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 October 8, 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 October 8, 1968

1. Authority to effect transactions in System Account.

Staff estimates of GNP in the third quarter had been revised upward since the preceding meeting of the Committee, mainly because consumer expenditures had proved stronger than expected. The estimates still suggested that expansion in real GNP had moderated from its very rapid pace in the first half of the year, but they indicated that economic growth had slowed by less than earlier projections had implied. Projections for the fourth quarter, which also had been raised, suggested that expansion would continue at about the rate now estimated for the third quarter.

According to retail sales figures for August and the first 3 weeks of September, consumer spending on both durable and nondurable goods was being maintained at the high level to which it had risen in July. Since growth of disposable income in the third quarter had been curtailed by the tax surcharge, it appeared that the rate of personal saving had declined sharply.

Little further change in the saving rate seemed likely in the fourth quarter, and with disposable income expected to continue rising slowly, growth in consumer spending was projected to slacken.

The staff projections also suggested that other categories of final demand--including Federal outlays, residential construction expenditures, and business spending on plant and equipment--would provide relatively little stimulus to economic expansion in the fourth quarter. On the other hand, the rate of inventory accumulation, which had declined in the third quarter, was now expected to rise in the fourth quarter.

In September output of steel was curtailed further as users of the metal continued to reduce inventories that had been accumulated prior to the wage settlement in the steel industry. As a consequence, the industrial production index was estimated to have declined again. Employment in manufacturing--even apart from the steel industry--had not increased since June, but labor markets remained generally firm and in recent months average hourly earnings had continued to increase at a rapid pace.

Average prices of industrial commodities rose appreciably in September after having changed little for several months. The rise, which was the largest for any month since late winter, reflected not only the advance in steel prices following the wage settlement but also increases for a broad list of other commodities. With average prices of farm products and foods turning up, the over-all wholesale price index rose in September by about as much as it had declined in August. The consumer price index increased considerably less in August than it had in June and July, partly because of a slowing of the advance in mortgage interest charges.

In foreign exchange markets, pressures on the French franc abated for a time in late September but then increased again. However, speculation on an imminent revaluation of the German mark had subsided in recent weeks, and market conditions in general had improved considerably. The exchange rate for sterling, which had strengthened after the September 9 announcement that final agreement had been reached on the new sterling balances arrangement, advanced further following the publication on September 17 of figures indicating that the British foreign trade deficit had narrowed sharply in August. On September 19 the Bank of England reduced its discount rate to 7 per cent from the 7-1/2 per cent rate that had been in effect since March 21.

In August a large rise in U.S. merchandise exports was exceeded by an even larger rise in imports, and the U.S. trade surplus declined from the low level of July. Part of the increase in both exports and imports was attributable to expectations of a possible strike of longshoremen on October 1. With respect to the over-all payments balance, tentative estimates for the third quarter indicated that the deficit on the liquidity basis was smaller than in the second quarter. All of the improvement, however, apparently had occurred in July; preliminary data suggested that sizable deficits had been incurred in August and September. It appeared that there was a moderate surplus in the third quarter on the official settlements basis, mainly as a result of a further increase in liabilities of U.S. banks to their branches abroad. Such liabilities rose sharply from mid-August to mid-September, but declined subsequently.

The Treasury was expected shortly to announce a cash offering of tax-anticipation bills, perhaps in the amount of $3 billion or $3.5 billion, for which commercial banks would be permitted to make payment by credits to tax and loan accounts. Also, an announcement was expected on October 23 of the terms on which the Treasury would refund notes and bonds maturing in mid-November, of which about $4 billion were held by the public. The possibility was noted that a pre-refunding of bonds maturing in mid-December, of which $1.6 billion were publicly held, might be undertaken along with the refunding of November maturities.

System open market operations since the preceding meeting of the Committee had been directed at maintaining about the prevailing conditions in the money and short-term credit markets. Although the System undertook an unusually large volume of operations for this purpose--absorbing reserves on a massive scale in the first part of the period and supplying substantial amounts of reserves later--money market conditions initially eased somewhat and subsequently firmed again. Thus, the effective rate in Federal funds transactions, which had averaged about 5-7/8 per cent in the period before the previous meeting, fluctuated below that level for a time and then moved up to the 6 per cent area. Rates posted by major banks on loans to Government securities dealers followed a similar pattern.

