FEDERAL RESERVE

press release

For immediate release July 31, 1967

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on May 2, 1967. It is being made available at this time in accordance with the schedule announced June 29, 1967 for releasing such entries approximately 90 days following the date of each meeting.

Entries for the earlier meetings of the Committee held in 1967 were made public on June 29 and were also published in the July Federal Reserve Bulletin.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

May 2, 1967

Authority to effect transactions in System Account.

Prospects for renewed economic expansion had improved recently, according to reports at this meeting, and business confidence in the outlook had strengthened markedly. Departmemt of Commerce figures for GNP in the first quarter confirmed earlier staff estimates that there had been no growth in real output of goods and services in that quarter. However, the official estimates--which were based in part on preliminary information for February and March--indicated that consumer expenditures had been considerably larger than anticipated, and the reduction in the rate of inventory accumulation correspondingly greater. Government outlays also appeared to have risen more than expected.

The inventory adjustments now under way were associated with both rising retail sales and a reduced level of industrial production. The retail sales estimate for February had been revised upward nearly to the January level, and the advance estimate for March showed a surprisingly large increase in that month. Although the advance estimate may have overstated the actual gain in March, weekly sales figures for the first part of April were relatively strong. Industrial output was somewhat lower in the first quarter than in the fourth quarter of 1966, and it was tentatively estimated to have fallen slightly in April. Employment in manufacturing industries declined again in March, and total nonfarm employment rose little. The unemployment rate was about unchanged in both March and April, but recent substantial increases in claims for unemployment insurance suggested weakness in some labor markets.

Continuing inventory adjustments--with a further large reduction in the accumulation rate in the second quarter and perhaps some net liquidation in the third -appeared to be in prospect. For the near term some further declines in industrial production and manufacturing employment seemed likely, and growth in over-all economic activity was expected to be well below the economy's potential. Nevertheless, the staff's projection for GNP in the second quarter had been revised upward moderately, in large part because of the apparent strengthening in consumer spending, and an initial projection for the third quarter suggested that activity then would be expanding at a more rapid rate. With housing starts increasing contra-seasonally in the first quarter, prospects for residential construction activity had improved. The projections assumed that total fixed investment by business would remain relatively stable at about the high first-quarter rate, that defense expenditures would continue to exceed earlier expectations, and that State and local government outlays would maintain their strong upward momentum.

The rise in the consumer price index in March was somewhat larger than the small average increase of the preceding 4 months

Contrary to earlier indications, average wholesale prices declined in March, and according to advance estimates they fell further in April. The declines in both months reflected reductions in prices of farm products and processed foods; average prices of industrial commodities were stable despite renewed weakness in prices of basic industrial materials. However, industrial prices were expected to continue under pressure from rising unit labor costs. Unit labor costs in manufacturing advanced slightly further in March, and for the first quarter as a whole they were now estimated to have been 4.7 per cent above a year earlier--the largest increase in nearly a decade.

The balance of payments deficit in the first quarter was now estimated to have been about the same as in the fourth quarter of 1966 on the "liquidity" basis of calculation, but of near record magnitude on the "official reserve transactions" basis. The liquidity deficit continued to be held down in the first quarter by various types of special transactions. First-quarter payments were affected favorably by a substantial rise in the surplus on merchandise trade; the nature of the factors offsetting this favorable development could not be determined as yet from the available data

The Board of Governors approved a reduction in the Federal Reserve discount rate from 4-1/2 to 4 per cent on April 6, and the Bank of Canada reduced its discount rate on the same day. On April 13 the German Federal Bank lowered its discount rate for the third time in 1967--to 3-1/2 per cent--and 2 weeks later it announced its second reduction of the year in reserve requirements. Meanwhile, market interest rates in a number of major industrial countries abroad continued to decline.

Recent System open market operations had been directed at maintaining the easier money market conditions that developed after the announcement of the Federal Reserve discount rate action on April 6. That announcement had been followed promptly by reductions in rates on Federal funds, on bank loans to Government securities dealers, and on negotiable CD's and other short-term market instruments. The market rate on 3-month Treasury bills declined more than 20 basis points, and was 3.75 per cent on the day before this meeting. Large demands by private investors, as well as System purchases, contributed to the declines in bill yields.

