RECORD OF POLICY ACTIONS OF THE FEDERAL OPEN MARKET COMMITTEE

The record of policy actions of the Federal Open Market Committee is presented in the ANNUAL REPORT of the Board of Governors pursuant to the requirements of Section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each such action, and that it shall include in its ANNUAL REPORT to the Congress a full account of such actions.

In the pages that follow, there are entries with respect to the policy actions taken at the meetings of the Federal Open Market Committee held during the calendar year 1966, including the votes on the policy decisions made at those meetings as well as a résumé of the basis for the decisions, as reflected by the minutes of the Committee. The summary descriptions of economic and financial conditions included in the entries are based on the information that was available to the Committee at the time of the meetings, rather than on data for the periods in question as they may have been subsequently revised.

It will be noted from the record of policy actions that in some cases the decisions were by unanimous vote and that in other cases dissents were recorded. The fact that a decision in favor of a general policy was by a large majority, or even that it was by unanimous vote, does not necessarily mean that all members of the Committee were equally agreed as to the reasons for the particular decision or as to the precise operations in the open market that were called for to implement the general policy.

The policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the

System Open Market Account. Both the Manager of the System Open Market Account and the Special Manager of the Account for foreign currency operations attend the meetings of the Committee. In the area of domestic open market activities the Bank operates under two separate policy directives from the Open Market Committee—a continuing authority directive and a current economic policy directive. At the beginning of the calendar year the continuing authority directive in effect was as follows:

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent current economic policy directive adopted at a meeting of the Committee:

(a) To buy or sell U.S. Government securities in the open market from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $2.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting;

(b) To buy or sell prime bankers' acceptances of the kinds designated in the Regulation of the Federal Open Market Committee in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed $125 million or 10 per cent of the total of bankers' acceptances outstanding as shown in the most recent acceptance survey conducted by the Federal Reserve Bank of New York;

(c) To buy U.S. Government securities with maturities as indicated below, and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, from nonbank dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or acceptances in 15 calendar days or less, at rates not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower; provided that in the event Government securities covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market. U.S. Government securities bought under the provisions of this section shall have maturities of 24 months or less at the time of purchase, except that, during any period beginning with the day after the Treasury has announced a refunding operation and ending on the day designated as the settlement date for the exchange, the U.S. Government securities bought may be of any maturity.

2. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to purchase directly from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the rate charged on such certificates shall be a rate ¼ of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed $500 million.

This directive was amended on five occasions during the year, as noted in the entries.

The current economic policy directive was changed frequently during the year. The directive in effect at the beginning of 1966 instructed the Federal Reserve Bank of New York as follows:

The economic and financial developments reviewed at this meeting indicate that domestic economic expansion is gaining in strength in a climate of optimistic business sentiment, with continuing active demands for credit and some further upward creep in prices. Although there appears to have been some recent improvement in our international payments, the need for further progress remains. In this situation, it is the Federal Open Market Committee's policy to complement other recent measures taken to resist the emergence of inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, while accommodating moderate growth in the reserve base, bank credit, and the money supply.

Until the next meeting of the Committee, and taking into account the forthcoming Treasury financing activity and widely fluctuating seasonal pressures at this time of year in addition to the recent increase in Reserve Bank discount rates, System open market operations shall be directed to moderating any further adjustments in money and credit markets that may develop.

In the foreign currency area, until June 7, 1966, the Federal Reserve Bank of New York operated under three instruments—(1) an authorization regarding open market transactions in foreign currencies, (2) a statement of guidelines for System foreign currency operations, and (3) a continuing authority directive on System foreign currency operations. On June 7, as indicated in the entry for that date, these were replaced by two new instruments.

The foreign currency instruments in effect at the beginning of the year were as follows:

Authorization Regarding Open Market Transactions In Foreign Currencies

Pursuant to Section 12A of the Federal Reserve Act and in accordance with Section 214.5 of Regulation N (as amended) of the Board of Governors of the Federal Reserve System, the Federal Open Market Committee takes the following action governing open market operations incident to the opening and maintenance by the Federal Reserve Bank of New York (hereafter sometimes referred to as the New York Bank) of accounts with foreign central banks.

I. Role of Federal Reserve Bank of New York

The New York Bank shall execute all transactions pursuant to this authorization (hereafter sometimes referred to as transactions in foreign

currencies) for the System Open Market Account, as defined in the Regulation of the Federal Open Market Committee.

II. Basic Purposes of Operations

The basic purposes of System operations in and holdings of foreign currencies are:

(1) To help safeguard the value of the dollar in international exchange markets;

(2) To aid in making the existing system of international payments more efficient and in avoiding disorderly conditions in exchange markets;

(3) To further monetary cooperation with central banks of other countries maintaining convertible currencies, with the International Monetary Fund, and with other international payments institutions;

(4) Together with these banks and institutions, to help moderate temporary imbalances in international payments that may adversely affect monetary reserve positions; and

(5) In the long run, to make possible growth in the liquid assets available to international money markets in accordance with the needs of an expanding world economy.

