

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

<i>Period</i>	<i>Action</i>	<i>Purpose</i>
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. 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 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. 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

<i>Period</i>	<i>Action</i>	<i>Purpose</i>
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. Granted temporary authority to the Federal Reserve Banks to provide emergency credit facilities, under certain conditions, to nonmember depository-type institutions, including mutual savings banks and savings and loan associations. No lending was necessary under this authority.	To help forestall excessive interest rate competition among financial institutions for consumer-type time deposits. To assure that funds could be provided to assist in meeting unusual withdrawals that might develop at nonmember depository 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. 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 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. 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. Terminated special discount arrangements announced on September 1 when member banks were asked to curtail their business loan expansion.	To continue, and in some respects to intensify, the voluntary effort to restrain the outflow of private capital. 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.

operations until the next meeting should be directed toward maintaining about the prevailing conditions in the money market. It recognized, however, that economic, military, or Federal budget developments might lead to sharp changes in market conditions, which System operations should be expected only to moderate.

The Treasury financing schedule was a primary consideration in the decision to maintain relatively steady money market conditions, but other reasons for this course also were advanced. Thus, it was noted that the need for actively seeking changes in conditions could be determined better after the President's Budget Message and Economic Report were transmitted to the Congress later in the month; that market adjustments to the official rate actions of December were still under way; and that more time was required to appraise the effects of recent increases in interest rates.

At the same time, a number of members expressed concern over the recent pace of growth in reserves, bank credit, and the money supply, in view of the potential for inflationary developments in the period ahead. The Committee agreed that for the longer run some moderation in these growth rates would be desirable and, accordingly, it modified the statement of policy in the first paragraph of its current economic policy directive to the Federal Reserve Bank of New York. The directive issued read as follows:

The economic and financial developments reviewed at this meeting indicate that domestic economic expansion has strengthened further in a climate of optimistic business sentiment and with some further upward creep in prices. Interest rates are higher in most markets in response to strong credit demands and recent official rate actions. Our international payments position improved considerably during 1965 but further progress is needed to attain effective balance. 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.

In light of the Treasury financing schedule, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the current conditions in the money market.

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

February 8, 1966

Authority to effect transactions in System Account.

Business activity continued to advance vigorously in early 1966, and the outlook was becoming increasingly expansive. In addition to sharply rising Federal expenditures, large consumer demands, and record business outlays on plant and equipment, heavy inventory accumulation was adding to aggregate demands. Total business inventories had risen sharply in the fourth quarter of 1965 despite rapid liquidation of steel stocks following the wage settlement in that industry; and in the current quarter, with liquidation of steel stocks ending, further substantial accumulation seemed probable.

The recent surge in activity carried rates of resource use to advanced levels. In December the rate of capacity utilization in manufacturing edged up to a 10-year high. In January the unemployment rate declined again, reaching the administration's "interim" target of 4.0 per cent. As yet, pressure on resources had not been reflected in an accelerated rate of advance in average industrial prices—the price index continued to creep up at about the 1.5 per cent annual rate of the last 15 months—but reports of moderate price advances were becoming more frequent.

Loan expansion at commercial banks was unusually strong in January as business borrowing remained heavy. The money supply continued to rise rapidly, although the increase was concentrated in the early part of January and for the month as a whole was less than the sharp December advance. The inflow of

time and savings deposits to commercial banks slowed considerably further from the reduced December pace. Net borrowed reserves of member banks averaged about \$60 million in January; they had been below \$100 million in November and December also, but earlier in 1965 they had fluctuated around \$150 million.

Yields on long-term Treasury and corporate bonds, which had been relatively stable following their initial adjustments to the early December increase in the discount rate, had advanced by 10 to 15 basis points since the preceding meeting of the Committee. Contributing to the advances were the resumption of bombing in North Vietnam; the growing calendar of new corporate issues; the prospect of large sales of financial assets by the Federal Government under provisions of the administration's budget document; and increasing market discussion of the possibility that a firmer monetary policy might be required to restrain inflationary pressures in the months ahead. Short-term interest rates also moved irregularly higher, with the market yield on 3-month Treasury bills advancing by about 5 basis points to above 4.60 per cent.

Money market conditions had been, on the whole, relatively comfortable in the recent period as earlier heavy pressures on banks in the central money markets moderated. System operations generally had been directed toward maintaining an "even keel" in the money market, as is customary during periods of Treasury financing. The current financing involved both a refunding of issues maturing in mid-February and an advance refunding of April, May, and August maturities, with settlement scheduled for February 15. In exchange for these securities, of which \$13.7 billion were held by the public, the Treasury offered two new issues: a 5 per cent $4\frac{3}{4}$ -year note (priced to yield 4.97 to 5.00 per cent, depending on the issue exchanged), and a $4\frac{7}{8}$ per cent 18-month note (priced to yield 4.96 per cent). The refunding was well received by investors despite the weakening of prices on outstanding issues subsequent to its announcement; \$6.5 billion of subscriptions were entered for the $4\frac{3}{4}$ -year note and \$0.9 billion

for the 18-month note. Subscriptions by Government security dealers were relatively small, and there appeared to be little speculative activity in the new issues.

The deficit in U.S. international payments in 1965 was now estimated to have been about \$1.3 billion on both the "liquidity" and "official reserve transactions" bases, compared with \$2.8 billion and \$1.2 billion, respectively, in 1964. Growth of merchandise exports had resumed in the second half of the year, and prospects for further increases were favorable. However, the rate of expansion of imports—of both manufactured goods and materials—had accelerated during 1965. In the fourth quarter, despite some reduction in imports of steel, total imports reached a level relative to GNP that was quite high by historical standards.

In the judgment of the Committee, recent and prospective economic developments clearly called for added policy measures to dampen the rise in aggregate demands. It was noted that efforts had been made to develop a Federal budget for fiscal year 1967 that would avoid adding to inflationary pressures. The budget estimates recently submitted to the Congress had to be regarded as more than usually uncertain, however, because of the difficulty of predicting the course of developments in Vietnam.

The Committee concluded that, while unfolding developments might lead to additional fiscal counteraction at some later date, the appropriate objective for monetary policy in the immediate future was a somewhat greater degree of restraint. Members observed that reserve availability had been permitted to increase in recent months so as to moderate market adjustments to the official rate actions of early December. It also was noted that the market situation with respect to the securities involved in the current Treasury financing probably would make it unnecessary to maintain an "even keel" policy for the entire period until the Committee's next meeting. Accordingly, the Committee agreed that gradual action to reduce net reserve availability should be initiated as soon as feasible in the light of the financing.

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