Total and nonborrowed reserves of member banks continued to grow in April, but at a rate sharply lower than in the first quarter. Free reserves, which fluctuated widely from week to week, averaged about $210 million, compared with $170 million in March; and average member bank borrowings declined to $150 million from $200 million

In contrast to developments in short term markets, long-term interest rates had risen considerably since the preceding meering of the Committee, reaching levels well above the highs of late February These rate advances reflected both the concinued heavy volume of new security flotations and the shift to more optimistic appraisals of the economic outlook by market participants. The volume of new corporate issues offered publicly in April, while less than the March total, was a record for the month, and the calendar of offerings scheduled for May and June was already large. Municipal bond flotations continued heavy, and another sizable issue of FNMA participation certificates was expected before midyear. Market attitudes also were influenced by the prospect that the Federal Government would have substantial needs for cash in the second half of the year.

On April 26 the Treasury announced a refunding of securities maturing in May and a prerefunding of issues maturing in June and August, with settlement scheduled for May 15. In exchange for these securities, of which about $9 billion were held by the public, the Treasury offered two new issues: a 15-month, 4-1/4 per cent note and a 5-year, 4-3/4 per cent note. The 5-year note, priced at par, was offered to holders of any of the maturing issues; the 15-month note, priced to yield 4.29 per cent, was offered to holders of securities maturing in May and June.

The seasonally adjusted rate of increase in mortgage debt outstanding rose somewhat in the first quarter after three successive quarters of decline, but it remained relatively low. Downward pressure on mortgage yields was maintained in March by continuing large inflows of funds to depositary-type institutions. These institutions were continuing to use a large part of their inflows to rebuild liquidity through repayment of debt and the acquisition of marketable securities, partly because the supply of mortgages available for immediate acquisition remained limited. However, the possibility of a further increase in flows of funds into mortgage markets in coming months was suggested by an expanding volume of mortgage commitments.

Data for city banks indicated that loan demands had been moderate in the first half of April despite large corporate tax payments. Corporations apparently used part of the proceeds of recent capital market flotations and some of their CD holdings to help finance their tax payments. Beginning in late March, banks sharply reduced the interest rates offered on large-denomination CD's, and the volume of such CD's outstanding declined over the tax period by more than had been contemplated in staff projections. However, growth in consumer-type time deposits accelerated in April and total time and savings deposits of commercial banks continued to expand rapidly--although not so rapidly as earlier in the year. Government deposits rose substantially as a result of receipts of taxes, and private demand deposits and the money supply declined. Daily-average member bank deposits--the bank credit proxy--rose at an annual rate of 13.5 per cent from March to April, about in line with expectations and somewhat less than the rate earlier in the year.

Net business demands for bank loans were expected to be quite moderate in May; the corporate tax period was past, needs for inventory financing appeared likely to be small, and--with the continuing large volume of capital market flotations--a rise in the rate of repayments of bank loans was possible. Growth in the bank credit proxy was projected to slow considerably in May--to an annual rate in the 1 to 4 per cent range--if money market conditions were unchanged. Staff projections for the month suggested a sharp decline in Government deposits, offset only in part by a rise in private demand deposits, and a sizable increase in the money supply. Growth in time and savings deposits was expected to moderate somewhat further.

The Committee concluded that it would be appropriate at this time to maintain the prevailing conditions in the money market. While the emphasis of individual members varied, both the general economic situation and outlook and the desirability of maintaining an "even keel" in the money market during the current Treasury financing were advanced as grounds for such a policy course. 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 suggest that prospects for renewed economic expansion have improved. The adjustment of excessive inventories is proceeding, as a result of the reduced level of industrial output and with consumer buying strengthening. Average wholesale prices have declined recently, reflecting reductions in farm and food prices and stability in prices of industrial commodities; but unit labor costs in manufacturing have risen further. Bank credit expansion has moderated in recent weeks from its earlier rapid rate. Long-term interest rates have risen considerably under the influence of heavy securities market financing and more optimistic market appraisals of the business outlook, but

short-term yields have declined further following the recent reduction in Reserve Bank discount rates. Interest rates abroad have continued to decline and some further reductions have been made in foreign central bank discount rates. The balance of payments deficit has remained substantial despite some improvement in the foreign trade surplus. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to renewed economic expansion, while recognizing the need for progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of the current Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing conditions in the money market.

Votes for this action: Messrs. Martin, Brimmer, Daane, Francis, Maisel, Mitchell, Robertson, Scanlon, Sherrill, Swan, Ellis, and Treiber. Votes against this action: None.