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.

somewhat more rapidly than in the second quarter despite weakness in residential construction, with industrial prices rising further. Total credit demands continue strong and financial markets, particularly for mortgages, remain tight. Despite the statistical improvement resulting largely from special transactions, the balance of payments situation continues to reflect a sizable underlying deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.

To implement this policy, while taking into account the forthcoming Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the current state of net reserve availability and related money market conditions; provided, however, that if required reserves expand more rapidly than expected and if conditions associated with the Treasury financing permit, operations shall be conducted with a view to attaining some further gradual reduction in net reserve availability and firming of money market conditions.

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

2. Amendment of continuing authority directive.

The Committee amended Section 1(a) of the continuing authority directive to the Federal Reserve Bank of New York regarding domestic open market operations, to raise from $1.5 billion to $2 billion the limit on changes in holdings of U.S. Government securities in the System Open Market Account between meetings of the Committee. With this amendment, Section 1(a) read as follows:

To buy or sell U.S. Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government 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 $2.0 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.

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

This action was taken after the Account Manager reported that the previously existing "leeway" might conceivably prove too small. There was a prospective need for the System to supply a rather large volume of reserves in the period until the next meeting, and in addition the uncertain duration of the airline strike was a complicating factor.

At the meeting of June 28, 1966, as indicated in the entry for that date, the Committee had amended Section 1(c) of the continuing authority directive to remove the 24-month maturity limitation on Government securities that might be held under repurchase agreements with nonbank dealers, in the expectation that the directive would be amended again to restore the maturity limitation after the then-current period of reserve need had passed. Because of the possibility that procedures similar to those described in the preceding entry might again be required in the period before the next meeting, the Committee agreed to continue paragraph 1(c) in its existing form for the time being.

August 23, 1966

Authority to effect transactions in System Account.

The economic outlook remained expansive, and prospects were for continuing high levels of resource use and strong upward pressures on wages and prices. Defense expenditures apparently were rising at an unabated rate, business fixed investment outlays were continuing to grow, and consumer spending was showing renewed strength after lagging in the spring.

Industrial production rose further in July, and nonfarm employment continued to expand vigorously. The unemployment rate, at 3.9 per cent, was little changed from the 4.0 per cent rate of the two prior months. On the other hand, private housing starts declined sharply further to the lowest monthly level in 6 years, as mortgage funds remained quite limited.

The wholesale price index increased appreciably in July, mainly because of a large rise in prices of foodstuffs; average industrial prices advanced only slightly further. Consumer prices continued to rise at a substantial rate, leading to further wage increases in industries with cost-of-living escalator contracts and stimulating demands for higher wages in industries where negotiations were under way or imminent. The settlement of the recent strike of airline machinists involved an increase in wages and other benefits well above administration guideposts.

Commercial banks increased their prime lending rate in mid-August to 6 per cent, from the 5¾ per cent rate that had been established near the end of June. Growth in business loans, which had reached the unusually high annual rate of 30 per cent in the June–July period, was slackening in August, in part because cash needs of corporations were temporarily reduced following the earlier accelerated payments of withheld Federal taxes. Banks reportedly were expecting loan demands to intensify again in September despite the increase in the prime rate. Inflows of private liquid funds through foreign branches of U.S. banks, which had been sizable in the first half of 1966, were exceptionally large in July and early August.

Total time and savings deposits of commercial banks continued to grow relatively rapidly, but most of the recent expansion was outside the major money centers. Large city banks, already paying the ceiling rate of 5½ per cent on negotiable CD's, were finding it increasingly difficult to replace maturing certificates as market interest rates rose. A large volume of such certificates would mature in September, and some run-off seemed likely although its dimensions were highly uncertain. Private

demand deposits were estimated to have shown little net change over the 3 months since May, and Government deposits were estimated to have declined. For August it appeared that both total deposits [2] and required reserves of member banks would fall below the levels projected earlier by the staff. With underlying loan demands remaining strong, however, staff projections for September suggested some acceleration in growth of member bank deposits, perhaps to an annual rate of 6 per cent, although the outlook was clouded by the uncertainties associated with possible run-offs of CD's.

The atmosphere in security markets since the preceding meeting of the Committee was one of marked uncertainty and apprehension. During this period average prices of common stocks declined to new lows for 1966, and yields on Treasury, corporate, and municipal bonds advanced sharply to the highest levels since the 1920's and early 1930's. Short-term interest rates also rose markedly further, with the yield on 3-month Treasury bills reaching 5.10 per cent—more than 30 basis points above its level 4 weeks earlier—before receding somewhat. Money market conditions continued to firm; dealer loan rates posted by major banks again reached new record levels, and Federal funds traded at rates as high as 6 per cent.

The recent pressures, which were evident in all maturity ranges and in all sectors of the financial markets, reflected the extremely large demands currently being made on those markets and concern over the extent of credit demands ahead. Total

[2] In recent months the Committee had been making increased use of daily-average statistics on total member bank deposits as a "bank credit proxy"—that is, as the best available measure, although indirect, of developing movements in bank credit. Since they can be compiled on a daily basis with a very short lag, the deposit figures are more nearly current than available bank loan and investment data. Moreover, average deposit figures for a calendar month are much less subject to the influence of single-date fluctuations than are the available month-end data on total bank credit, which represent estimates of loans and investments at all commercial banks on one day—the last Wednesday—of each month. For recent statistics on daily-average member bank deposits, see the Federal Reserve *Bulletin* for October 1966 (p. 1478) and subsequent months. Some brief comments on the relation between the deposit series and bank credit statistics are given in the note on p. 1460 of the October *Bulletin*.

offerings of new corporate issues in August appeared likely to exceed those of any August on record, and the calendar of municipal issues was sizable. In addition, the Treasury, after completing its mid-August refunding, announced an auction of $3 billion in tax-anticipation bills for payment on August 26. Also contributing to the uncertain atmosphere were concern about inflationary developments and prospective monetary policy and the possibility of a substantial run-off of negotiable CD's.

