FEDERAL RESERVE
press release

For immediate release October 14, 1968

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 July 16, 1968. Such records are made available approximately 90 days after the date of each meeting of the Committee and will be found in the Federal Reserve Bulletin and the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on July 16, 1968

1. Authority to effect transactions in System Account.

Staff estimates for the second quarter continued to indicate sharp further advances in real GNP and in average prices as measured by the "GNP deflator." It now appeared, however, that growth in consumer expenditures had been smaller than expected earlier and that business fixed investment had declined somewhat. Much of the increase in real GNP was a consequence of a marked rise in the rate of inventory accumulation, reflecting in part a build-up of stocks of steel as a precaution against a possible strike when current wage contracts expired on July 31.

Industrial production was estimated to have increased somewhat further in June and retail sales, according to the advance estimate, were unchanged. Although the labor market remained generally firm, growth of nonfarm employment had slowed in recent months. The unemployment rate rose from 3.5 per cent in May to 3.8 per cent in June, when young workers entered the labor force in larger numbers than usual.

The consumer price index advanced again in May and was about 4 per cent above a year earlier. Average hourly earnings had continued to rise at a substantial rate in recent months, but increases in consumer prices had held down gains in real earnings and had contributed to demands for higher wages. At the wholesale level, average prices of industrial goods rose again in June after declining in May. Although increases had become less widespread recently, it appeared likely that industrial prices would remain under upward pressure in coming months.

In late June legislation was enacted that provided for a 10 per cent surcharge on income taxes, retroactive to April 1, 1968, for individuals and to January 1, 1968, for corporations. The legislation also provided for a $6 billion reduction from the January Budget estimate for Federal expenditures in the fiscal year 1969. However, the exemption from cuts of certain categories of expenditures together with upward revisions in estimates of defense spending suggested that the net reduction was likely to be less than $6 billion.

Staff projections suggested that the pace of advance in aggregate demands would moderate considerably in the third quarter, partly as a result of this legislation. It was expected that consumer expenditures would advance at only about the moderate pace of the second quarter--with a decline in the rate of personal saving roughly offsetting the combined effects on disposable income of the income tax surcharge and smaller employment gains; that the rise in Federal spending would slow; and that residential construction outlays would turn down. On the other hand, some increase in business fixed investment outlays appeared likely. A significant reduction was now anticipated in the rate of inventory accumulation; businesses were expected to shift from accumulation to decumulation of steel stocks after the strike deadline and to adjust stocks of consumer goods in line with the recently smaller gains in sales.

In foreign exchange markets, the French franc continued under heavy pressure in late June and early July. The Bank of France increased its discount rate from 3-1/2 to 5 per cent effective July 3, and on July 10 announced that it had arranged for $1.3 billion in new international credit facilities. The exchange rate for sterling reached a new low in late June, but subsequently strengthened markedly as a result of two developments: (1) an announcement on July 8 that 12 central banks and the Bank for International Settlements had given firm assurances of their willingness to participate in new arrangements to offset fluctuations in the sterling balances of countries in the sterling area; and (2) the publication on July 11 of figures indicating that British imports had declined significantly in June for the first time since devaluation of the pound. The price of gold in the private London market recently had fallen from around $41 to around $39 per ounce on rumors of an arrangement designed to encourage sales of gold in the market by South Africa.

Tentative estimates suggested that the deficit in the U.S. balance of payments on the liquidity basis had declined markedly in the second quarter. All of the improvement, however, appeared to reflect special official transactions; except for these transactions, the deficit would have been large. The merchandise trade account was in deficit in May for the second time in 3 months. On the official settlements basis the payments balance was estimated to have been in substantial surplus in the second quarter, as a result of a record increase in liabilities of U.S. banks to foreign branches.

On July 2 the Treasury auctioned $4 billion of tax-anticipation bills maturing in March and April 1969, for which commercial banks were permitted to make payment in full by credits to tax and loan accounts. The Treasury was expected to announce at the end of July the terms on which it would refund the $8.6 billion of securities maturing in mid-August, of which $3.6 billion were held by the public. Current estimates suggested that the Treasury also would have to raise a substantial amount of new cash in August.

