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.

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.

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-

ings deposits at these banks, and possibly also from time and savings deposits at country banks, where growth slackened.

In security markets, the declines in yields on Treasury notes and bonds and on new corporate and municipal issues that had begun in early March continued into early April. The month-long rally—in which one-half to two-thirds of the yield advances following the December increase in the discount rate were erased—apparently reflected increasing expectations of a Federal tax increase, a growing belief that earlier yield advances had outpaced economic developments, and some moderation in the flow of new private offerings. Most recently, however, a general note of caution appeared to have returned to security markets, and some yields edged up again. Near the end of April the Treasury was expected to announce the terms on which it would refund securities maturing in mid-May, of which about $2.5 billion were held by the public.

Recent System open market operations had kept bank reserve positions under pressure. Over the three statement weeks ending April 6, net borrowed reserves averaged about $230 million and member bank borrowings about $580 million—in each case slightly higher than the levels of the previous 3-week period. For March as a whole, higher member bank borrowing accounted for all of the increase in total reserves; nonborrowed reserves declined for the first time since September. The effective rate on Federal funds had been 4¾ per cent on most days since the preceding meeting of the Committee, and on one day a small volume of funds traded at a new high rate of 4⅞ per cent. Most other short-term yields remained at the recent highs established after the March 10 increase in the prime loan rate of banks, or they edged up further. The yield on 3-month Treasury bills fluctuated but on balance rose somewhat to 4.59 per cent on the day preceding this meeting.

The Committee agreed that additional stabilization policy measures would be desirable in light of present and prospective inflationary pressures. In the course of the discussion note was

taken of the President's recent request that businesses reduce their planned capital outlays, and also of the possibility that the administration might recommend an increase in Federal taxes. It was pointed out, however, that large cutbacks in actual investment expenditures probably could not be expected quickly because of the long lead-times of most capital projects and the firm commitments already made. As to a tax increase, even if one were recommended soon—and that issue remained in doubt—some time would be required for congressional consideration, and additional time probably would elapse before any increase enacted had substantial effects on aggregate spending.

In the area of monetary policy divergent views were expressed about the appropriate interpretation of recent banking and capital market developments. Some members felt that the recent high growth rates in the money supply and bank credit had been undesirable in light of the objective of resisting inflationary pressures, and a similar view was advanced with respect to the declines in longer-term market interest rates. Of the members who held these views some thought that, in retrospect, the Committee's recent policy directives might better have been formulated in terms calling for greater resistance to such developments, which they considered to be evidences of a relaxation in monetary conditions.

Other members shared the view that monetary relaxation would be undesirable under present circumstances, but thought that there had been no relaxation in the pressure the System was placing on banks nor in the trend toward firmer lending policies at banks. In their judgment the recent developments had to be interpreted in light of the fact that there often were marked short-run fluctuations in banking variables and interest rates—in the latter partly because of the effects of changing expectations.

At the conclusion of the discussion the Committee agreed that its policy of gradually reducing net reserve availability, initiated at the February 8 meeting, should be continued until the next meeting; and that consideration should be given in the conduct

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.
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> 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