FEDERAL RESERVE

press release

For immediate release November 13, 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 August 15, 1967. Such records are made available approximately 90 days after the date of each meeting of the Committee and are also published in the monthly Federal Reserve Bulletin and in the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on August 15, 1967

Authority to effect transactions in System Account.

Economic activity had been expanding more rapidly in recent weeks, according to reports at this meeting. The latest business developments lent support to the expectation that the rate of growth in real GNP would accelerate in the third quarter, when it was anticipated that final sales would continue to increase rapidly and that the depressant influence of inventory adjustments would wane.

In July industrial production turned up after declining irregularly over the first half of the year, nonfarm employment rose further, and the unemployment rate edged down to 3.9 per cent from 4.0 per cent in June. According to the advance estimate, retail sales increased in July from a June level that had been revised upward substantially. Housing starts declined somewhat in June after rising sharply in May, but they remained above their reduced year-earlier level. Following the sharp contraction in the rate of accumulation earlier in the year, business inventories declined substantially in June, and in many industries stocks were moving into better relation with sales.

In a message to Congress on August 3 the President proposed a new fiscal program, the main element of which was a 10 per cent surcharge on Federal income taxes, to be effective October 1, 1967, for individuals and to be retroactive to July 1, 1967, for corporations. A staff projection suggested that, even if the President's fiscal program was enacted promptly in the form recommended, the growth rate in real GNP in the fourth quarter would be slightly higher than that expected in the third. It was anticipated that the tax increases, if enacted, would moderate the pace of expansion in final spending--particularly by consumers. However, it was thought likely that this effect would be about offset in terms of the rise in total GNP by a shift from small decumulation of inventories in the third quarter to moderate accumulation in the fourth. Among the uncertainties affecting the projections for the second half of the year was the possibility of a strike in the automobile industry in early September when existing wage contracts would expire.

The rise in the wholesale price index slowed in July, according to the advance estimate, as prices of farm products and foods increased only moderately further. However, average industrial prices apparently edged up after 4 months of stability, and increases for a number of industrial commodities had been announced following the mid-July date to which the index applied. In June, as in May, the consumer price index rose at a faster rate than in the first quarter. Unit labor costs in manufacturing advanced further in June, and for the second quarter as a whole they were estimated--after upward revisions in the data for some months--to be 5.5 per cent higher than a year earlier.

Recent data on the U.S. balance of payments supported earlier estimates indicating that the deficit on the "liquidity" basis of calculation was about as large in the second quarter as in the first and that it was considerably above the 1966 rate. Although the merchandise trade surplus increased somewhat in the second quarter as a whole, there was no improvement after April, partly because industrial activity continued sluggish in important industrial countries abroad. The liquidity deficit apparently remained large in July and there seemed to be little reason to expect it to decline substantially during the second half of the year.

The deficit on the "official reserve transactions" basis was quite large in the second quarter, although only about half the record high of the first quarter. The balance on this basis had fluctuated widely over the past year as a result of marked swings in the indebtedness of U.S. banks to their foreign branches. Banks had borrowed heavily through their branches abroad from about the middle of 1966 until late in the year, had repaid a large amount of this debt over the ensuing period until mid-May 1967, and then had resumed such borrowing at a substantial rate.

The President's tax message was followed by a rally in the Government securities market, but this response was short-lived. Subsequently, yields on most coupon-bearing Treasury issues advanced to levels about equal to their previous 1967 highs, as market participants focused on the uncertainties of the congressional reaction to the President's recommendations and on the volume of Federal financing in prospect for the rest of the calendar year even if the tax program was enacted in the form recommended. Yields on municipal securities moved lower, however--mainly because the volume of new offerings had abated somewhat recently, but apparently also because the proposed tax increase enhanced the attractiveness of tax-exempt issues to investors. Markets for corporate bonds continued to be dominated by the heavy flow of new issues, and yields remained close to the highs reached in late June. The volume of new corporate bonds offered publicly in July was more than four times that of a year earlier and was at a new record level; and the calendar for August was large, although not so large as in July.

With a Treasury refunding under way in August, System open market operations since the preceding meeting of the Committee had been directed toward maintaining steady conditions in the money market. The market operations needed for this purpose proved to be relatively limited and were reflected in a small rise in System holdings of Treasury bills. Free reserves of member banks averaged about $265 million in the 4 weeks ending August 9, compared with $285 million in the preceding 4 weeks, and member bank borrowings continued light. Interest rates on Federal funds and on bank loans to Government securities dealers had remained relatively stable since the preceding meeting of the Committee, and the market rate on 3-month Treasury bills was about unchanged on balance. However, rates on a variety of short-term market instruments, including 9- and 12-month Treasury bills, had risen somewhat further.

