deposit shrinkages.
	In exercise of authority given by new temporary legislation, reduced from 5½ to 5 per cent the maximum interest rate payable on any time deposit under $100,000, other than savings deposits, effective September 26.	To limit further escalation of interest rates paid in competition for consumer savings, and to help keep the growth of commercial bank credit to a moderate pace.
October–late November	Increased System holdings of U.S Government securities by nearly $500 million. Average member bank borrowings declined to $680 million.	To permit somewhat less firm conditions in the money market in view of the recent lack of growth in bank credit.
Late November–December	Increased System holdings of U.S. Government securities by about $970 million, including about $660 million in repurchase agreements. Average member bank borrowings declined to $550 million.	To relax monetary restraint somewhat in the light of both the outlook for slower economic growth and persisting lack of expansion in bank credit.
December	Issued new 1967 guidelines for banks and other financial institutions as part of broader governmental program of voluntary foreign credit restraint.	To continue, and in some respects to intensify, the voluntary effort to restrain the outflow of private capital.
	Terminated special discount arrangements announced on September 1 when member banks were asked to curtail their business loan expansion.	To eliminate discount arrangements that were no longer needed, since expansion in business loans had been reduced to a moderate rate and banks were no longer unloading securities in unreceptive markets to obtain loanable funds.

The following current economic policy directive was issued to the Federal Reserve Bank of New York:

The economic and financial developments reviewed at this meeting indicate that the domestic economy is expanding vigorously, with prices continuing to creep up and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist the emergence of inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by moderating the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee, with appropriate regard for the current Treasury financing, shall be conducted with a view toward a gradual reduction in reserve availability.

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

March 1, 1966

1. Authority to effect transactions in System Account.

Estimates of the pace of the business expansion had been scaled upward recently, according to reports at this meeting, and activity was now expected to increase more in 1966 than had appeared likely a few weeks earlier. Revised data indicated that GNP had advanced at a $16 billion annual rate in the fourth quarter of 1965—compared with the $12 billion average rate of the two preceding quarters—and recent developments suggested that it was continuing to rise at about the same rate in the current quarter.

Pressures on manpower and industrial resources were increasing as enlarged defense expenditures were superimposed on high and rising private demands. From October through January nonfarm employment grew at an annual rate of 7 per cent, and

with tightening labor markets, wages were advancing somewhat more rapidly than earlier in many industries. Industrial production rose sharply further in January, and the rate of capacity utilization in manufacturing edged up again. Retail sales, which had increased more in late 1965 than previously estimated, declined slightly in January but appeared to be rising again in early February.

Only a slight acceleration in the rate of advance in industrial commodity prices was indicated by data for January and preliminary estimates for February. It seemed likely, however, that the continued rapid expansion of demands expected in coming months and the associated pressures on resources would be conducive to somewhat larger and more widespread price increases.

The pace of bank credit expansion was considerably reduced in late January and early February, according to data for city banks. Growth of business loans moderated from the earlier high rate but remained fairly rapid. Growth in time and savings deposits at commercial banks slackened further to a rate less than half that of the fourth quarter, with the slowdown concentrated at city banks. The money supply, which reached a peak in early January and declined substantially later in that month, was estimated to have changed little in February.

Unusually large demands were being made on capital markets. The volume of new corporate and municipal bond issues in January and February, and the calendar of prospective offerings for March, suggested that the combined total of offerings in the first quarter would be greater than in any prior quarter. In addition, a sizable volume of Government agency issues was being sold. Against a background of inflationary expectations associated with the vigorous economic expansion and of continuing market discussions of a possibly firmer monetary policy, investor response to the offerings was cautious and interest rates on long-term corporate, municipal, and Treasury issues rose sharply further. Yields on some maturities of Treasury bonds were now at the highest levels in more than 40 years. Average prices of common stocks reached a new peak in early February but subsequently declined in active trading.

Recent open market operations were directed at restraining net reserve availability, and conditions in money markets were firm. Since the preceding meeting of the Committee, yields on 3-month Treasury bills advanced by about 5 basis points on balance, to around 4.65 per cent; rates offered by large banks on negotiable CD's edged higher; and the effective rate on Federal funds was usually above the discount rate. For February as a whole, member bank borrowings rose somewhat, to about $470 million from $430 million in January, and net borrowed reserves averaged about $110 million compared with a revised figure of $50 million for January. Growth rates of total and nonborrowed reserves declined substantially.

