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.

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

GNP growth in the fourth quarter had again been reduced somewhat.

A Commerce Department–SEC survey taken in late October and November indicated that business expenditures on plant and equipment had been somewhat lower in the third quarter than estimated earlier, and that outlays planned for the fourth quarter had been reduced appreciably—the first significant downward revision in capital spending plans in 3 years. Plans for the first half of 1967 implied an increase less than one-third the size of the large gain actually recorded in the corresponding half of 1966. While estimates of current and prospective defense expenditures were conjectural, the best available evidence suggested continued sizable increases in the fourth quarter of 1966 and the first quarter of 1967, but at rates progressively slower than the extraordinarily rapid rate of the third quarter of 1966.

The proportions of consumers planning to buy automobiles and major appliances within 6 months were significantly lower in mid-October than a year earlier, according to a Census Bureau survey. Retail sales, which had changed little in September and October, declined by 1 per cent in November according to preliminary data, mainly because of a 5 per cent reduction in sales at automobile dealers. Retail inventories rose sharply in October, and manufacturers of automobiles and some other consumer durable goods subsequently announced production cutbacks. With output of steel and construction materials also declining, the industrial production index for November was tentatively estimated at only slightly above its August–September average.

The rate of housing starts was likely to be lower in the fourth quarter as a whole than in the third, although not so low as in October. It appeared that the extended decline in residential construction might taper off in the first quarter of 1967; if so, this would provide some offset to the slowing of growth foreseen for other categories of demand.

The consumer price index rose in October at the substantial pace of the preceding 4 months, with prices of services continuing to increase rapidly. It was likely that a smaller increase would be shown in the consumer index for November, as earlier declines in wholesale prices of foodstuffs carried over to retail prices. At the wholesale level, on the other hand, the declines in prices of both foodstuffs and sensitive materials appeared to be leveling off after the end of October, and industrial commodities were under upward pressure from rising labor costs.

The money supply declined further on the average from October to November, but turned up after mid-November as Government deposits were drawn down. With the run-off of negotiable CD's at banks slackening to less than half the September–October rate, total time and savings deposits increased slightly. Daily-average member bank deposits—the "bank credit proxy" —declined at an annual rate of about 5 per cent from October to November, somewhat more than expected earlier. On a last-Wednesday-of-the-month basis, bank credit rose slightly in November because of bank acquisitions of tax-anticipation bills issued by the Treasury late in the month. Bank holdings of other securities declined, and loan volume was unchanged on balance.

New staff projections for December suggested that member bank deposits would show relatively little increase from November if money market conditions remained unchanged. Total time and savings deposits were expected to grow slightly, despite anticipated further attrition in outstanding CD's at a rate probably somewhat above that of November. Private demand deposits and the money supply were expected to continue rising as Government deposits were reduced further. On Friday, December 9, the Treasury replenished its cash balances by selling a special certificate of indebtedness in the amount of $169 million to the Federal Reserve. The certificate was redeemed 3 days later.

System open market operations since the preceding meeting of the Committee had been directed at attaining somewhat easier conditions in the money market. A substantial volume of reserves was provided through outright purchases of Treasury bills

and through repurchase agreements with nonbank dealers, including some repurchase agreements involving obligations of Federal agencies as authorized by the Committee on November 1. Various money market rates moved lower, partly as a result of System operations and of market interpretations that these operations reflected a shift of monetary policy in the direction of less restraint. The 3-month Treasury bill rate declined by nearly 20 basis points, to 5.03 per cent on the day before this meeting. Long-term interest rates also edged down, despite increased current and prospective borrowing by corporations and State and local governments and market expectations of a sale of participation certificates by the Federal National Mortgage Association.

