FEDERAL RESERVE

press release

For immediate release April 14, 1969

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 January 14, 1969. 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 January 14, 1969

Authority to effect transactions in System Account.

According to preliminary Commerce Department estimates, expansion in real gross national product moderated to an annual rate of 3.8 per cent in the fourth quarter of 1968 from 5.0 per cent in the third quarter and more than 6 per cent in the first half of the year. However, the pace of advance in average prices--as measured by the GNP deflator--increased in the fourth quarter. Staff projections suggested that the rate of expansion in economic activity would slacken further in the first half of 1969.

Growth in consumer spending slowed sharply in the fourth quarter as the increase in disposable income remained moderate and the rate of personal saving rose. Growth in Federal outlays on goods and services continued to slacken. At the same time, the rate of business inventory accumulation increased substantially, and both business spending on plant and equipment and residential construction outlays advanced considerably.

In December retail sales declined markedly--perhaps partly because of an influenza epidemic--and reached their lowest level since the spring of 1968. However, industrial production and nonfarm payroll employment continued to rise rapidly, and the unemployment rate remained at the low level of 3.3 per cent to which it had fallen in November. With tight conditions persisting in labor markets, average wage rates in all major industry groups advanced considerably further.

Average wholesale prices of industrial commodities rose during the month ending in mid-December to a level 2.5 per cent above a year earlier, and an unusually large number of increases in such prices were announced subsequently. The consumer price index advanced substantially further in November and was 4.8 per cent above its year-earlier level--the largest increase in any 12-month period since 1951.

The staff projections for the first half of 1969 suggested that increases in consumer spending would remain moderate--partly because of the effects on disposable income of higher social security taxes and retroactive payments on 1968 income taxes--and that the rate of inventory accumulation would decline as businesses adjusted to the slower growth in final sales. It appeared likely that there would be little further rise in Federal outlays, with a sizable surplus emerging in the fiscal position of the Government, and that residential construction activity would be increasingly limited by the reduced availability of mortgage funds. On the other hand, prospects were for continued rapid growth in business capital outlays.

With respect to the U.S. balance of payments, in the last week of December there was an exceptionally large volume both of foreign official transactions that reduced U.S. liquid liabilities and of inflows of private funds, including a sizable volume of funds drawn from the Euro-dollar market by direct-investment affiliates of U.S. corporations. These inflows were large enough to produce a substantial, although probably temporary, surplus in the fourth quarter in the payments balance on the liquidity basis of calculation.1/ The surplus on the official reserve transactions basis was lower in the fourth quarter than in the third, in part because there was a year-end decline in Euro-dollar liabilities of U.S. banks to their foreign branches as a counterpart of the private capital inflows. In early January liabilities to foreign branches increased sharply and interest rates in the Euro-dollar market, which had reached record levels in late 1968, rose further.

For the full year 1968, despite a sharp deterioration in the merchandise trade balance, there was a small surplus in the over-all payments balance on the liquidity basis and a larger one on the official settlements basis; on both bases, substantial deficits had been incurred in 1967. While data were still preliminary and incomplete, it appeared that the elements making for the shift to surplus in 1968 included a heavy volume of foreign private long-term

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1/ The balance on the "liquidity" basis is measured by changes in U.S. reserves and in liquid U.S. liabilities to all foreigners. The balance on the "official reserve transactions" basis (sometimes referred to as the "official settlements" basis) is measured by changes in U.S. reserves and in liquid and certain nonliquid liabilities to foreign official agencies, mainly monetary authorities. The latter balance differs from the former by (1) treating changes in liquid U.S. liabilities to foreigners other than official agencies as ordinary capital flows, and (2) treating changes in certain nonliquid liabilities to foreign monetary authorities as financing items rather than ordinary capital flows.

investment in the United States, particularly in equity securities; a reduction in net use of U.S. funds for direct investment abroad that was apparently larger than the $1 billion required by the Commerce Department guidelines; and a larger net inflow of bank-reported claims than was required under the Federal Reserve guidelines, in contrast to the outflow of 1967. Also affecting the liquidity balance was a substantial volume of special transactions with foreign governments; and affecting the official settlements balance was a large net inflow of liquid funds through foreign branches of U.S. banks and other foreign banks. With respect to U.S. merchandise trade, the surplus for the first 11 months of 1968 totaled only about $300 million, compared with about $3.5 billion for the full year 1967.