Conditions in securities markets had eased somewhat in reaction to the enactment of fiscal-restraint legislation, and yields on Government securities of all maturities had declined moderately on balance in the period since the preceding meeting of the Committee. The market rate on 3-month Treasury bills initially fell sharply--from 5.60 per cent on June 18 to 5.20 per cent on June 21. The abruptness of this decline was related to heavy reinvestment demands by holders of maturing tax-anticipation bills and to substantial purchases of bills by the System on June 19 to offset the effects on bank reserves of large-scale international transactions. Subsequently the 3-month bill rate came under upward pressure partly as a result of the Treasury's offering of tax bills in early July, and on the day before this meeting it was 5.42 per cent, 18 basis points below its level 4 weeks earlier. Rates on other short-term instruments showed smaller net declines over the interval, and some--such as those on commercial paper--remained at their mid-June levels.

Yields on long-term corporate and municipal bonds, for which the volume of new issues continued sizable in June and July, were little changed over most of the period since the preceding meeting of the Committee. Conditions in private bond markets had become more buoyant in recent days, however, following the good reception accorded a large corporate issue. Expectations of a near-term relaxation in monetary conditions contributed to the improvement in bond markets, as did the announcements of new international support for sterling and the French franc.

System open market operations since the preceding meeting of the Committee had been directed at maintaining firm conditions in the money market, while accommodating tendencies for short-term interest rates to decline following congressional action on fiscal legislation. The interest rate on System repurchase agreements with nonbank dealers was reduced to 5-5/8 per cent on July 5 from the level of 5-3/4 per cent that had been employed since late April. The effective rate on Federal funds, which was mainly in a 6-1/4 to 6-1/2 per cent range early in the interval, subsequently fluctuated primarily in a 6 to 6-1/8 per cent range. Member bank borrowings averaged $595 million and net borrowed reserves $260 million in the 4 weeks ending July 10, compared with averages of $720 million and $410 million, respectively, in the preceding 4 weeks.

Conditions in markets for residential mortgages continued to tighten through mid-June but appeared to have stabilized thereafter. Preliminary indications suggested that the savings flow experience of nonbank depositary institutions during the interest-and-dividend-crediting period around the end of June was better than many industry observers had expected.

Growth in time and saving deposits at commercial banks in June remained at the low annual rate of about 3 per cent that had prevailed in the two preceding months. However, the net reduction during the course of the month in the volume of large-denomination CD's outstanding was considerably less than normal for the season, and in late June and early July the outstanding volume was increasing. By the time of this meeting most banks issuing such CD's had reduced their offering rates for certificates of longer maturity to levels below the Regulation Q ceilings. Private demand deposits and the money supply continued to expand rapidly in June, although not so rapidly as in May, and U.S. Government deposits increased slightly after declining steadily since February. In the second quarter as a whole, during which Government deposits fell substantially on balance, the money supply grew at an annual rate of about 8.5 per cent, compared with about 4.5 per cent in the first quarter.

Commercial bank credit, as measured by the bank credit proxy--daily-average member bank deposits--increased at an annual rate of 6 per cent in June after rising relatively little in May and declining in April. For the 3 months together, the proxy series increased at an annual rate of 1 per cent, compared with a rate of about 7 per cent in the first quarter. Allowance for changes in the daily average of U.S. bank liabilities to foreign branches, which are among the nondeposit liabilities omitted in calculating the credit proxy, would have served to increase the growth rates by about 2.5 percentage points in the second quarter and 0.5 of a percentage point in the first.

It was expected that the pattern of bank credit growth in July and August would be strongly influenced by Treasury financing operations and by business borrowing to finance additional tax payments required under the terms of the new legislation. Staff projections suggested that if prevailing money market conditions were maintained the bank credit proxy would grow at annual rates in the ranges of 1 to 4 per cent in July, 10 to 12 per cent in August, and 6 to 8 per cent in the 2 months taken together. In an alternative projection, in which somewhat easier money market conditions were assumed, the annual rate of increase in the bank credit proxy in July and August together was estimated in a range of 7 to 9 per cent. These projections assumed that the Treasury would raise a total of about $7.5 billion of new cash in the 2 months, including the $4 billion already raised in July through the sale of tax-anticipation bills. Allowance for a further increase in average liabilities to foreign branches, expected to occur in July, would have added about 1 percentage point to the limits of the ranges of growth projected for July and August together.