III. Specific Aims of Operations

Within the basic purposes set forth in Section II, the transactions shall be conducted with a view to the following specific aims:

(1) To offset or compensate, when appropriate, the effects on U.S. gold reserves or dollar liabilities of disequilibrating fluctuations in the international flow of payments to or from the United States, and especially those that are deemed to reflect temporary forces or transitional market unsettlement;

(2) To temper and smooth out abrupt changes in spot exchange rates and moderate forward premiums and discounts judged to be disequilibrating;

(3) To supplement international exchange arrangements such as those made through the International Monetary Fund; and

(4) In the long run, to provide a means whereby reciprocal holdings of foreign currencies may contribute to meeting needs for international liquidity as required in terms of an expanding world economy.

IV. Arrangements with Foreign Central Banks

In making operating arrangements with foreign central banks on System holdings of foreign currencies, the New York Bank shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee.

The Bank shall instruct foreign central banks regarding the investment of such holdings in excess of minimum working balances in accordance with Section 14(e) of the Federal Reserve Act.

The Bank shall consult with foreign central banks on coordination of exchange operations.

Any agreements or understandings concerning the administration of the accounts maintained by the New York Bank with the central banks designated by the Board of Governors under Section 214.5 of Regulation N (as amended) are to be referred for review and approval to the Committee, subject to the provision of Section VIII, paragraph 1, below.

V. Authorized Currencies

The New York Bank is authorized to conduct transactions for System Account in such currencies and within the limits that the Federal Open Market Committee may from time to time specify.

VI. Methods of Acquiring and Selling Foreign Currencies

The New York Bank is authorized to purchase and sell foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the Stabilization Fund of the Secretary of the Treasury established by Section 10 of the Gold Reserve Act of 1934 and with foreign monetary authorities.

Unless the Bank is otherwise authorized, all transactions shall be at prevailing market rates.

VII. Participation of Federal Reserve Banks

All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G (1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

VIII. Administrative Procedures

The Federal Open Market Committee authorizes a Subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board of Governors (or in the absence of the

Chairman or of the Vice Chairman of the Board of Governors the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate) to give instructions to the Special Manager, within the guidelines issued by the Committee, in cases in which it is necessary to reach a decision on operations before the Committee can be consulted.

All actions authorized under the preceding paragraph shall be promptly reported to the Committee.

The Committee authorizes the Chairman, and in his absence the Vice Chairman of the Committee, and in the absence of both, the Vice Chairman of the Board of Governors:

(1) With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

(2) To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities;

(3) From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Problems.

IX. Special Manager of the System Open Market Account

A Special Manager of the Open Market Account for foreign currency operations shall be selected in accordance with the established procedures of the Federal Open Market Committee for the selection of the Manager of the System Open Market Account.

The Special Manager shall direct that all transactions in foreign currencies and the amounts of all holdings in each authorized foreign currency be reported daily to designated staff officials of the Committee, and shall regularly consult with the designated staff officials of the Committee on current tendencies in the flow of international payments and on current developments in foreign exchange markets.

The Special Manager and the designated staff officials of the Committee shall arrange for the prompt transmittal to the Committee of all statistical and other information relating to the transactions in and the amounts of holdings of foreign currencies for review by the Committee as to conformity with its instructions.

The Special Manager shall include in his reports to the Committee a statement of bank balances and investments payable in foreign currencies, a statement of net profit or loss on transactions to date, and a summary of outstanding unmatured contracts in foreign currencies.

X. Transmittal of Information to Treasury Department

The staff officials of the Federal Open Market Committee shall transmit all pertinent information on System foreign currency transactions to designated officials of the Treasury Department.

XI. *Amendment of Authorization*

The Federal Open Market Committee may at any time amend or rescind this authorization.

Guidelines for System Foreign Currency Operations

1. Holdings of Foreign Currencies

Until otherwise authorized, the System will limit its holdings of foreign currencies to that amount necessary to enable its operations to exert a market influence. Holdings of larger amounts will be authorized only when the U.S. balance of international payments attains a sufficient surplus to permit the ready accumulation of holdings of major convertible currencies.

Foreign currency holdings shall be invested as far as practicable in conformity with Section 14(e) of the Federal Reserve Act.

2. Exchange Transactions

System exchange transactions shall be geared to pressures of payments flows so as to cushion or moderate disequilibrating movements of funds and their destabilizing effects on U.S. and foreign official reserves and on exchange markets.

In general, these transactions shall be geared to pressures connected with movements that are expected to be reversed in the foreseeable future; when expressly authorized by the Federal Open Market Committee, they may also be geared on a short-term basis to pressures connected with other movements.