On the day of this meeting the Treasury was auctioning $1.75 billion of tax-anticipation bills due in June for payment on January 20. The Treasury was expected to announce around the end of January the terms on which it would refund notes and bonds maturing in mid-February, of which about $5.4 billion were held by the public.

Open market operations since the December 17, 1968, meeting of the Committee had been directed toward attaining firmer conditions in money and short-term credit markets, while taking account of the increase from 5-1/4 to 5-1/2 per cent in Federal Reserve Bank discount rates announced on the day of that meeting. The System absorbed reserves early in the interval and again near the close. But in the intervening period it supplied reserves to cushion an unduly sharp market reaction to the increase in restraint and to cope with substantial year-end strains. The effective rate on Federal funds fluctuated widely--with some trading at rates as high as 7-1/8 per cent, a new record, at the end of December--but was mostly in a range of 6-1/4 to 6-5/8 per cent, considerably above the range of previous weeks. In the single week ending January 1 member bank borrowings averaged $1.3 billion, a 16-year high; and in the 4 weeks ending January 8 they averaged $815 million, compared with an average of $515 million in the preceding 4 weeks. Average excess reserves also increased substantially in the interval, however, so that the rise in net borrowed reserves was relatively moderate.

Interest rates on both short- and long-term Treasury securities rose to new highs in the week following the mid-December meeting of the Committee, and although these yields subsequently declined somewhat, they remained well above earlier levels. The market rate on 3-month Treasury bills, for example, advanced from 5.94 per cent on December 16 to a peak of 6.29 per cent on December 24 and then declined irregularly to 6.13 per cent on the day before this meeting. Yields on other short-term market instruments also rose considerably on balance. In markets for corporate and municipal bonds, yields fluctuated in a rather narrow range around the highs reached in mid-December. New-issue volume in December was unusually small for corporate bonds; for municipal bonds, it was below the monthly average for the year largely because of the withdrawal of several scheduled offerings.

Net inflows of deposits to nonbank financial intermediaries slackened somewhat in November and apparently also in December. Yields on home mortgages in the secondary market continued to advance and by early January were close to the high that had been reached in the preceding June.

Since late November most major banks had been offering the maximum permissible rates under Regulation Q for large-denomination negotiable certificates of deposit (CD's) of all maturities. But as short-term market rates of interest continued to rise, CD's became progressively less competitive, and during December and early January there were declines in the volume outstanding--particularly at large money market banks--of considerably greater than seasonal dimensions. However, inflows of consumer-type time and savings deposits remained substantial during much of December, and on the average total time and savings deposits at banks increased at about the relatively rapid rate of November. The money stock expanded in December at an estimated annual rate of about 6 per cent--roughly half the November rate--although it bulged sharply around the turn of the year.

The prime lending rate of commercial banks, which had been raised to 6-1/2 per cent on December 2, was advanced to 6-3/4 per cent on December 18--the day after the increase in discount rates was announced--and then to a record 7 per cent on January 7. In December, according to preliminary estimates, growth in business loans slowed considerably, as did bank acquisitions of municipal securities. However, the sharp decline in bank holdings of Treasury securities that had occurred in November was not repeated in December.

Total bank credit, as measured by the bank credit proxy--daily-average member bank deposits[2/]--rose from November to December at an annual rate of about 13 per cent, compared with 11 per cent in the previous month and 13 per cent in the second half of 1968. After adjustment for changes in the daily average of U.S. bank liabilities to foreign branches--which increased slightly in November but fell sharply in December--the proxy series expanded at an annual rate of about 11.5 per cent in both months.