A number of factors combined to complicate operations and to require a large volume of transactions by the System in this period. In addition to normal seasonal fluctuations, these factors included large international transactions affecting reserves; a sharp, although temporary, decline in Treasury balances at Reserve Banks before the September 18 payment date for corporate taxes; and the adoption of new methods for calculating required reserves of member banks under the revision of Regulation D that became effective on September 12.[1/]

With respect to the last of these factors, the introduction of a 2-week lag in the deposit balances used for calculating required reserves, at a time when deposits were rising seasonally, had the effect of temporarily reducing required reserves and increasing excess reserves considerably relative to the levels that would have obtained under the prior procedures, thus necessitating offsetting open market operations. In addition, operations were complicated by uncertainties as to how member banks would react--particularly during a transition period--to this and the other changes in procedures, including the new carry-over provisions for reserve excesses and deficiencies. The effects of the carry-over provisions on reserve-management practices of banks were expected to have the incidental consequence of weakening

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1/ Under Regulation D, as amended effective Sept. 12, 1968, all member banks are required to meet their daily-average reserve requirements on a weekly basis; previously, a biweekly settlement period had been employed for country banks. In addition, required reserves are calculated on the basis of average deposits 2 weeks earlier rather than on the basis of average deposits in the current settlement period. Similarly, the vault cash component of the total reserves maintained by banks is recorded with a 2-week lag. Also, member banks are permitted to carry forward into the next reserve week excesses, as well as deficiencies, in reserve requirements averaging up to 2 per cent of required reserves, except that any portion of such excesses or deficiencies not offset in the next week may not be carried forward into later weeks.

the short-run relationship between marginal reserves--that is, free or net borrowed reserves--and the other measures used to assess money market conditions. As it turned out, net borrowed reserves increased on the average in the 3 weeks beginning September 12; average borrowings by member banks declined to about $475 million from $520 million in the preceding 4 weeks, but excess reserves declined more.

Yields on both short- and long-term Treasury securities, like day-to-day money market rates, moved down after mid-September and then rose again--changing little on balance during the period since the preceding meeting of the Committee. The market rate on 3-month Treasury bills, for example, fell from a high of 5.30 per cent reached before mid-September to 5.09 per cent late in the month and then advanced; on the day before this meeting it was 5.26 per cent, 2 basis points above its level 4 weeks earlier.

The initial downward pressures on Treasury security yields were reinforced by expectations of a reduction in the 6-1/2 per cent prime lending rate of banks that had prevailed since mid-April. The prime rate was reduced in late September, to 6-1/4 per cent by most banks and to 6 per cent by a few. Among the factors contributing to the subsequent upward pressures on Treasury security yields were the failure of the 6 per cent prime rate to become general, indications that economic conditions were stronger than had been expected, and increasing attention among market participants to forthcoming Treasury financing operations.

In private capital markets yields on new corporate bonds had been relatively stable in recent weeks, but yields on State and local government issues had declined considerably, mainly because of continued heavy acquisitions by commercial banks. At the close of the period, however, both corporate and municipal yields were rising again.

Conditions in markets for residential mortgages appeared to have eased slightly further in September. Net inflows of deposits to nonbank financial intermediaries increased only moderately in August, the latest month for which data were available. However, liquidity ratios at Federal savings and loan associations declined markedly in both July and August after the Federal Home Loan Bank Board reduced minimum liquidity requirements, and this development helped to sustain mortgage lending activity by such associations.

Time and savings deposits at commercial banks, which had grown rapidly in July and August, expanded substantially again in September. Inflows of consumer-type deposits increased further, and the outstanding volume of large-denomination CD's declined less than seasonally despite moderate reductions in offering rates on all CD's except those of short maturity. Private demand deposits and the money supply declined; on balance the money supply had not increased since the first week of July, after rising substantially in preceding months.