Partial data on the U.S. balance of payments for early 1966 suggested a continued deficit on the "liquidity" basis of calculation, after allowance for seasonal influences. U.S. banks reduced the volume of their credits to foreigners more than seasonally in January, partly as a result of the pressures of domestic credit demands. On the other hand, the surplus on U.S. merchandise trade was reduced; in January, as well as in December, exports were lower than the October–November average, and imports were higher.

The Committee agreed that, in the light of existing and prospective inflationary pressures, it should continue to pursue the policy initiated at the preceding meeting of moving gradually to reduce net reserve availability with a view to limiting growth of bank reserves, bank credit, and the money supply to moderate rates. A number of reasons were advanced for proceeding cautiously in reducing net reserve availability. These included the existing strains in financial markets and the seasonal pressures expected around the March tax and dividend dates; the need for more time to determine the effects of recent System policy actions on the growth trends of bank credit and the money supply; and the desirability of avoiding further rises in market interest rates

to levels that would require consideration of another increase in the discount rate. Several members expressed the hope that Federal fiscal policy would soon assume an increased share of the burden of curbing excessive increases in aggregate demands, and some mentioned that possibility as a further reason for moving slowly in firming monetary policy.

The following current economic policy directive was issued to the Federal Reserve Bank of New York:

The economic and financial developments reviewed at this meeting indicate that the domestic economy is expanding vigorously, with prices continuing to creep up and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by moderating the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining some further gradual reduction in reserve availability.

Votes for this action: Messrs. Martin, Hayes, Bopp, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

2. Amendment of continuing authority directive.

Section 1(a) of the continuing authority directive to the Federal Reserve Bank of New York regarding domestic open market operations was amended to reduce from $2 billion to $1.5 billion the limit on changes in holdings of U.S. Government securities in the System Open Market Account between meetings of the Committee. With this amendment, Section 1(a) read as follows:

To buy or sell U.S. Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $1.5 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting.

Except for the change resulting from this amendment, the directive was renewed in its existing form, as set forth in the preface to this record of Federal Open Market Committee policy actions for 1966.

Votes for this action: Messrs. Martin, Hayes, Bopp, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

The limit in question had been increased from $1.5 billion to $2 billion in early December, when the Manager of the System Open Market Account reported that transactions in excess of the prior limit might conceivably be necessary to carry out the intent of the current economic policy directive then in effect. It was reduced at this meeting on recommendation of the Manager, who indicated that the circumstances calling for the higher limit seemed to have passed.

3. Review of continuing authorizations.

This being the first meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1966, and their assumption of duties, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. The action taken with respect to the continuing authority directive for domestic open market operations has been described in the preceding portion of the entry for this date.

The Committee reaffirmed its authorization regarding open

market transactions in foreign currencies, its guidelines for System foreign currency operations, and its continuing authority directive on foreign currency operations, in the forms in which all three were outstanding at the beginning of the year 1966, as set forth in the preface to this record of policy actions.

Votes for these actions: Messrs. Martin, Hayes, Bopp, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against these actions: None.

March 22, 1966

Authority to effect transactions in System Account.

Economic activity was still advancing rapidly, and pressures on available resources were growing. Although business inventory accumulation tentatively was estimated to have slowed somewhat in the first quarter of 1966 from the high fourth-quarter rate, final demands appeared to be rising more rapidly.

Federal defense purchases were undergoing a particularly large increase in the first quarter. Consumer spending also appeared to be running well above the fourth quarter; January retail sales figures, originally estimated to show a slight decline, were being revised upward substantially, and estimates for February indicated that sales were maintaining an advanced pace. Businesses planned to increase their spending on plant and equipment throughout 1966, according to a Commerce Department–Securities and Exchange Commission survey taken in February. For the year as a whole, planned capital expenditures were reported to be about 16 per cent larger than the high outlays of 1965.

With industrial production recording another sizable increase in February, capacity utilization rates in manufacturing again edged up, and the average workweek lengthened to a new postwar record. Nonfarm employment increased substantially further,