Subject to express authorization of the Committee, the Federal Reserve Bank of New York may enter into reciprocal arrangements with foreign central banks on exchange transactions ("swap" arrangements), which arrangements may be wholly or in part on a standby basis.

Drawings made by either party under a reciprocal arrangement shall

be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

The New York Bank shall, as a usual practice, purchase and sell authorized currencies at prevailing market rates without trying to establish rates that appear to be out of line with underlying market forces.

If market offers to sell or buy intensify as System holdings increase or decline, this shall be regarded as a clear signal for a review of the System's evaluation of international payments flows.

It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions in order that System transactions do not conflict with those being undertaken by foreign monetary authorities.

3. Transactions in Spot Exchange

The guiding principle for transactions in spot exchange shall be that, in general, market movements in exchange rates, within the limits established in the International Monetary Fund Agreement or by central bank practices, index affirmatively the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public.

Temporary or transitional fluctuations in payments flows may be cushioned or moderated whenever they occasion market anxieties, or undesirable speculative activity in foreign exchange transactions, or excessive leads and lags in international payments.

Special factors making for exchange market instabilities include (i) responses to short-run increases in international political tension, (ii) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, or (iii) market rumors of a character likely to stimulate speculative transactions.

Whenever exchange market instability threatens to produce disorderly conditions, System transactions are appropriate if the Special Manager, in consultation with the Federal Open Market Committee, or in an emergency with the members of the Committee designated for that purpose, reaches a judgment that they may help to reestablish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified, curtailed, or eventually discontinued pending a reassessment by the Committee of supply and demand forces.

Insofar as is practicable, the New York Bank shall purchase a currency through spot transactions at or below its par value, and sell a currency through spot transactions at rates at or above its par value.

Spot transactions at rates other than those set forth in the preceding paragraph shall be specially authorized by the Committee or by the members of the Committee designated in Section VIII of the Authorization for Open Market Transactions in Foreign Currencies, except that purchases of exchange to meet System commitments may be executed without special authorization at rates above par when necessary.

4. Transactions in Forward Exchange

Transactions in forward exchange, either outright or in conjunction with spot transactions, may be undertaken:

(1) When forward premiums or discounts are inconsistent with interest rate differentials and are giving rise to disequilibrating movements of short-term funds;
(2) When it is deemed appropriate to supplement existing market supplies of forward cover, directly or indirectly, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders;
(3) To allow greater flexibility in covering System commitments, including those under swap arrangements;
(4) To facilitate the use of holdings of one currency for the settlement of commitments denominated in other currencies.

Forward sales of authorized currencies to the U.S. Stabilization Fund out of existing System holdings or in conjunction with spot purchases of such currencies also may be undertaken in order to allow greater flexibility in covering commitments of the U.S. Treasury.

In all other cases, proposals of the Special Manager to initiate forward operations shall be submitted to the Committee for advance approval.

Continuing Authority Directive for System Foreign Currency Operations

The Federal Reserve Bank of New York is authorized and directed to purchase and sell through spot transactions any or all of the following currencies in accordance with the Guidelines for System Foreign Currency Operations as amended November 23, 1965; provided that the aggregate amount of foreign currencies held under reciprocal currency arrangements shall not exceed $2.8 billion equivalent at any one time, and provided further that the aggregate amount of foreign currencies held as a

result of outright purchases shall not exceed $150 million equivalent at any one time:

Pounds sterling
French francs
German marks
Italian lire
Netherlands guilders
Swiss francs
Belgian francs
Canadian dollars
Austrian schillings
Swedish kronor
Japanese yen

The Federal Reserve Bank of New York is also authorized and directed to operate in any or all of the foregoing currencies in accordance with the Guidelines and up to a combined total of $275 million equivalent, by means of:

(a) Purchases through forward transactions, for the purpose of allowing greater flexibility in covering commitments under reciprocal currency agreements;
(b) Purchases and sales through forward as well as spot transactions, for the purpose of utilizing its holdings of one currency for the settlement of commitments denominated in other currencies;
(c) Purchases through spot transactions and concurrent sales through forward transactions, for the purpose of restraining short-term outflows of funds induced by arbitrage considerations; and
(d) Sales through forward transactions, for the purpose of influencing interest arbitrage flows of funds and of minimizing speculative disturbances.

The Federal Reserve Bank of New York is also authorized and directed to make purchases through spot transactions, including purchases from the U.S. Stabilization Fund, and concurrent sales through forward transactions to the U.S. Stabilization Fund, of any of the foregoing currencies in which the U.S. Treasury has outstanding indebtedness, in accordance with the Guidelines and up to a total of $100 million equivalent. Purchases may be at rates above par, and both purchases and sales are to be made at the same rates.

The Federal Reserve Bank of New York is also authorized and directed to make purchases of sterling on a covered or guaranteed basis in terms of the dollar up to a total of $200 million equivalent.