Recent System open market operations were directed towards keeping continued pressure on bank reserve positions while maintaining an "even keel" in the money market during the Treasury's refunding operation. Weekly average net borrowed reserve figures fluctuated in a range of $300 million to $465 million in three statement weeks ending August 17; over the period they averaged $400 million, compared with $365 million in the preceding 4 weeks. Member bank borrowings averaged about $765 million, up about $25 million from the preceding 4-week period.

The balance of payments deficit on the "liquidity" basis widened to an annual rate of roughly $3 billion in July and early August, twice the rate of the first half of 1966 when the deficit had been held down by large shifts of foreign official funds from liquid to nonliquid claims on the United States. The balance on the "official reserve transactions" basis behaved differently, however. Following a deficit at a rate of nearly $1 billion in the first half of 1966, there was a substantial surplus in July and early August, as private liquid funds in unusually large volume were attracted to the United States from abroad.

On August 17 the Board of Governors announced a further increase in reserve requirements on time deposits in excess of $5 million, from 5 to 6 per cent, effective September 8 at reserve city banks and September 15 at other member banks. The action, which would increase required reserves by an estimated $450 million, was taken for purposes similar to those under-

lying the increase in such reserve requirements from 4 to 5 per cent that had been announced on June 26; namely, to exert a tempering influence on bank issuance of time certificates of deposit, and to apply some additional restraint upon the expansion of bank credit to businesses and other borrowers.

The Committee agreed that no relaxation in the prevailing degree of monetary restraint would be warranted at this juncture, unless unusual liquidity pressures developed or money market conditions threatened to become disorderly. A substantial number of members thought that, absent such developments, open market operations should be conducted so as to reduce net reserve availability somewhat further, in coordination with the Board's action to increase reserve requirements. Some of these members favored seeking still greater restraint if bank credit appeared to be expanding at a rate in excess of that projected by the staff for September. At the same time it was noted that any move toward further restraint should be implemented gradually and cautiously, in view of current and prospective strains in financial markets.

Other members, who tended to give somewhat greater weight to the risks of placing undue pressures on financial markets and to the recent moderation of bank credit growth, favored reducing net reserve availability only if bank credit were expanding more rapidly than expected. A third view expressed was that the risks of developments disruptive to financial markets and to the economy in general might be sufficiently great to militate against any further increase in credit restraint at this juncture.

At the conclusion of the discussion, 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 expanding more rapidly than in the second quarter, despite further weakening in residential construction. Recent wage and price developments suggest that inflationary pressures are becoming more intense. Credit demands continue strong, financial markets have tightened further, and interest rates have risen substantially in an atmosphere of great uncertainty. The balance of payments continues to reflect a sizable underlying deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting 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 shall be conducted with a view to supplying the minimum amount of reserves consistent with the maintenance of orderly money market conditions and the moderation of unusual liquidity pressures; provided, however, that if bank credit expands more rapidly than expected, operations shall be conducted with a view to seeking still greater reliance on borrowed reserves.

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

September 13, 1966

1. Authority to effect transactions in System Account.

Economic expansion remained vigorous, according to reports at this meeting, with the main stimuli continuing to come from defense spending and business outlays on fixed investment. On September 8 the President proposed a number of fiscal actions to reduce inflationary pressures, including (1) measures to reduce lower-priority Federal spending and (2) a 16-month suspension of two tax incentives for corporate investment: the 7 per cent tax credit on machinery and equipment investment and the accelerated depreciation allowances on commercial and industrial building.

Defense spending was now estimated to be rising more rapidly in the third quarter than the second. Earlier estimates of the pace of business capital outlays were supported by results of the August Commerce–SEC survey of spending plans. That survey, like the May canvass, indicated that capital spending in 1966 as a whole would be 17 per cent above 1965, but would rise at a slower pace in the second half of the year than in the

first. With respect to consumer spending, a Census Bureau survey taken in mid-July indicated that consumer intentions to buy new automobiles were about as numerous as a year earlier, and that plans to buy household durable goods were considerably stronger.

Industrial production rose substantially further in August, according to preliminary estimates. Nonfarm employment also continued to rise quite vigorously, and the unemployment rate remained unchanged at 3.9 per cent. The gains in employment were somewhat more selective than earlier; in particular, advances in manufacturing were increasingly concentrated in industries oriented to defense and business capital goods. The latest data for manufacturers' inventories—for July—indicated a sharp step-up in the pace of accumulation from the high second-quarter level, with all of the acceleration in durable goods industries.

Estimates suggested that average wholesale prices rose further in August, but by less than in July. It appeared that food price advances were smaller than in the preceding month and that increases in industrial prices were at the reduced July rate. The recent moderation in the rise of average industrial prices was attributable mainly to declines for sensitive materials, which began in June. Price developments in the months ahead seemed likely to be especially influenced by the outcome of wage negotiations, more of which would take place in coming months than earlier in the year. An early-September wage settlement affecting telephone installers—like the August airline-machinists settlement—involved an increase well above administration guideposts.

The money supply declined somewhat further in August, bringing growth for the first 8 months of 1966 to an annual rate of about 1.5 per cent, compared with 4.8 per cent for the full preceding year. Time and savings deposits of commercial banks increased rapidly in the first half of August, but the rate of growth fell off sharply after midmonth when major banks began to experience declines in their negotiable CD's outstanding. Daily averages of both total deposits of member banks—the "bank credit proxy"—and required reserves were weaker in