FEDERAL RESERVE

press release

For immediate release November 12, 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 August 13, 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 August 13, 1968

Authority to effect transactions in System Account.

Reports at this meeting indicated that some elements of economic activity had expanded vigorously in early summer. Staff projections suggested, however, that expansion in over-all activity would slow considerably in the months ahead as a result of the new fiscal restraint measures and a marked reduction in inventory accumulation.

Retail sales rose sharply in July, according to the advance report. Industrial production increased moderately, and nonfarm employment continued upward at the reduced pace of recent months. The unemployment rate edged down to 3.7 per cent from 3.8 per cent in June, but remained above the low of 3.5 per cent recorded in the two preceding months.

Average prices of industrial commodities advanced only slightly further in July, but increases in steel prices were announced following the wage settlement in the steel industry at the end of the month. Because of a marked, although largely seasonal, increase in prices of farm products and foods, the wholesale price index rose considerably in July. In June the consumer price index rose more than it had in other recent

months. About one-half of the advance reflected higher costs of consumer services, including mortgage interest charges.

The staff projections suggested that inventory accumulation, which had contributed significantly to the rapid growth of real GNP in the second quarter, would slow in the third and fourth quarters. A sharp curtailment of steel production had already begun, and it was expected that liquidation of the stocks of steel that had been built up as a precaution against a strike would continue throughout the rest of the year and perhaps into early 1969. Growth in final sales was projected to remain at about the reduced second-quarter rate, in the expectation that the rise in Federal spending would taper off and that the income tax surcharge would damp increases in consumer expenditures.

In foreign exchange markets the French franc had remained under pressure in recent weeks. The position of sterling had improved earlier, following the announcement that 12 central banks had expressed willingness to participate in new arrangements to offset fluctuations in overseas sterling balances and a report indicating that the British foreign trade deficit had narrowed in June. The sterling exchange rate moved lower on the day of this meeting, however, after publication of figures indicating that the British trade deficit had widened again in July. The price of gold in the private London market recently had continued to fluctuate in a narrow range around $39 per ounce.

In the second quarter the U.S. foreign trade balance had deteriorated further. Nevertheless, the over-all payments balance on the liquidity basis, although still in deficit, had improved substantially, partly as a result of various special official transactions. Even apart from such transactions, however, the balance had improved markedly in May and June, when there were sizable net inflows of private capital; and it appeared that the improvement had been maintained in July. A substantial surplus was recorded in the payments balance on the official settlements basis in the second quarter, mainly because of a massive increase in liabilities of U.S. banks to their branches abroad. Such liabilities increased further in early July, but declined in subsequent weeks.

On July 31 the Treasury offered a new 6-year, 5-5/8 per cent note priced to yield about 5.70 per cent, for payment on August 15. Commercial banks were permitted to pay for 50 per cent of their allotments by credits to Treasury tax and loan accounts. The issue was very well received, and the Treasury raised about $1.9 billion of new cash in addition to refunding $3.6 billion of publicly held securities maturing in mid-August. This was the largest sale to the public of an intermediate-term issue in more than 20 years.

Most interest rates had declined substantially on balance since the previous meeting of the Committee. The declines were largely attributable to market expectations that credit conditions would ease as a result of slower economic growth, smaller prospective Treasury financing needs, and relaxation of monetary restraint following the recent enactment of fiscal legislation. Expectations of a near-term shift in monetary policy, perhaps including a cut in the discount rate, appeared to have been encouraged by a reduction in the interest rate on System repurchase agreements from 5-5/8 to 5-1/2 per cent on the day after the Committee's preceding meeting.

Contributing to the rate declines were increases in bank purchases of Treasury and municipal securities and a large build-up of dealer inventories of Treasury securities, as well as prospects for a substantial reduction in the volume of new corporate bond issues. The fact that only an intermediate-term obligation was offered in the Treasury's August financing--in contrast to the customary practice of including a short-term "anchor" issue--added to downward pressures on rates in short-term markets, where the declines were most pronounced.

Most recently, however, continued firmness in day-to-day money market rates had raised doubts about prospects for an immediate substantial easing of monetary policy. Both short- and long-term interest rates had turned up and had erased part of

their earlier declines. On the day before this meeting the market rate on 3-month Treasury bills was 5.05 per cent, 16 basis points above the low reached in the preceding week but still 37 basis points below its mid-July level.

Net inflows of funds to mutual savings banks and savings and loan associations slowed in July. There were signs, however, that conditions in primary and secondary mortgage markets were beginning to ease, after tightening gradually but steadily for more than a year.