The Federal Reserve Bank of New York is also authorized and directed to assume commitments for forward sales of lire up to $500 million equivalent as a means of facilitating the retention of dollar holdings by private foreign holders.

The continuing authority directive on foreign currency operations was amended on one occasion, as noted in the entry for April 12, 1966, prior to the adoption of the new foreign currency instruments.

January 11, 1966

Authority to effect transactions in System Account.

Economic activity was rising vigorously at the end of 1965, according to reports at this meeting, and over the year it had grown more rapidly than previously estimated. Although both plant capacity and the labor force expanded substantially in 1965, the margins of unutilized resources at the year-end were the narrowest in more than 8 years. Price increases had remained selective and moderate, but rises persisted and the wholesale price index for industrial commodities in December was about 2 per cent higher than in the summer of 1964. Despite uncertainties regarding the course of hostilities in Vietnam and the size of Federal outlays for defense, the outlook appeared to be for continued large gains in activity and further upward pressures on prices. Optimism about business prospects was reflected in the stock market; average prices of common stocks ended the year at a record high.

Estimates of gross national product in the first three quarters of 1965 had been raised substantially by the Department of Commerce. Preliminary indications were that GNP rose considerably further in the fourth quarter, and that for the year as a whole it was 7.5 per cent above 1964. The rate of capacity utilization in manufacturing, which had been rising since 1961, remained high throughout 1965. The total labor force expanded much more than expected—in the fourth quarter it was about 1.8 million persons larger than a year earlier, compared with the previous year's rise of 1.1 million persons—but employment increased by 2.2 million in the corresponding period, and the unemployment rate declined to 4.1 per cent in December 1965 from 5.0 per cent a year earlier.

Business plans called for another large increase in production facilities in 1966, and the labor force was expected to show substantial further growth. Nevertheless, if—as now seemed probable—GNP continued to expand at its recent high rate, it was likely that pressures on productive capacity would be as great or greater than in 1965 and that shortages of various types of labor would become increasingly severe. Under such circumstances prices probably would be under increased upward pressures.

Aggregate private demands for credit were particularly large in the fourth quarter of 1965, paralleling the vigorous rise in physical investment. Bank credit appeared to share about proportionately in the growth of total credit. For the year as a whole both bank credit and the money supply (private demand deposits plus currency outside of banks) rose more than in 1964—10 per cent and 4.8 per cent, respectively, compared with 8.4 per cent and 4.3 per cent in the prior year. Growth in time and savings deposits at commercial banks, at 16 per cent, also was more rapid than in 1964.

In December, bank credit expanded at a rate slightly faster than in the year as a whole, chiefly as a result of heavy demands for business loans. The money supply rose sharply during the month. The inflow of time and savings deposits slackened, however, despite advances in interest rates on new certificates of deposit (CD's), particularly on certificates of shorter maturity. Required reserves of member banks increased markedly, not only because of rapid growth in total deposits, but also because of relative shifts in the deposit "mix," involving accelerated rates of expansion in high-requirement demand deposits and in deposits at high-requirement reserve city banks.

The Treasury had been active in security markets recently. On the day before this meeting subscriptions had been accepted for a cash offering of $1.5 billion of 10-month certificates, bearing a 4¾ per cent coupon and priced to yield 4.85 per cent; early indications were that the offering had been well received by investors. Near the end of December $1 billion of tax-anticipation bills maturing in June had been auctioned, and beginning in January the size of the weekly auctions of 3-month bills was increased from $1.2 billion to $1.3 billion to raise $100 million in new cash each week. The next Treasury financing operation would involve the refunding of $4.8 billion in notes maturing February 15, of which $2.5 billion were held by the public. An announcement concerning the terms of the refunding was anticipated late in January.

Conditions in financial markets had been unsettled in recent weeks as a result of the conjunction of year-end seasonal pressures, heavy private credit demands, the successive Treasury financing operations, continuing adjustments to the official actions of early December increasing the discount rate and the maximum rates permitted to be paid on time deposits, and a transit strike in New York City, which reduced the efficiency with which market transactions could be conducted. At the same time, investor expectations were affected by conflicting reports of developments with respect to Vietnam, growing concern over inflationary pressures, and uncertainty about Federal budget prospects. On balance, yields on long-term securities changed little after the rises of early December that followed the official rate actions. Short- and intermediate-term yields advanced substantially further, however, with the market rate on 3-month Treasury bills

moving up about 20 basis points to 4.55 per cent on the day preceding this meeting. Money market conditions were quite firm, partly because of the large increase in required reserves of member banks and the concentration of pressures on large banks.

