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.

of open market operations to the trends in aggregate reserves, with somewhat tauter reserve conditions permitted if the aggregates rose sharply. However, it was felt that at this juncture reserve pressures should not be intensified to the point at which rising market rates would call into question the viability of the current discount rate and the maximum rates permitted to be paid by member banks on time and savings deposits. At the same time it was agreed that the forthcoming Treasury financing should be taken into account although, because of the moderate size and probable routine nature of the financing, it was expected that the requirements for maintaining an "even keel" in the money market would be less than usually was the case during Treasury operations.

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 industrial 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 restricting 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, while taking into account the forthcoming Treasury financing.

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

2. Authority to purchase and sell foreign currencies.

The Committee amended the third paragraph of its continuing authority directive for System foreign currency operations to increase, from $100 million to $200 million, the dollar limit

on spot purchases and concurrent forward sales to the U.S. Stabilization Fund of currencies in which the U.S. Treasury had outstanding indebtedness. With this amendment, the paragraph read as follows:

The Federal Reserve Bank of New York is also authorized and directed to make purchases through spot transactions, including purchases from the U.S. Stabilization Fund, and concurrent sales through forward transactions to the U.S. Stabilization Fund, of any of the foregoing currencies in which the U.S. Treasury has outstanding indebtedness, in accordance with the Guidelines and up to a total of $200 million equivalent. Purchases may be at rates above par, and both purchases and sales are to be made at the same rates.

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

Transactions of the kind authorized by this paragraph, which involved no risk of loss, were for the purpose of facilitating payment by the Treasury of maturing bonds denominated in foreign currencies. The amendment was approved after the Special Manager of the System Open Market Account reported that a larger sum than previously authorized probably could be usefully devoted to this purpose at present.

May 10, 1966

Authority to effect transactions in System Account.

Economic activity continued to expand in April, following a first quarter in which personal consumption expenditures, business fixed investment, and Federal outlays all increased substantially. For the first quarter, GNP was officially estimated to have been at a seasonally adjusted annual rate $17 billion higher than in the fourth quarter of 1965. This was the largest quarterly rise since the Korean war. About one-third of the advance reflected price increases, but growth in real output was large considering the high rate of plant utilization and the reduced supply of available labor. Some developments in April and early May, including declines in sales of new automobiles and in prices of common stocks, suggested that the economy was somewhat less ebullient than earlier. The over-all outlook, however, was for further substantial expansion and upward pressures on prices.

In April, retail sales weakened somewhat, primarily because purchases of new domestic automobiles declined by about 15 per cent from the advanced first-quarter rate. Nonfarm employment, which was affected by strikes, was unchanged for the month, but the unemployment rate edged down to the February level of 3.7 per cent from 3.8 per cent in March. Incomplete figures suggested that industrial production had increased in April, but by less than in other recent months. Wholesale prices of foodstuffs declined appreciably further, but prices of industrial commodities continued to advance at the accelerated first-quarter rate.

Growth in consumption expenditures seemed likely to moderate in the current quarter from the rapid first-quarter pace, but further substantial advances in Federal outlays and in business capital spending appeared to be in process. In connection with the latter, a private survey taken in March found that business concerns planned to spend 19 per cent more on plant and equipment in 1966 as a whole than in 1965. First-quarter developments were more nearly in line with this finding than with the 16 per cent planned increase reported in the Commerce–SEC survey a month earlier.

Commercial bank credit expanded substantially further in April, at a rate about the same as in March and almost half again faster than in the first quarter as a whole. Growth in business loans was moderate relative to the first-quarter rate, but bank holdings of securities increased markedly as corporations sold securities to help finance Federal tax payments.

Expansion in the money supply, which had been rapid in March, accelerated in April to an annual rate of 13.5 per cent, compared with about 4.5 per cent in the first quarter. Growth in time and saving deposits also accelerated, to more than twice the 7 per cent rate of the first quarter. Earlier in the year inflows of savings funds to commercial banks—as well as to savings and loan associations and mutual savings banks—had been sharply reduced as investors, attracted by rising interest rates on market securities, acquired such instruments in a volume unprecedented in the postwar period. Inflows to commercial banks recovered in late March and April, however, after many banks increased rates paid on time deposits (other than passbook savings) following the rise in their prime lending rates. Partial data suggested that nonbank intermediaries experienced larger than seasonal withdrawals of funds in April.

Despite the reduction of savings flows to depositary-type institutions in the first quarter, total mortgage debt outstanding grew more than in any prior first quarter. Savings and loan associations and mutual savings banks reduced their mortgage acquisitions moderately, but the Federal National Mortgage Association greatly increased its net purchases and banks and other lenders generally maintained their earlier rates of acquisition. Recently, savings and loan associations and mutual savings banks reportedly had become more restrictive in their lending policies, and a future slackening in the rate of growth of mortgage debt appeared probable as outstanding commitments were worked down. In March, yields on mortgages on new homes reached their highest levels in 5 years.

In security markets, average prices of common stocks edged down in late April and then fell more sharply in early May. Yields on new corporate bonds and on State and local government securities had risen since the preceding meeting of the Committee; new issues were marketed in sizable volume in April, and many market participants apparently concluded that prospects for a tax increase were diminished and that those for further firming of monetary policy were enhanced. Treasury note and bond yields also advanced over most of the period, but they subsequently declined again as common stock prices fell and automobile production cutbacks were announced. The 3-month Treasury bill rate was little changed over the interval, closing at 4.61 per cent on the day before this meeting, but yields on a variety of other short-term instruments moved higher. Late in the period Federal funds traded at 5 per cent for the first time, and a few transactions were reported at 5⅛ per cent.