With interest rates on competing market instruments declining on balance in July, the volume of large-denomination CD's outstanding at commercial banks increased by an unusually large amount. Banks recently had reduced their offering rates on all CD's except those with short maturities, and by the time of this meeting such rates were still at the Regulation Q ceilings only for CD's maturing within 2 months. Growth in consumer-type time and savings deposits continued in July at about the moderate pace of previous months. Government deposits declined on average, and growth in private demand deposits and the money supply accelerated--the latter to an annual rate of about 13 per cent, from 8.5 per cent in the second quarter and 4.5 per cent in the first.

Business loans outstanding at banks increased more than seasonally in July, although the rise was somewhat less than

might have been expected in view of the additional corporate tax payments required under the new fiscal legislation. Bank investments expanded sharply, however, as did loans to finance securities holdings. Total bank credit, as measured by the bank credit proxy--daily-average member bank deposits--grew at an annual rate of 9 per cent, compared with rates of 1 per cent in the second quarter and 7 per cent in the first. Allowance for changes in the daily average of U.S. bank liabilities to foreign branches would have served to increase the growth rate by 2 percentage points in July and slightly more in the second quarter.

System open market operations in the early part of the interval following the preceding meeting of the Committee had been directed at accommodating the tendencies for short-term interest rates to decline. Later in the period, however, when it became apparent that bank credit was increasing at a rate significantly above that projected at the time of the previous meeting, operations were modified to the extent permitted by the Treasury financing. Member bank borrowings, which had averaged $555 million in the 2 weeks ending July 24, rose to an average of $670 million in the following 2 weeks; and average net borrowed reserves increased from $215 million to $320 million. Since the preceding meeting, the effective rate on Federal funds had fluctuated mostly in a 6 to 6-1/4 per cent range and bank rates on loans to Government securities dealers, whose financing needs were heavy, also had remained high.

New staff projections suggested that the bank credit proxy would increase from July to August at an annual rate of 16 to 18 per cent if the prevailing stance of monetary policy were maintained. About three-fourths of the estimated growth reflected an expected increase in average Government deposits from July to August as a result of Treasury cash borrowing. Much slower growth--at an annual rate of 5 to 7 per cent--was anticipated for September, when the Treasury was not expected to engage in new borrowing except in connection with its regular bill offerings. The money supply was projected to remain about unchanged in August and to grow moderately in September when a decline in Government deposits was anticipated. Expansion in time and savings deposits was expected to moderate somewhat in August and September.

The Committee agreed that the rate of economic growth was likely to slow during the second half of the year. Several members noted, however, that some moderation in the recent rapid pace of expansion would be desirable in light of prevailing inflationary pressures, and that the evidence available to date was not sufficient to indicate the amount of slowing in prospect. Considerable concern was expressed about the rapid rates of increase in bank credit experienced in July and projected for August, even though it was noted that the spurt was projected to be temporary. At the same time, it was thought generally that it would be undesirable for short-term interest rates, which had been advancing in recent days, to rise substantially further.

The Committee concluded that it would be appropriate at this time to maintain, on balance, about the prevailing conditions in money and short-term credit markets, with some easing in day-to-day money market rates to be permitted if Treasury bill and other short-term rates remained under marked upward pressure. It was also agreed, however, that operations should be modified if bank credit growth in August and September appeared to be significantly exceeding current projections.

Several members expressed the view that in light of the marked net decline in short-term interest rates since the enactment of fiscal legislation, a near-term reduction in the discount rate would be appropriate to bring it into better alignment with current market rates. These members noted that a cut in the discount rate might have the effect of moderating further upward pressures on short-term rates without requiring reserve injections of the size that might otherwise be needed for that purpose.

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

> The information reviewed at this meeting indicates that some elements of economic activity continued to expand vigorously in early summer. Expansion in over-all activity, however, is projected to slow considerably in coming months as a result of the new fiscal restraint measures and a marked reduction in inventory accumulation. Industrial prices have been increasing less rapidly in

recent months, but consumer prices have continued to rise substantially. Wage pressures remain strong, and the recent wage settlement in the steel industry was followed by announcements of steel price increases. Both short- and long-term interest rates have declined considerably, in large part as a result of expectations of easier credit conditions. Bank time and savings deposits, particularly large-denomination CD's, have expanded sharply in early summer; growth in the money supply has continued large as U.S. Government deposits have been drawn down further on average; and growth in total bank credit has been unusually rapid. Although the U.S. balance of payments has recently shown a marked improvement, the 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, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining, on balance, about the prevailing conditions in money and short-term credit markets; provided, however, that operations shall be modified if bank credit appears to be significantly exceeding current projections.

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

Absent and not voting: Mr. Hayes. (Mr. Treiber voted as his alternate. Also, 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.)