Open market operations during the period were directed at accommodating the enlarged needs for reserves and at moderating the upward pressures on short-term rates. As a result of these operations, in December the supply of nonborrowed reserves of member banks increased at the unusually rapid annual rate of 21 per cent, and borrowings of member banks on the average exceeded their excess reserves by only $25 million, as compared with $80 million in November and $135 million in October.

Tentative estimates of the U.S. balance of payments in 1965 suggested that the deficit was substantially diminished from the prior year on both the "liquidity" and "official reserve transactions" bases of calculation.[1] On the former basis the deficit appeared likely to have been about $1¼ billion, or less than half that in 1964, and on the latter basis it was estimated at about $750 million, compared with $1.2 billion in the prior year. Prospects for further substantial reductions in the "liquidity" deficit in 1966 appeared to depend heavily on improvement in the U.S. trade surplus; changes from recent levels in other categories of the payments accounts seemed likely to be roughly offsetting.

In the discussion of policy, Committee members noted that short-term interest rates were higher at present than had been expected at the time of the preceding meeting as a result of developments in the market and despite sizable additions to the supply of bank reserves. The Committee decided that open market

[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 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 as ordinary capital flows.

operations until the next meeting should be directed toward maintaining about the prevailing conditions in the money market. It recognized, however, that economic, military, or Federal budget developments might lead to sharp changes in market conditions, which System operations should be expected only to moderate.

The Treasury financing schedule was a primary consideration in the decision to maintain relatively steady money market conditions, but other reasons for this course also were advanced. Thus, it was noted that the need for actively seeking changes in conditions could be determined better after the President's Budget Message and Economic Report were transmitted to the Congress later in the month; that market adjustments to the official rate actions of December were still under way; and that more time was required to appraise the effects of recent increases in interest rates.

At the same time, a number of members expressed concern over the recent pace of growth in reserves, bank credit, and the money supply, in view of the potential for inflationary developments in the period ahead. The Committee agreed that for the longer run some moderation in these growth rates would be desirable and, accordingly, it modified the statement of policy in the first paragraph of its current economic policy directive to the Federal Reserve Bank of New York. The directive issued read as follows:

The economic and financial developments reviewed at this meeting indicate that domestic economic expansion has strengthened further in a climate of optimistic business sentiment and with some further upward creep in prices. Interest rates are higher in most markets in response to strong credit demands and recent official rate actions. Our international payments position improved considerably during 1965 but further progress is needed to attain effective balance. In this situation, it is the Federal Open Market Committee's policy to resist the emergence of inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by moderating the growth in the reserve base, bank credit, and the money supply.

In light of the Treasury financing schedule, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the current conditions in the money market.

Votes for this action: Messrs. Martin, Hayes, Balderston, Daane, Ellis, Galusha, Maisel, Mitchell, Patterson, Robertson, Scanlon, and Shepardson. Votes against this action: None.

February 8, 1966

Authority to effect transactions in System Account.

Business activity continued to advance vigorously in early 1966, and the outlook was becoming increasingly expansive. In addition to sharply rising Federal expenditures, large consumer demands, and record business outlays on plant and equipment, heavy inventory accumulation was adding to aggregate demands. Total business inventories had risen sharply in the fourth quarter of 1965 despite rapid liquidation of steel stocks following the wage settlement in that industry; and in the current quarter, with liquidation of steel stocks ending, further substantial accumulation seemed probable.

The recent surge in activity carried rates of resource use to advanced levels. In December the rate of capacity utilization in manufacturing edged up to a 10-year high. In January the unemployment rate declined again, reaching the administration's "interim" target of 4.0 per cent. As yet, pressure on resources had not been reflected in an accelerated rate of advance in average industrial prices—the price index continued to creep up at about the 1.5 per cent annual rate of the last 15 months—but reports of moderate price advances were becoming more frequent.

Loan expansion at commercial banks was unusually strong in January as business borrowing remained heavy. The money supply continued to rise rapidly, although the increase was concentrated in the early part of January and for the month as a whole was less than the sharp December advance. The inflow of time and savings deposits to commercial banks slowed considerably further from the reduced December pace. Net borrowed reserves of member banks averaged about $60 million in January; they had been below $100 million in November and December also, but earlier in 1965 they had fluctuated around $150 million.

Yields on long-term Treasury and corporate bonds, which had been relatively stable following their initial adjustments to the early December increase in the discount rate, had advanced by 10 to 15 basis points since the preceding meeting of the Committee. Contributing to the advances were the resumption of bombing in North Vietnam; the growing calendar of new corporate issues; the prospect of large sales of financial assets by the Federal Government under provisions of the administration's budget document; and increasing market discussion of the possibility that a firmer monetary policy might be required to restrain inflationary pressures in the months ahead. Short-term interest rates also moved irregularly higher, with the market yield on 3-month Treasury bills advancing by about 5 basis points to above 4.60 per cent.