Growth of business loans at banks slowed in September. Although banks' holdings of municipal securities expanded considerably further, their holdings of Treasury securities were about unchanged--in contrast to the two preceding months when banks had been heavy buyers of securities offered in Treasury financings. Total bank credit, as measured by the bank credit proxy--daily-average member bank deposits--rose at an annual rate of about 9 per cent in September, compared with a rate of more than 21 per cent in August. Allowance for changes in the daily average of U.S. bank liabilities to foreign branches would have served to increase the growth rate by about 1.5 percentage points in September and 0.5 of a percentage point in August.

Bank credit growth was expected to accelerate somewhat in October as a result of the anticipated cash financing by the Treasury. The latest staff projections suggested that the bank credit proxy would expand at an annual rate of 10 to 13 per cent if the conditions in money and short-term credit markets that had prevailed on the average since the Committee's preceding meeting were maintained. This projection assumed that the Treasury would offer $3.5 billion of tax-anticipation bills for payment in the latter part of the month and that commercial banks initially would acquire the bulk of the offering. Slower growth of bank credit was projected for November, when the Treasury was not expected to raise new cash. The October projection allowed for some moderation in the rate of expansion in time and savings deposits and for little growth in private demand deposits. A small increase in the money supply, reflecting mainly an expansion in currency, was anticipated.

The Committee was divided in its views on the appropriate course for monetary policy under current circumstances, with a majority favoring no change and a minority advocating at least a slight increase in monetary restraint. The majority was opposed to greater restraint at present primarily because it continued to expect the rate of expansion of consumer spending and of economic activity in general to slow down as the effects of the recent fiscal restraint measures were increasingly felt. The fact that the Treasury would be undertaking a major refunding operation before the Committee's next meeting also was cited as a consideration militating against a change in policy at this time.

The Committee concluded that open market operations should be directed at maintaining the conditions in money and short-term credit markets that had prevailed on the average in the period since the preceding meeting, on the understanding that operations would not be undertaken to offset any moderate upward pressures on Treasury bill rates that might develop. The proviso was added that operations should be modified, insofar as the forthcoming Treasury refunding permitted, if the rate of bank credit expansion appeared to be significantly in excess of current projections.

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

> The information reviewed at this meeting suggests that over-all economic expansion has moderated, although less than projected, from its very rapid pace earlier in the year, but upward pressures on prices and costs are persisting. Most market interest rates have changed little on balance in recent

weeks. Bank credit and time and savings deposits expanded rapidly this summer, but the money supply has shown no net growth since July after rising substantially for several months. The earlier improvement in the U.S. balance of payments was not maintained in August and September, according to preliminary indications, and 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 about the prevailing conditions in money and short-term credit markets; provided, however, that operations shall be modified, to the extent permitted by the forthcoming Treasury refunding operation, if bank credit expansion appears to be significantly exceeding current projections.

Votes for this action: Messrs. Martin, Brimmer, Daane, Galusha, Maisel, Mitchell, Morris, Robertson, and Sherrill. Votes against this action: Messrs. Hayes, Hickman, and Kimbrel.

Messrs. Hayes, Hickman, and Kimbrel dissented from this action because they thought that the rates of bank credit growth recorded in recent months and the rate projected for October were excessive, particularly in light of the persisting inflationary pressures and the unexpected strength in the economy. Accordingly, they favored seeking money market conditions somewhat firmer than those advocated by the majority, to the extent the Treasury refunding operation permitted.

2. Amendment to authorization for System foreign currency operations.

At its meeting on March 14, 1968, the Committee had authorized the Special Manager to undertake negotiations looking toward increases, up to specified limits, in a number of the System's reciprocal currency arrangements, on the understanding that any such enlargements--and the corresponding amendments to paragraph 2 of the authorization for System foreign currency operations--would become effective upon a determination by Chairman Martin that they were in the national interest. As indicated in the policy record for March 14, the Chairman had made the indicated determination for certain of these arrangements on March 17.

Among the arrangements covered by the Committee's action of March 14 was that with the Bank of Italy, for which negotiations looking toward an increase of up to $250 million equivalent had been authorized. Recently these negotiations had been successfully completed, and on the day of this meeting Chairman Martin determined that an increase in the swap arrangement with the Bank of Italy from $750 million to $1 billion equivalent was in the national interest. Accordingly, the corresponding amendment to paragraph 2 of the authorization for System foreign currency operations became effective on October 8, 1968.