FEDERAL RESERVE

press release

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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 September 12, 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 September 12, 1967

Authority to effect transactions in System Account.

Economic activity had strengthened recently and the prospect was for more rapid growth in coming months. It appeared that industrial production had advanced in August at about the July rate and since June had recovered much of the decline experienced earlier in the year. Non-farm employment also rose further in August, and the unemployment rate again edged down--to 3.8 per cent from 3.9 per cent in July. Housing starts, which had fallen slightly in June, rebounded in July. Real GNP was expected to rise at a substantial rate in the third quarter as a whole, despite a strike that began in early September at a major automobile producer.

It appeared likely that growth in real GNP would accelerate further in the fourth quarter to a rate that would reinforce existing upward pressures on costs and prices. This expectation was premised on the assumptions--which were necessarily uncertain--that work stoppages in the automobile industry would be of relatively short duration and limited extent, and that a surcharge on Federal income taxes, which was now under consideration by Congress, would not go into effect before the end of the year. With growth in personal incomes accelerating as a result of more rapid increases in both employment and wage rates, consumer spending was expected to rise substantially, accounting for about half of the large advance in GNP foreseen for the fourth quarter. Also anticipated were continued sizable increases in Federal and State

and local government spending, a moderate further rise in residential construction outlays, and some net growth in business inventories following the small decline expected for the third quarter. A Commerce-SEC survey taken in August indicated that businesses planned slightly smaller expenditures on plant and equipment during 1967 than had been reported in April and May, but the latest survey still suggested that such outlays would be slightly higher in the second half of the year than in the first half.

Prices of industrial commodities increased appreciably from mid-July to mid-August, according to preliminary estimates, although the total wholesale price index declined because of a downturn in prices of farm products and foods following 3 months of advance. Price increases were being announced for a wide variety of industrial materials and products as producers sought to pass on, at a time of strengthening demands, the increases in costs they had incurred earlier. The rise in industrial prices from July to August represented a departure from the pattern of stability that had prevailed over the preceding 5 months, when a downdrift in prices of materials had offset moderate advances in prices of industrial products. The consumer price index rose substantially further in July, partly because of seasonal increases in food prices.

With respect to the balance of payments, U.S. banks borrowed heavily through foreign branches during July and August, a period in which rates on Euro-dollar deposits were unusually low relative to rates offered by U.S. banks on domestic CD's. As a result, a

substantial surplus developed after midyear in the payments balance on the "official reserve transactions" basis of calculation.

Tentative data suggested that the payments deficit on the "liquidity" basis was at a somewhat lower rate in July and August than in the first half of 1967, but that it was still undesirably large. The surplus on merchandise trade was about unchanged in July at a level below the average for the first 5 months of the year. Thus far in 1967 imports had remained unexpectedly high and exports had shown no tendency to grow, in part because of continued stagnation of business activity in most industrial countries abroad. Moderately stimulative monetary and fiscal measures had been taken in some countries; the most recent of these measures was a further reduction in Germany of minimum reserve requirements of commercial banks, effective September 1. However, the use of expansionary public policies had been restrained in many countries by concern over actual or prospective inflationary pressures or, as in the United Kingdom, by balance of payments problems.

On August 17, shortly after completing its mid-August refunding, the Treasury announced an offering of a 3-1/2 year, 5-3/8 per cent note (priced to yield 5.40 per cent), to raise $2.5 billion of new money. The payment date for the note, which carried full tax-and-loan-account privileges, was August 30. It was reported that the Treasury was tentatively planning to obtain part of the new cash it would require in the fourth quarter by auctioning about $4.5 billion of tax-anticipation bills in early October. On Friday,

September 8, the Treasury replenished its balances by selling a special certificate of indebtedness in the amount of $153 million to the Federal Reserve. The certificate was redeemed 3 days later.

Recent System open market operations had been directed at maintaining generally steady conditions in the money market while the Treasury's note financing was under way. In the 4 weeks ending September 6 free reserves of member banks averaged about $285 million and member bank borrowings about $75 million, both little changed from the averages of the previous 4 weeks. In the latter part of August the interest rate on Federal funds fell to a level generally below the 4 per cent discount rate, and rates on bank loans to Government securities dealers also frequently dropped below the discount rate. In early September, however, rates of both types moved back to 4 per cent and above. Market rates on Treasury bills had fluctuated rather widely since the preceding meeting of the Committee, with the rate on 3-month bills rising 18 basis points on balance to 4.34 per cent on the day before this meeting. Yields on most other types of short-term securities fluctuated near their highs for the year.

Capital markets remained under pressure in the latter part of August as a result of continued heavy corporate bond flotations and Treasury financing activity, and longer-term yields advanced to levels near or above the peaks reached earlier in the summer. The atmosphere in markets for U.S. Government notes and bonds and corporate securities subsequently improved, however, as the volume

of publicly offered corporate bonds appeared to be moderating. In contrast, pressures persisted in markets for municipal securities, where the volume of new offerings in prospect for September was considerably above the reduced August level.