The deficit in the U.S. balance of payments on the "liquidity" basis was relatively large in October and November, and the balance on official reserve transactions reverted to deficit from the surplus recorded in the third quarter. It was likely that the liquidity balance would improve in December, particularly if British debt service payments were not waived—as they had been in the two prior years—and if an expected payment under the German military offset agreement were made before the end of the year. The December balance on official reserve transactions could depend heavily on the changes in liabilities of U.S. banks to their foreign branches; if these liabilities declined toward the year-end, as they had in earlier years, the deficit incurred in the fourth quarter could be enlarged. Such liabilities had fluctuated widely in November and early December, but had increased on balance.

Guidelines and targets for 1967 in the President's voluntary program to improve the nation's balance of payments were announced on the day of this meeting by the Board of Governors and the Department of Commerce. The Federal Reserve guidelines for banks retained the existing ceiling for outstanding foreign assets, but banks were asked to limit the rate at which they used their leeway under the ceiling. Nonbank financial institutions were asked to limit the increases in covered assets to 5 per cent over the period from September 1966 through December 1967. The new target formula set by the Department of Commerce for corporations' direct investment transactions was designed to keep the total net outflow on direct investments in 1967 close to the volume presently expected for 1966.

The Committee concluded that the additional evidence of moderation in the pace of the business expansion confirmed the appropriateness of the decision at the preceding meeting to relax monetary restraint somewhat, and a majority of the members thought that some further relaxation would be desirable at present in light of both the outlook for slower economic growth and the persisting lack of expansion in bank credit. While it was agreed that the balance of payments continued to pose a serious problem, the view was expressed that the voluntary program in that area, as extended, would serve to enlarge the scope for adaptation of monetary policy to developments taking place in the domestic economy.

Within the majority favoring further relaxation of monetary restraint there were divergent views regarding the manner in which the goals for open market operations over the next 4 weeks might best be specified in the current economic policy directive to be issued to the Federal Reserve Bank of New York. One group suggested specifying the objective of operations in terms of attaining moderate expansion in the money supply and bank credit, noting that relatively vigorous operations might possibly be required to achieve that goal under present circumstances. Another group favored continuing the approach initiated at the preceding meeting, by calling again for somewhat easier conditions in the money market unless bank credit expansion became unduly rapid. At the conclusion of the discussion, however, the members of both groups joined in voting for the following current economic policy directive:

The economic and financial developments reviewed at this meeting indicate that over-all domestic economic activity is continuing to expand, with

rising defense expenditures but with additional evidences of moderating tendencies in the private economy. While there has been some slowing in the pace of advance of most broad price measures, upward price pressures persist for many finished goods and services. Bank credit and money have shown no net expansion in recent months. Although demands on bond markets have increased, upward pressures on long-term interest rates have moderated. The balance of payments remains a serious problem. In this situation, it is the Federal Open Market Committee's policy to foster 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, Brimmer, Clay, Hickman, Maisel, Mitchell, Robertson, and Wayne. Votes against this action: Messrs. Hayes, Daane, Irons, and Shepardson.

The members dissenting from this action favored maintaining the easier money market conditions achieved under the approach initiated at the preceding meeting, but not actively seeking further easing of conditions at this time. While the emphasis on particular factors varied, they generally stressed the underlying strength of the economy and their continuing concern about the balance of payments situation. They also voiced concern about recent and prospective cost and price developments. Despite the recent evidences of slower growth, the private sector of the economy did not appear to them as fundamentally weak and there were expansionary forces in the public sector. They thought, therefore, that the possibility of a reappearance of general strength and resurgence of pressures could not be ruled out.

Dissenting members were skeptical that defense spending would decelerate and emphasized that the continuing uncertainties regarding fiscal policy were grounds for proceeding cautiously in making monetary policy changes. Caution was par-

ticularly called for, in their view, because of the possible threat to the balance of payments from any deterioration in the capital account. The voluntary guidelines did not appear to provide full safeguard against such outflows.

Furthermore, it was noted that there were indications that the money supply had begun growing again in recent weeks. Efforts of banks to improve their liquidity positions before expanding loans and investments might have accounted for the seeming lack of response of bank credit thus far to the easing of monetary restraint already accomplished. The latter view was shared by some members of the majority.