Staff projections suggested that if existing Regulation Q ceilings and prevailing money market conditions were maintained there would be further large declines in the volume of CD's outstanding and a marked slowing of inflows of consumer-type time and savings deposits. The average level of the money stock was expected to be considerably higher in January than in December because of the sharp but largely temporary increase in late December and early January. With respect to bank credit, the staff projections suggested that the proxy series

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2/ In recent years the Committee has been making use of daily-average statistics on total member bank deposits as a "bank credit proxy"--that is, as the best available measure, although indirect, of developing movements in bank credit. Because they can be compiled on a daily basis with a very short lag, the deposit figures are more nearly current than available bank loan and investment data. Moreover, average deposit figures for a calendar month are much less subject to the influence of single-date fluctuations than are the available month-end data on total bank credit, which represent estimates of loans and investments at all commercial banks on one day--the last Wednesday--of each month. For statistics on daily-average member bank deposits, see table in the statistical section of the Federal Reserve Bulletin (on page A-17 of the January 1969 issue). Some brief comments on the relation between the member bank deposit series and the bank credit statistics are given in the note on p. 1460 of the October 1966 Bulletin.

As indicated in that note, movements in total member bank deposits and in commercial bank credit can diverge for various reasons, including changes in nondeposit liabilities of banks. Because changes in U.S. bank liabilities to foreign branches recently have been an important source of divergence from time to time, an "adjusted" proxy series, taking approximate account of such changes, is now also being calculated for Committee use.

would expand in January at an annual rate in the range of zero to 3 per cent. After adjustment for the marked increase in U.S. bank liabilities to foreign branches that had already occurred in early January, growth in the credit proxy was projected in a range of 2 to 5 per cent. For February, prospects were for continued run-offs of CD's and no significant increase in the rate of bank credit growth.

In the Committee's discussion it was noted that, despite the indications of slowing in the rate of economic expansion, upward pressures on prices persisted and inflationary expectations remained widespread. It also was noted that the recent improvement in the U.S. balance of payments, while encouraging, did not imply that a sustainable equilibrium had been achieved, particularly in view of the marked deterioration in the U.S. trade surplus during 1968.

The Committee agreed that under these circumstances it would be desirable at present to maintain the existing degree of monetary restraint. The fact that the Treasury would be announcing a refunding around the end of January also was mentioned as militating in favor of an unchanged policy. The sharp slowing of growth in bank credit projected for January and February was generally considered to be appropriate, especially in light of the high growth rates of recent months. The view was expressed, however, that it would be undesirable to curtail bank credit drastically for an extended period.

The Committee decided that open market operations should be directed at maintaining the prevailing firm conditions in money and short-term credit markets, with the proviso that operations should be modified--to the extent permitted by the forthcoming Treasury refunding--if bank credit expansion appeared to be deviating significantly in either direction from current projections. Comments were made as to the desirability, on the one hand, of moderating any undue liquidity pressures that might develop and, on the other hand, of also moderating any tendency toward easing of money market conditions that might be brought about by seasonal forces.

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

> The information reviewed at this meeting suggests that expansion in real economic activity has been moderating, with slower growth in consumer outlays but higher rates of business inventory accumulation and capital expenditures. Upward pressures on prices and costs, however, are persisting. Since the mid-December firming of monetary policy, most interest rates have risen further and, with the outstanding volume of large-denomination CD's declining sharply, bank credit expansion has slowed. Growth in the money supply moderated somewhat on average in December from its rapid November pace. The U.S. foreign trade surplus remains very small but near the end of the year unusual capital inflows had a markedly favorable effect on the over-all balance of payments. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging a more sustainable rate of economic growth and attaining reasonable equilibrium in the country's balance of payments.
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> To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing firm conditions in money and short-term credit markets; provided, however, that operations shall be modified, to the extent permitted by the forthcoming Treasury refunding, if bank credit expansion appears to be deviating significantly from current projections.

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

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

Mr. Morris dissented from this action because he thought the directive as adopted could be consistent with an unduly restrictive monetary policy. In his judgment the current state of the economy called for a substantial moderation of bank credit growth from the 13 per cent rate that had prevailed over the second half of 1968, but not for so sharp a change as was implied by the projections for January and February.