Money market conditions had been, on the whole, relatively comfortable in the recent period as earlier heavy pressures on banks in the central money markets moderated. System operations generally had been directed toward maintaining an "even keel" in the money market, as is customary during periods of Treasury financing. The current financing involved both a refunding of issues maturing in mid-February and an advance refunding of April, May, and August maturities, with settlement scheduled for February 15. In exchange for these securities, of which $13.7 billion were held by the public, the Treasury offered two new issues: a 5 per cent 4¾-year note (priced to yield 4.97 to 5.00 per cent, depending on the issue exchanged), and a 4⅞ per cent 18-month note (priced to yield 4.96 per cent). The refunding was well received by investors despite the weakening of prices on outstanding issues subsequent to its announcement; $6.5 billion of subscriptions were entered for the 4¾-year note and $0.9 billion

for the 18-month note. Subscriptions by Government security dealers were relatively small, and there appeared to be little speculative activity in the new issues.

The deficit in U.S. international payments in 1965 was now estimated to have been about $1.3 billion on both the "liquidity" and "official reserve transactions" bases, compared with $2.8 billion and $1.2 billion, respectively, in 1964. Growth of merchandise exports had resumed in the second half of the year, and prospects for further increases were favorable. However, the rate of expansion of imports—of both manufactured goods and materials—had accelerated during 1965. In the fourth quarter, despite some reduction in imports of steel, total imports reached a level relative to GNP that was quite high by historical standards.

In the judgment of the Committee, recent and prospective economic developments clearly called for added policy measures to dampen the rise in aggregate demands. It was noted that efforts had been made to develop a Federal budget for fiscal year 1967 that would avoid adding to inflationary pressures. The budget estimates recently submitted to the Congress had to be regarded as more than usually uncertain, however, because of the difficulty of predicting the course of developments in Vietnam.

The Committee concluded that, while unfolding developments might lead to additional fiscal counteraction at some later date, the appropriate objective for monetary policy in the immediate future was a somewhat greater degree of restraint. Members observed that reserve availability had been permitted to increase in recent months so as to moderate market adjustments to the official rate actions of early December. It also was noted that the market situation with respect to the securities involved in the current Treasury financing probably would make it unnecessary to maintain an "even keel" policy for the entire period until the Committee's next meeting. Accordingly, the Committee agreed that gradual action to reduce net reserve availability should be initiated as soon as feasible in the light of the financing.

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 the domestic economy is expanding vigorously, with prices continuing to creep up and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist the emergence of inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by moderating the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee, with appropriate regard for the current Treasury financing, shall be conducted with a view toward a gradual reduction in reserve availability.

Votes for this action: Messrs. Martin, Hayes, Balderston, Daane, Ellis, Galusha, Maisel, Mitchell, Patterson, Robertson, Scanlon, and Shepardson. Votes against this action: None.

March 1, 1966

1. Authority to effect transactions in System Account.

Estimates of the pace of the business expansion had been scaled upward recently, according to reports at this meeting, and activity was now expected to increase more in 1966 than had appeared likely a few weeks earlier. Revised data indicated that GNP had advanced at a $16 billion annual rate in the fourth quarter of 1965—compared with the $12 billion average rate of the two preceding quarters—and recent developments suggested that it was continuing to rise at about the same rate in the current quarter.

Pressures on manpower and industrial resources were increasing as enlarged defense expenditures were superimposed on high and rising private demands. From October through January nonfarm employment grew at an annual rate of 7 per cent, and

with tightening labor markets, wages were advancing somewhat more rapidly than earlier in many industries. Industrial production rose sharply further in January, and the rate of capacity utilization in manufacturing edged up again. Retail sales, which had increased more in late 1965 than previously estimated, declined slightly in January but appeared to be rising again in early February.

Only a slight acceleration in the rate of advance in industrial commodity prices was indicated by data for January and preliminary estimates for February. It seemed likely, however, that the continued rapid expansion of demands expected in coming months and the associated pressures on resources would be conducive to somewhat larger and more widespread price increases.

The pace of bank credit expansion was considerably reduced in late January and early February, according to data for city banks. Growth of business loans moderated from the earlier high rate but remained fairly rapid. Growth in time and savings deposits at commercial banks slackened further to a rate less than half that of the fourth quarter, with the slowdown concentrated at city banks. The money supply, which reached a peak in early January and declined substantially later in that month, was estimated to have changed little in February.

Unusually large demands were being made on capital markets. The volume of new corporate and municipal bond issues in January and February, and the calendar of prospective offerings for March, suggested that the combined total of offerings in the first quarter would be greater than in any prior quarter. In addition, a sizable volume of Government agency issues was being sold. Against a background of inflationary expectations associated with the vigorous economic expansion and of continuing market discussions of a possibly firmer monetary policy, investor response to the offerings was cautious and interest rates on long-term corporate, municipal, and Treasury issues rose sharply further. Yields on some maturities of Treasury bonds were now at the highest levels in more than 40 years. Average prices of common stocks reached a new peak in early February but subsequently declined in active trading.