It appeared likely that private demand deposits and the money supply would continue to expand at a substantial rate on average in July, but to slow sharply in the latter part of the month and to change little on average in August, a period in which Government deposits were expected to rise substantially on balance. The outlook also favored further rapid growth in large-denomination CD's outstanding, at least in July.

In the course of the Committee's discussion a number of members indicated that they were inclined to maintain prevailing money market conditions for the time being, while awaiting evidence of the probable effectiveness of the recently enacted fiscal-restraint measures in containing inflationary pressures and improving the underlying position of the balance of payments. Other members, while not advocating a substantially easier monetary policy at present, thought that the prospective effects of the new fiscal legislation warranted seeking somewhat less firm money market conditions to the extent such a course was consistent with the forthcoming Treasury financing.

After considering these alternatives, the Committee agreed upon an intermediate course. Specifically, it was decided that open market operations should be directed at accommodating easing tendencies in money market conditions in the period ahead if such tendencies arose from market forces; and at cushioning upward pressures on interest rates if they should develop. It also was agreed that operations should be modified, to the extent permitted by the Treasury financing, if bank credit appeared to be deviating significantly from current projections.

The Committee also discussed the appropriate interest rate for System repurchase agreements (RP's) with nonbank dealers. The members noted that market participants had attached some degree of policy significance to recent changes in the RP rate and to the fact that the rate employed most lately was still 1/8 of a percentage point above the discount rate. While the views of members differed regarding the desirability of regular use of a flexible RP rate as an instrument for influencing money market conditions, the Committee thought that under existing circumstances it would be appropriate to employ a 5-1/2 per cent rate beginning with the next occasion on which the Account Management made repurchase agreements.

The following current economic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting indicates that over-all economic activity continued to expand rapidly in the second quarter, with inventory accumulation accelerating while the rise in capital outlays and in consumer spending slowed. The new fiscal restraint measures are expected to contribute to a considerable moderation of the rate of advance in aggregate demands. Industrial prices have been increasing less rapidly than earlier but consumer prices have continued to rise substantially and wage pressures remain strong. Growth in bank credit and time and savings deposits has been

moderate on average in recent months; growth in the money supply has been larger as U.S. Government deposits have been reduced. Conditions in money and capital markets have eased somewhat, mainly in response to the increase in fiscal restraint. Although there recently have been large inflows of foreign capital, the U.S. foreign trade balance and underlying payments position continue to be matters of serious concern. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to sustainable economic growth, continued resistance to inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of forthcoming Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to accommodating the tendency toward somewhat less firm conditions in the money market that has developed since the preceding meeting of the Committee; provided, however, that operations shall be modified, to the extent permitted by Treasury financing, if bank credit appears to be deviating significantly from current projections.

Votes for this action: Messrs. Martin, Hayes, Brimmer, Daane, Galusha, Hickman, Kimbrel, Maisel, Mitchell, Robertson, Sherrill, and Bopp. Votes against this action: None.

(Mr. Bopp voted as an alternate member in place of Mr. Ellis, whose membership on the Committee had terminated on June 30, 1968, the effective date of his resignation as President of the Federal Reserve Bank of Boston.)

2. Amendments to authorization for System foreign currency operations.

The Committee ratified an action taken by members on July 2, 1968, effective on that date, to increase the System's swap arrangement with the Bank of France from $100 million to $700 million equivalent, and to make the corresponding amendment to paragraph 2 of the authorization for System foreign currency operations. As a result of this action, paragraph 2 read as follows:

> The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, relations with foreign banks and bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	100
National Bank of Belgium	225
Bank of Canada	1,000
National Bank of Denmark	100
Bank of England	2,000
Bank of France	700
German Federal Bank	1,000
Bank of Italy	750
Bank of Japan	1,000
Bank of Mexico	130
Netherlands Bank	400
Bank of Norway	100
Bank of Sweden	250
Swiss National Bank	600
Bank for International Settlements:	
System drawings in Swiss francs	600
System drawings in authorized European currencies other than Swiss francs	1,000

Votes for ratification of this action: Messrs. Martin, Hayes, Brimmer, Daane, Galusha, Hickman, Kimbrel, Maisel, Mitchell, Robertson, Sherrill, and Bopp. Votes against ratification of this action: None.

