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.

covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

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

Section 6 of Public Law 89-597, enacted in late September, amended Section 14(b) of the Federal Reserve Act to authorize the Reserve Banks "To buy and sell in the open market, under the direction and regulations of the Federal Open Market Committee, any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States." The amendment of the continuing authority directive was made pursuant to that legislation, after the Account Manager indicated that he would consider repurchase agreements in agency issues to be a useful addition to the tools presently available for reserve management. It was agreed to postpone a decision regarding authorization of outright transactions in agency issues pending further study of their potential value in implementing monetary policy objectives.

November 22, 1966

1. Authority to effect transactions in System Account.

Evidences of moderating tendencies in the pace of business expansion were increasing. The Commerce Department had reduced its estimate of GNP for the third quarter and now indicated an increase only about $1 billion larger than that for the second quarter. Staff projections of fourth-quarter growth in GNP also had been lowered somewhat, primarily because of a downward revision in the estimate for consumer expenditures. Substantial gains in defense spending and business fixed investment were still projected for the fourth quarter.

Industrial production rose relatively little in October after

remaining stable in September, and with manufacturing capacity continuing to expand, the plant utilization rate apparently edged down. Total retail sales were about unchanged in October as declines at automobile dealers and other durable goods stores offset advances at nondurable goods stores. Housing starts dropped sharply further to the lowest level since World War II. Expansion in nonfarm employment resumed, however, and labor market conditions continued tight. The unemployment rate, at 3.9 per cent, was little different from the 3.8 per cent rate of September, and the average workweek in manufacturing continued close to the postwar peak.

The wholesale price index declined in October as a result of a substantial drop for foodstuffs. Average prices of industrial commodities, which had been stable for several months, continued unchanged in October and were about 2 per cent above a year earlier. The progressive decline in sensitive materials prices, which offset increases in prices of finished industrial products, seemed to be tapering off, however, and labor costs were rising as the pattern of larger wage increases continued. For both reasons average industrial prices appeared likely to begin rising again, although perhaps at a slower pace than early in the year.

The money supply declined in October by somewhat more than had been estimated earlier. Since April the money supply had fallen on balance at an annual rate of about 1.5 per cent. Commercial bank credit, on a last-Wednesday-of-the-month basis, was now estimated to have contracted further in October after declining on balance over the two preceding months. Growth in business loans slackened to an annual rate of about 7 per cent in the 3 months ending in October, from 21 per cent in the first 7 months of the year and more than 18 per cent in 1965 as a whole.

New staff projections for daily-average member bank deposits —the "bank credit proxy"—suggested a decline at an annual rate of 3 per cent in November, slightly more than anticipated

3 weeks earlier. Private demand deposits appeared to be expanding less rapidly than expected as loan growth weakened, and Government deposits at banks appeared to be declining somewhat more rapidly than anticipated. Some further decline in member bank deposits seemed likely in December, if money market conditions remained unchanged, as a result of continuing run-offs of negotiable CD's and reductions in Government balances. Treasury deposits at both commercial banks and Federal Reserve Banks were expected to reach relatively low levels by midmonth, perhaps requiring the Treasury to borrow directly from the Federal Reserve for short periods.

Yields on long-term bonds moved higher over the first 3 weeks of November, partly as a result of substantial additions to the calendar of prospective new corporate and municipal bond offerings. Long-term yields also were affected by press reports that the Federal National Mortgage Association might resume sales of participation certificates before the end of the year and by continuing uncertainties regarding the prospects for further fiscal measures.

System open market operations since the preceding meeting of the Committee had been directed at maintaining steady conditions in the money market while the distribution of securities issued in the Treasury's November refinancing was under way. Pressures on reserve positions of central money market banks developed early in November partly as a result of a marked shift in reserves toward other banks. Rates on Federal funds and dealer loans advanced, and 3-month Treasury bill yields rose by about 20 basis points to around 5.45 per cent at midmonth. In view of the pressures in the central money market and of the relatively weak performance of bank credit, the Federal Reserve provided a large volume of reserves through open market operations early in the period, expanding net reserve availability somewhat. Net borrowed reserves averaged about $230 million in the two statement weeks ending November 16, compared with $340 million in the two preceding weeks and $430 million in October.

