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.

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, and the unemployment rate dropped from 4.0 per cent in January to 3.7 per cent, the lowest level since the early 1950's.

Pressures on resources were being reflected increasingly in cost and price developments. Average hourly earnings in manufacturing continued to rise at a moderate and steady pace, and unit labor costs now also appeared to be moving up. New data suggested some acceleration in the rate of advance of industrial commodity prices in the first 2 months of the year, accompanied by a broadening of the range of commodities that were showing increases. Weekly indexes indicated little further change in average industrial prices through mid-March, but other information suggested that a further rise was in process. Average wholesale prices of foodstuffs rose sharply in February, but apparently declined slightly thereafter.

Growth in member bank reserves slackened considerably in February and early March, and bank credit expanded only slightly. In the face of continuing strong demand for loans, city banks reduced their holdings of both Treasury and other securities in early March, and on March 10 major banks increased their prime lending rate from 5 to 5½ per cent. Time and savings deposits continued to grow relatively slowly. The money supply declined in February but then rose quite sharply in the first half of March; for the first quarter as a whole, its growth was tentatively estimated at an annual rate of 5.5 per cent, compared with 7.5 per cent in the preceding quarter.

Treasury coupon securities experienced their first sustained rally in several months during the first 3 weeks of March, with yields on 5- to 10-year maturities falling by almost ¼ of a percentage point and longer-term bond yields declining by as much as ⅛ of a percentage point. The rally appeared to be partly a technical reaction to the extended increases in yields of previous months, but it drew strength from a decline in common stock prices and, in particular, from growing discussion of possible additional Federal tax measures to contain inflationary pressures. Yields on State and local government bonds and new corporate

issues also turned down after 6 weeks of nearly continuous advance. Contributing to the declines in municipal yields were cancellations and postponements of some new issues that had been planned and a reduction in dealer inventories to the lowest level in several years.

System open market operations since the preceding meeting of the Committee had been directed toward limiting net reserve availability while facilitating the large financial flows associated with quarterly corporate payments of dividends and taxes. In the 3 weeks ending March 16, net borrowed reserves of member banks averaged almost $215 million and borrowings from the Reserve Banks about $540 million, compared with revised averages for February of $120 million and $475 million, respectively. Money market conditions were generally firm, and most short-term interest rates continued to move up. However, yields on 3-month Treasury bills declined irregularly from about 4.65 per cent in early March to 4.52 per cent on the day preceding this meeting, as a result of strong investor demand and low dealer inventories.

The U.S. balance of payments position improved in the first 2 months of 1966, according to incomplete data, as tightening U.S. credit markets contributed to large net reflows of bank credit. The demand for imports continued to expand under the influence of the rapidly advancing pace of domestic activity, however, and the outlook for U.S. foreign trade suggested that it might be difficult to maintain the favorable payments trend in coming months.

In the Committee's discussion it was noted that the policy actions taken at the two preceding meetings apparently were beginning to have the desired effect of moderating growth rates in bank reserves, bank credit, and the money supply. As to the policy to be pursued in the coming 3 weeks, some members favored continuing the process of gradually increasing the reserve pressure on the banking system. Others expressed a preference for maintaining about the current state of net reserve availability, or of money market conditions in general, pending a clearer indication of the consequences of previous policy actions. Some members in each of these groups thought that the conduct of open market operations should be conditioned in part by the strength of demands that might be made on the banking system; they felt that net reserve availability could be allowed to become tauter than otherwise if bank credit and money supply growth proved strong and required reserves consequently expanded sharply.

Despite these shadings of opinion, the range of difference in views on policy for the next 3 weeks was not great; no members advocated overt firming action at this time, and none favored relaxation. At the conclusion of the discussion the Committee agreed to renew the current economic policy directive adopted at the preceding meeting without change.

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

April 12, 1966

1. Authority to effect transactions in System Account.

Rapid economic advance continued unabated through the end of the first quarter, according to reports at this meeting. The driving forces of the expansion—defense outlays and business capital expenditures—showed no signs of slackening, and consumer spending was being spurred by sharp rises in incomes and employment. Further large gains in expenditures by Government, business, and consumers were expected in the second quarter.

Industrial production rose considerably further in March; for the first quarter as a whole it increased at an annual rate of about 13 per cent from the fourth quarter of 1965. Retail sales also

expanded further in March, according to preliminary estimates, after rising substantially in February. Nonfarm employment continued to grow rapidly, and shortages of experienced workers were becoming increasingly serious. In March, after six consecutive months of decline, the unemployment rate rose slightly—from 3.7 per cent to 3.8 per cent—but the rise was accounted for mainly by teenagers, a group for which monthly unemployment changes tend to be volatile.

Average prices of industrial commodities advanced further in March, but because of a slight decline in prices of farm products and foods, the total index of wholesale prices was unchanged from February. Over the first 3 months of the year average prices of industrial commodities had increased at an annual rate of about 3 per cent, approximately twice the rate of 1965. The consumer price index rose in February to a level about 2.5 per cent above a year earlier. Most of the February rise was accounted for by foods, but average prices of other commodities and of services also advanced.

Commercial bank credit, which had changed little in February, expanded substantially in March. Business loan demands in particular were strong over the corporate tax and dividend payment dates. Finance companies, which had a substantial volume of open market paper maturing in the same period, also borrowed heavily. Banks liquidated a large volume of securities, including municipals, to help finance these loan demands. Some reduction in the rate of growth of bank loans was expected after the April tax date, but underlying credit demands appeared likely to remain strong.

The money supply rose sharply in March, in part reflecting a contraseasonal reduction in Treasury deposits at commercial banks. Growth in time and savings deposits continued at the more moderate February rate. Time deposit inflows at city banks expanded considerably in response to higher offering rates on both negotiable and nonnegotiable certificates of deposit. However, some of the funds probably were withdrawn from sav-