Recent open market operations were directed at restraining net reserve availability, and conditions in money markets were firm. Since the preceding meeting of the Committee, yields on 3-month Treasury bills advanced by about 5 basis points on balance, to around 4.65 per cent; rates offered by large banks on negotiable CD's edged higher; and the effective rate on Federal funds was usually above the discount rate. For February as a whole, member bank borrowings rose somewhat, to about $470 million from $430 million in January, and net borrowed reserves averaged about $110 million compared with a revised figure of $50 million for January. Growth rates of total and nonborrowed reserves declined substantially.

Partial data on the U.S. balance of payments for early 1966 suggested a continued deficit on the "liquidity" basis of calculation, after allowance for seasonal influences. U.S. banks reduced the volume of their credits to foreigners more than seasonally in January, partly as a result of the pressures of domestic credit demands. On the other hand, the surplus on U.S. merchandise trade was reduced; in January, as well as in December, exports were lower than the October–November average, and imports were higher.

The Committee agreed that, in the light of existing and prospective inflationary pressures, it should continue to pursue the policy initiated at the preceding meeting of moving gradually to reduce net reserve availability with a view to limiting growth of bank reserves, bank credit, and the money supply to moderate rates. A number of reasons were advanced for proceeding cautiously in reducing net reserve availability. These included the existing strains in financial markets and the seasonal pressures expected around the March tax and dividend dates; the need for more time to determine the effects of recent System policy actions on the growth trends of bank credit and the money supply; and the desirability of avoiding further rises in market interest rates

to levels that would require consideration of another increase in the discount rate. Several members expressed the hope that Federal fiscal policy would soon assume an increased share of the burden of curbing excessive increases in aggregate demands, and some mentioned that possibility as a further reason for moving slowly in firming monetary policy.

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 the domestic economy is expanding vigorously, with prices continuing to creep up and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by moderating the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining some further gradual reduction in reserve availability.

Votes for this action: Messrs. Martin, Hayes, Bopp, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

2. Amendment of continuing authority directive.

Section 1(a) of the continuing authority directive to the Federal Reserve Bank of New York regarding domestic open market operations was amended to reduce from $2 billion to $1.5 billion the limit on changes in holdings of U.S. Government securities in the System Open Market Account between meetings of the Committee. With this amendment, Section 1(a) read as follows:

To buy or sell U.S. Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $1.5 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting.

Except for the change resulting from this amendment, the directive was renewed in its existing form, as set forth in the preface to this record of Federal Open Market Committee policy actions for 1966.

Votes for this action: Messrs. Martin, Hayes, Bopp, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

The limit in question had been increased from $1.5 billion to $2 billion in early December, when the Manager of the System Open Market Account reported that transactions in excess of the prior limit might conceivably be necessary to carry out the intent of the current economic policy directive then in effect. It was reduced at this meeting on recommendation of the Manager, who indicated that the circumstances calling for the higher limit seemed to have passed.

3. Review of continuing authorizations.

This being the first meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1966, and their assumption of duties, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. The action taken with respect to the continuing authority directive for domestic open market operations has been described in the preceding portion of the entry for this date.

The Committee reaffirmed its authorization regarding open

market transactions in foreign currencies, its guidelines for System foreign currency operations, and its continuing authority directive on foreign currency operations, in the forms in which all three were outstanding at the beginning of the year 1966, as set forth in the preface to this record of policy actions.

Votes for these actions: Messrs. Martin, Hayes, Bopp, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against these actions: None.

March 22, 1966

Authority to effect transactions in System Account.

Economic activity was still advancing rapidly, and pressures on available resources were growing. Although business inventory accumulation tentatively was estimated to have slowed somewhat in the first quarter of 1966 from the high fourth-quarter rate, final demands appeared to be rising more rapidly.

Federal defense purchases were undergoing a particularly large increase in the first quarter. Consumer spending also appeared to be running well above the fourth quarter; January retail sales figures, originally estimated to show a slight decline, were being revised upward substantially, and estimates for February indicated that sales were maintaining an advanced pace. Businesses planned to increase their spending on plant and equipment throughout 1966, according to a Commerce Department–Securities and Exchange Commission survey taken in February. For the year as a whole, planned capital expenditures were reported to be about 16 per cent larger than the high outlays of 1965.

With industrial production recording another sizable increase in February, capacity utilization rates in manufacturing again edged up, and the average workweek lengthened to a new postwar record. Nonfarm employment increased substantially further, and the unemployment rate dropped from 4.0 per cent in January to 3.7 per cent, the lowest level since the early 1950's.