(Mr. Bopp voted as an alternate member in place of Mr. Ellis, whose membership on the Committee had terminated on June 30, 1968.)

Although the arrangement between the Bank of France and the Federal Reserve had been the first negotiated when the System's swap network was established in 1962, it had remained at $100 million since early 1963 while various other lines in the network had been enlarged from time to time. The increase in this arrangement served to bring the relative sizes of the arrangements in the System's swap network into better balance. It formed part of a package of credit facilities provided to the Bank of France at this time by a number of central banks to help deal with destabilizing exchange market pressures.

The Committee also amended the foreign currency authorization in another respect at this meeting. Under paragraph 1C(1) of the authorization, as it had been amended on November 14, 1967, the Federal Reserve Bank of New York was authorized to have outstanding forward commitments to deliver foreign currencies to the Stabilization Fund of up to $350 million equivalent. The limit had been increased to that level (from a previous figure of $200 million) in November to facilitate the "warehousing" by the System Account of Stabilization Fund holdings of sterling if the resources of the Stabilization Fund proved inadequate to meet all the demands upon them from time to time in the future.

At this meeting the Committee approved an increase in the limit in question up to an amount not exceeding $1,050 million equivalent, on the understandings that (1) the specific amount would be determined by Chairman Martin (or in his absence, Mr. Robertson, Vice Chairman of the Board of Governors) and (2) that the action would become effective upon a determination by Chairman Martin (or in his absence, Mr. Robertson) that it was in the national interest.

> Votes for this action: Messrs. Martin, Hayes, Brimmer, Daane, Galusha, Hickman, Kimbrel, Maisel, Mitchell, Robertson, Sherrill, and Bopp. Votes against this action: None.
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> (Mr. Bopp voted as an alternate member in place of Mr. Ellis, whose membership on the Committee had terminated on June 30, 1968.)

This action was taken against the background of discussions at meetings in Basle, Switzerland, on July 6-8, 1968, and prior discussions between representatives of the U.S. Treasury and the Federal Reserve. At the Basle meetings agreement in principle had been reached among representatives of the Bank for International Settlements, the Bank of England, and 12 other central banks including the Federal Reserve regarding new arrangements for offsetting fluctuations in sterling balances held by countries in the overseas sterling area (OSA). In general, the agreement provided for the extension of a medium-term facility of $2 billion equivalent to the Bank of England by the BIS, with backing provided by the participating central banks, acting where appropriate on behalf of their Governments. It was understood that the agreement was contingent on the satisfactory completion of negotiations by the British authorities with the OSA countries concerning the management by the latter of their sterling reserves.

In the System's preliminary discussions with the U.S. Treasury it had been agreed that the Treasury should participate as principal in the arrangement, with the dollars to be made available on a swap basis against sterling by the Stabilization Fund. It was also agreed that if the resources of the Stabilization Fund should prove insufficient from time to time to meet these and other commitments, the Federal Reserve would undertake to warehouse temporarily for the Stabilization Fund necessary portions of the sterling acquired by the latter.

It was reported at this meeting of the Committee that the U.S. share in the arrangement would be in the neighborhood of $600 million to $700 million. After approving System participation in the arrangement in the manner described, the Committee noted that the agreement was contingent on certain negotiations by the British authorities and that the specific size of the U.S. share had not yet been determined. Accordingly, it was decided that both the effective date of the amendment to paragraph 1C(1) of the authorization and the new figure for maximum forward commitments to the Stabilization Fund to be established by that amendment (within the limit set by today's action) should be subject to determination by Chairman Martin, or in his absence, Mr. Robertson.

Subsequently, agreement was reached on the new arrangement at a meeting in Basle on September 9, 1968, with the U.S. share established at $650 million, and the arrangement went into force on September 23, 1968. On September 24, Chairman Martin determined that an increase in the limit on forward commitments to deliver foreign currencies to the Stabilization Fund of $650 million equivalent, to $1 billion, was in the national interest. Accordingly, effective September 24, 1968, paragraph 1C(1) of the authorization for System foreign currency operations was amended to read as follows:

> 1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive:
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> C. To have outstanding forward commitments undertaken under paragraph A above to deliver foreign currencies, up to the following limits:
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> (1) Commitments to deliver foreign currencies to the Stabilization Fund, up to $1 billion equivalent;
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