The pressures eased after midmonth, and by the date of this meeting Treasury bill yields and money market rates had fallen back to about their levels of 3 weeks earlier.

The U.S. balance of payments in the first 9 months of 1966 was estimated to have been in deficit at an annual rate of about $1.2 billion on the "liquidity" basis, and to have been in surplus at a rate of $0.8 billion on the "official reserve transactions" basis. Preliminary data suggested that the liquidity deficit in October and early November was at a rate of roughly $2 billion, about the same as would have been recorded earlier in the year in the absence of shifts of foreign official funds from liquid to nonliquid form. Inflows of liquid funds through foreign branches of U.S. banks accelerated sharply in late October and early November; in the 4 weeks ending November 9 they were at a rate approaching the July peak, although some reflow occurred in the following week. With net inflows of liquid funds thus continuing large, the balance on the official reserve transactions basis apparently remained near zero early in the fourth quarter. A cessation, and possibly a reversal, of those flows seemed likely in coming weeks as a result of year-end seasonal pressures in the Euro-dollar market.

In the Committee's discussion it was noted that the appropriate course for monetary policy over the coming months would depend importantly on the nature of fiscal policy actions. The Committee concluded, however, that an overt, although modest and gradual, lessening of monetary restraint was warranted at present in view of the evidences of moderating tendencies in private demands and the recent lack of expansion in bank credit and money. Accordingly, it was agreed that somewhat easier money market conditions should be sought unless bank credit expansion became unduly rapid.

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 over-all domestic economic activity is continuing to expand, with sharply rising defense expenditures but with evidences of moderating tendencies in various sectors of the private economy. While there has been some slowing in the pace of advance of broad price measures, upward price pressures persist for many finished goods and services. Bank credit and money have shown no expansion in recent months. Long-term interest rates have again risen somewhat after declining from their late summer peaks. The balance of payments remains a serious problem. In this situation, it is the Federal Open Market Committee's policy to maintain money and credit conditions conducive to noninflationary economic expansion and progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining somewhat easier conditions in the money market, unless bank credit appears to be resuming a rapid rate of expansion.

> Votes for this action: Messrs. Martin, Bopp, Brimmer, Clay, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: Messrs. Hayes and Daane.

In dissenting from this action, Messrs. Hayes and Daane, recognizing the less rapid pace of expansion in the private sector of the economy, indicated that they would have preferred to maintain the somewhat easier money market conditions already prevailing at the time of this meeting and to resolve doubts on the side of ease. In their judgment, with defense expenditures apparently continuing to rise rapidly, inflation—both demand-pull and cost-push—remained a serious threat to both the domestic economy and the U.S. balance of payments in which the trade balance was a crucial element. Furthermore, they felt that any premature pronounced easing could bring about adverse effects on capital outflows. Hence, they deemed it unwise to shift more overtly to a posture of less monetary restraint at this time, particularly in advance of more concrete information on Federal taxes and expenditures.

2. Amendment of continuing authority directive.

The Committee amended Section 2 of the continuing authority directive to the Federal Reserve Bank of New York to increase, from $500 million to $1 billion, the dollar limit on special short-term certificates of indebtedness purchased directly from the Treasury that might be held by the Federal Reserve Banks at any one time. With this amendment, Section 2 read as follows:

The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to purchase directly from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the rate charged on such certificates shall be a rate ¼ of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed $1 billion.

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

This action was taken after the Account Manager reported that the amount the Treasury might have to borrow directly from the Federal Reserve Banks in December was highly uncertain and that it appeared at least possible that the amount might be somewhat in excess of the $500 million limit previously specified.

December 13, 1966

Authority to effect transactions in System Account.

Additional indications that the pace of economic expansion was moderating were reported at this meeting. Growth was slowing in business capital expenditures and apparently in Federal defense outlays. Expansion in consumer spending also was slackening, despite continued rapid gains in nonfarm employment through November and a dip in the unemployment rate to 3.7 per cent from 3.9 per cent in October. Staff projections of