In its refunding operation the Treasury redeemed securities maturing in mid-August with the proceeds of a sale of a 5-1/4 per cent, 15-month note (priced to yield 5.30 per cent), and it also raised $300 million of new cash. The Treasury was expected to raise an additional $2 billion to $2.5 billion of new cash later in August by the sale of another new issue, but the specific terms had not yet been decided upon.

Secondary-market yields on Federally underwritten home mortgages, which had turned up in May, apparently rose little further in July, when inflows of funds to savings and loan associations and mutual savings banks were unusually large for that time of the year. The pace of mortgage lending by such institutions had accelerated in June--bringing the net increase in outstanding mortgages on homes in the second quarter as a whole to the highest rate since early 1966.

Commercial bank credit expanded markedly in July, partly because of bank acquisitions of tax-anticipation bills auctioned by the Treasury. Also, business loans at banks, which had risen seasonally in June in connection with midmonth corporate income tax payments, failed to show their usual decline in July; as compared with the pattern in other recent years, loan repayments tended to lag, not appearing in volume until late July and early August. This development, which probably was related to the acceleration in the schedule on which businesses pay to the Treasury the taxes they withhold on individual incomes, resulted in a sharp rise in business loans after seasonal adjustment on the basis of past patterns. Daily-average member bank deposits--the bank credit proxy--increased at an annual rate of about 15 per cent from June to July, reflecting a marked expansion in private demand deposits and the money supply, a rise in U.S. Government deposits, and continued rapid growth in time and savings deposits. The volume of negotiable CD's outstanding continued to increase as banks raised their offering rates on these deposits somewhat further.

With business loan repayments becoming large, it appeared likely that growth in bank credit and money would slow over the course of August. For July and August together, however, the bank credit proxy was now projected to rise at an annual rate in the range of 14 to 16 per cent. This was somewhat higher than the range previously expected, partly because of differences between the emerging pattern of Treasury financing and the pattern that had been anticipated earlier.

Staff projections suggested a slower rate of increase in the bank credit proxy from August to September--in the range of 7 to 9 per cent, annual rate--if money market conditions were unchanged. The money supply, which appeared likely to increase much less in August than in July, was projected to decline somewhat in September as Government deposits rose, and growth in time and savings deposits was expected to be somewhat slower. It was recognized that a strike in the automobile industry in September, should one develop, could alter the outlook for bank credit and for demand and time deposits, since it would affect corporate cash flows, personal income, and credit demands.

In the course of the Committee's discussion the members agreed that the fiscal program recommended by the President would, if enacted, make a substantial contribution to balanced economic growth. They also agreed that the continuing substantial deficit in the U.S. balance of payments represented a serious national problem, and some members suggested that a strengthening of elements of the voluntary programs for limiting capital outflows might be desirable.

A number of members expressed the judgment that both the impending Treasury financing and uncertainties about the outcome with respect to the fiscal program now under active consideration by Congress militated against a change in monetary policy at present. At the same time, most members were of the view that recent rates of growth in bank credit were higher than should be sustained in light of the current economic outlook. The Committee concluded that open market operations should be directed at maintaining about the prevailing conditions in the money market, but that operations should be modified, insofar as the Treasury financing permitted, to moderate any apparent tendency for bank credit to expand more than currently expected.

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 economic activity has been expanding more rapidly in recent weeks. With strengthening of private demands for final products and further curtailment of inventory investment, a better balance between inventories and sales is emerging. Upward pressures on costs persist and the over-all indexes of both wholesale and consumer prices have risen further. The balance of payments deficit has remained substantial and is a serious national problem. Bank credit expansion has continued large, while most short- and long-term interest rates have fluctuated close to their highs of the year, under the combined pressure of heavy private security market financing and of current and prospective Federal financing. A new fiscal program has been proposed by the President, including a sizable increase in income taxes, which would make a substantial contribution to balanced economic growth. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions, including bank credit growth, conducive to continuing economic expansion, while recognizing the need for reasonable price stability for both domestic and balance of payments purposes.

To implement this policy, while taking account of expected Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the prevailing conditions in the money market; but operations shall be modified, insofar as Treasury financing permits, to moderate any apparent tendency for bank credit to expand more than currently expected.

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