The Treasury's mid-May refunding, involving a new 18-month 4⅞ per cent note priced to yield 4.98 per cent, was accorded a relatively poor reception; of the $2.5 billion of maturing issues held by the public, 43 per cent were redeemed for cash. This refunding reportedly completed the Treasury's financing activity for the current fiscal year. However, large offerings by Federal agencies were scheduled before the end of June, and these were likely to add considerably to pressures in financial markets.

System open market operations since the Commitee's preceding meeting had been aimed at reducing net reserve availability further, while taking due account of the Treasury refunding operation. Net borrowed reserves in April averaged around $275 million, compared with $210 million in March; and average borrowings increased to about $640 million from $545 million. Yet nonborrowed reserves rose at the rapid annual rate of about 13 per cent in April as the System supplied most of the reserves to accommodate the sharp rise in deposits.

The first-quarter deficit in the U.S. balance of payments was estimated at about a $2 billion annual rate on the "liquidity" basis of calculation, after seasonal adjustment. This was somewhat above the rate in the second half of 1965 and higher than had been expected. The surplus on merchandise trade was reduced as imports rose faster than exports, and although there were further reflows of bank credit, the outflow of U.S. capital into new foreign security issues increased.

It was the consensus of the Committee that recent growth rates

in bank reserves, bank credit, and the money supply were excessive, particularly in the light of prevailing inflationary pressures. While it was noted that April banking developments reflected a number of special factors and were not necessarily indicative of underlying trends, the members agreed that both domestic and balance of payments considerations called for further monetary restraint.

There were differences in view, however, with respect to the manner in which such a policy decision should be implemented. Some members indicated that they would be prepared to accept a relatively large reduction in net reserve availability in the period before the next meeting if that should prove necessary to restrict growth in bank reserves. Other members, noting the stresses evident in various financial markets and the risks of precipitating undesirably large market adjustments, favored a more cautious approach toward reducing net reserve availability. No members recommended increases in the discount rate or in ceiling rates on time and savings deposits at present, although some noted that conditions might develop that would require consideration of an increase in the discount rate.

The Committee concluded that net reserve availability should be reduced gradually further and that the reduction should be greater if growth in required reserves failed to moderate substantially. 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 industrial prices continuing to rise 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 strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.
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> To implement this policy, while taking into account the current Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining some further

gradual reduction in net reserve availability, and a greater reduction if growth in required reserves does not moderate substantially.

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

June 7, 1966

1. Authority to effect transactions in System Account.

Reports at this meeting indicated that the pace of economic expansion had slowed thus far in the second quarter, mainly because of a sharp decline in sales of new automobiles, but that activity was likely to accelerate again in the third quarter. Experienced labor continued in short supply, although employment rose in May among teenagers and other new entrants to the labor force and the over-all unemployment rate increased to 4.0 per cent from 3.7 per cent in April.

Prices of industrial commodities, which rose on average at an annual rate of about 3.5 per cent in the first 4 months of the year, apparently advanced in May also and were expected to remain under upward pressure. Consumer prices increased further in April to a level 2.9 per cent above a year earlier.

Total retail sales declined again in May, according to preliminary indications, as a result of a further reduction in new-automobile sales. Consumer spending of other types remained strong, however, and renewed strength in demand for autos over coming months was suggested by results of a buying intentions survey conducted by the Census Bureau in mid-April. Also, consumer spending was expected to be stimulated after midyear by inauguration of payments under the medicare program and by pay increases now under consideration in Congress for Federal military and civilian employees.

Both defense expenditures and business capital outlays continued to be strong expansive forces. While the rate of defense spending after midyear was uncertain, available information on new defense orders and on order backlogs through April suggested a further substantial rise in the third quarter. Additional indications that business capital outlays would continue to expand sharply throughout 1966 were contained in a Commerce–SEC survey of spending plans taken in May. For the year as a whole, the survey showed a rise in capital spending of 17 per cent over 1965, compared with 16 per cent shown by the corresponding February survey. An 18 per cent increase was found in a May "recheck" of results of a private survey that had yielded a 19 per cent figure in a March canvass.

Residential construction activity, on the other hand, appeared likely to decline in coming months. Mortgage market conditions continued to tighten through April as many lenders cut back new commitments because of reduced net inflows of savings funds, concern about possible outflows after the midyear interest-crediting date, and uncertainties about prospective market conditions and other factors. The cutbacks, which reportedly were particularly large at savings and loan associations and mutual savings banks, were not as yet fully reflected in current mortgage lending, much of which was based on takedowns of earlier commitments.

Growth in time and savings deposits at commercial banks moderated somewhat in May. The money supply declined sharply following rapid gains in March and April, and bank credit expanded at a rate only half that of the two preceding months. Banks liquidated a substantial volume of Treasury securities but increased by nearly the same amount their holdings of other securities, including Federal agency issues. Business loan demand was strong and was expected to continue so in coming weeks, partly because of large tax payments by corporations.

Interest rates on most types of market securities had increased since the preceding meeting of the Committee as a result of heavy demands for funds. Treasury, corporate, and municipal bond yields all advanced, with yields on new corporate issues