Business loans outstanding at commercial banks, which had risen sharply in July, declined by nearly as much in August. These changes probably were related in large part to delays in loan repayments relative to the usual seasonal pattern, because of the need in July of this year to finance accelerated payments to the Treasury of taxes withheld on individual incomes. Despite the contraction in business loans, total bank credit expanded rapidly in August, as it had in July. Banks again acquired a substantial volume of newly issued Treasury securities and they increased their loans to Government securities dealers considerably further. According to preliminary estimates the bank credit proxy--daily-average deposits of member banks--rose at an annual rate of 17 per cent from July to August, slightly more than had been anticipated. Most of this increase in the proxy series occurred in late July and early August; growth slackened markedly in the last 3 weeks of August.

Among deposit categories, total time and savings deposits continued to grow rapidly from July to August as the volume of outstanding negotiable CD's increased sharply further and inflows of other time and savings deposits remained large. Private demand deposits--and the money supply--again rose substantially on average, although growth ceased in the latter part of August when credit demands abated. U.S. Government deposits increased somewhat.

Staff projections now suggested that the bank credit proxy would rise at an annual rate in the range of 9 to 12 per cent from August to September if money market conditions were unchanged. Loan demands appeared likely to be relatively moderate in September, and with U.S. Government deposits expected to rise slightly on average, it was anticipated that there would be little or no growth in private demand deposits and in the money supply. The rate of expansion in total time and savings deposits was expected to slacken considerably, primarily because banks were expected to become less aggressive in issuing negotiable CD's.

Considerable concern was expressed in the course of the Committee's discussion about the evidences of developing inflationary pressures in the economy and the prospects for overly rapid growth in aggregate demands later in the year. The members agreed that congressional enactment of the surcharge on income taxes recommended by the President would make a needed contribution to balanced economic growth.

Many members also indicated that they were disturbed by the rapid rates of increase in bank credit and the money supply in recent months. The Committee was divided, however, with regard to the appropriate course for monetary policy under current circumstances. The majority concluded that open market operations should be directed at maintaining prevailing conditions in the money market, with the proviso that operations should be modified as necessary to moderate any apparent tendency for bank credit to expand significantly more than currently expected.

Members of the majority advanced various reasons in support of this course, including the desirability of waiting for firmer indications of the likely nature of action by Congress with regard to the President's tax proposals. Other considerations cited were the risks that under present conditions in financial markets even a modest move toward greater monetary restraint at this time might have an exaggerated impact on market expectations and result in sharp further increases in interest rates, with attendant adverse effects on depositary-type financial intermediaries and on the position of sterling in foreign exchange markets. Also noted were existing uncertainties with respect to the extent, duration, and ultimate economic effects of the strike in the automobile industry.

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 economic activity has strengthened and, despite the strike in the automobile industry, that prospects favor more rapid growth later in the year. Upward pressures on costs persist and average prices of industrial commodities have turned up following several months of stability. While there recently have been large inflows of liquid funds from abroad, the balance of payments continues to reflect a substantial underlying deficit. 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 recent and prospective Federal financing. The President's new fiscal program calling for a sizable increase in income taxes, which would make a substantial contribution to balanced economic growth, is now before Congress. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions, including bank credit growth, conducive to sustainable economic expansion, recognizing the need for reasonable price stability for both domestic and balance of payments purposes.

To implement this policy, 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 as necessary to moderate any apparent tendency for bank credit to expand significantly more than currently expected.

Votes for this action: Messrs. Martin, Brimmer, Daane, Maisel, Mitchell, Robertson, Sherrill, Swan, and Wayne. Votes against this action: Messrs. Hayes, Francis, and Scanlon.

Messrs. Hayes, Francis, and Scanlon dissented from this action because they thought that greater monetary restraint was required in light of recent rates of growth in bank credit, present and prospective inflationary pressures, and the unsatisfactory balance of payments situation. They considered it particularly important to modify monetary policy at this time because they felt that Treasury financing operations would limit the opportunities for such action later in the year. The dissenting members differed, however, with respect to the degree of restraint they thought was appropriate under present circumstances.

Mr. Francis favored seeking significantly firmer money market conditions, and firming still further if growth in bank credit did not moderate substantially. In his judgment, both monetary policy and fiscal policy were characterized by excessive ease at present, the lagged effects of which would magnify the pressures on the economy expected in the months ahead. He observed that fiscal policy was likely to remain extraordinarily stimulative even if the President's tax proposals were enacted in the form recommended. He expressed the view that the limitation by appropriate monetary action of

excessive demand, inflation, speculation, and further deterioration in the U.S. balance of payments appeared to be more crucial than any temporary hardships on the Treasury, financial intermediaries, and long-term borrowers resulting from higher interest rates.

Messrs. Hayes and Scanlon, on the other hand, agreed with members of the majority that there were risks in moving toward firmer money market conditions at present. In their judgment, however, those risks argued not for maintaining prevailing money market conditions but for exercising caution in probing toward moderately less easy conditions.