Pressures on resources were being reflected increasingly in cost and price developments. Average hourly earnings in manufacturing continued to rise at a moderate and steady pace, and unit labor costs now also appeared to be moving up. New data suggested some acceleration in the rate of advance of industrial commodity prices in the first 2 months of the year, accompanied by a broadening of the range of commodities that were showing increases. Weekly indexes indicated little further change in average industrial prices through mid-March, but other information suggested that a further rise was in process. Average wholesale prices of foodstuffs rose sharply in February, but apparently declined slightly thereafter.

Growth in member bank reserves slackened considerably in February and early March, and bank credit expanded only slightly. In the face of continuing strong demand for loans, city banks reduced their holdings of both Treasury and other securities in early March, and on March 10 major banks increased their prime lending rate from 5 to 5½ per cent. Time and savings deposits continued to grow relatively slowly. The money supply declined in February but then rose quite sharply in the first half of March; for the first quarter as a whole, its growth was tentatively estimated at an annual rate of 5.5 per cent, compared with 7.5 per cent in the preceding quarter.

Treasury coupon securities experienced their first sustained rally in several months during the first 3 weeks of March, with yields on 5- to 10-year maturities falling by almost ¼ of a percentage point and longer-term bond yields declining by as much as ⅛ of a percentage point. The rally appeared to be partly a technical reaction to the extended increases in yields of previous months, but it drew strength from a decline in common stock prices and, in particular, from growing discussion of possible additional Federal tax measures to contain inflationary pressures. Yields on State and local government bonds and new corporate

issues also turned down after 6 weeks of nearly continuous advance. Contributing to the declines in municipal yields were cancellations and postponements of some new issues that had been planned and a reduction in dealer inventories to the lowest level in several years.

System open market operations since the preceding meeting of the Committee had been directed toward limiting net reserve availability while facilitating the large financial flows associated with quarterly corporate payments of dividends and taxes. In the 3 weeks ending March 16, net borrowed reserves of member banks averaged almost $215 million and borrowings from the Reserve Banks about $540 million, compared with revised averages for February of $120 million and $475 million, respectively. Money market conditions were generally firm, and most short-term interest rates continued to move up. However, yields on 3-month Treasury bills declined irregularly from about 4.65 per cent in early March to 4.52 per cent on the day preceding this meeting, as a result of strong investor demand and low dealer inventories.

The U.S. balance of payments position improved in the first 2 months of 1966, according to incomplete data, as tightening U.S. credit markets contributed to large net reflows of bank credit. The demand for imports continued to expand under the influence of the rapidly advancing pace of domestic activity, however, and the outlook for U.S. foreign trade suggested that it might be difficult to maintain the favorable payments trend in coming months.

In the Committee's discussion it was noted that the policy actions taken at the two preceding meetings apparently were beginning to have the desired effect of moderating growth rates in bank reserves, bank credit, and the money supply. As to the policy to be pursued in the coming 3 weeks, some members favored continuing the process of gradually increasing the reserve pressure on the banking system. Others expressed a preference for maintaining about the current state of net reserve availability, or of money market conditions in general, pending a clearer indication of the consequences of previous policy actions. Some members in each of these groups thought that the conduct of open market operations should be conditioned in part by the strength of demands that might be made on the banking system; they felt that net reserve availability could be allowed to become tauter than otherwise if bank credit and money supply growth proved strong and required reserves consequently expanded sharply.

Despite these shadings of opinion, the range of difference in views on policy for the next 3 weeks was not great; no members advocated overt firming action at this time, and none favored relaxation. At the conclusion of the discussion the Committee agreed to renew the current economic policy directive adopted at the preceding meeting without change.

Votes for this action: Messrs. Martin, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, Shepardson, and Treiber. Votes against this action: None.

April 12, 1966

1. Authority to effect transactions in System Account.

Rapid economic advance continued unabated through the end of the first quarter, according to reports at this meeting. The driving forces of the expansion—defense outlays and business capital expenditures—showed no signs of slackening, and consumer spending was being spurred by sharp rises in incomes and employment. Further large gains in expenditures by Government, business, and consumers were expected in the second quarter.

Industrial production rose considerably further in March; for the first quarter as a whole it increased at an annual rate of about 13 per cent from the fourth quarter of 1965. Retail sales also expanded further in March, according to preliminary estimates, after rising substantially in February. Nonfarm employment continued to grow rapidly, and shortages of experienced workers were becoming increasingly serious. In March, after six consecutive months of decline, the unemployment rate rose slightly—from 3.7 per cent to 3.8 per cent—but the rise was accounted for mainly by teenagers, a group for which monthly unemployment changes tend to be volatile.

Average prices of industrial commodities advanced further in March, but because of a slight decline in prices of farm products and foods, the total index of wholesale prices was unchanged from February. Over the first 3 months of the year average prices of industrial commodities had increased at an annual rate of about 3 per cent, approximately twice the rate of 1965. The consumer price index rose in February to a level about 2.5 per cent above a year earlier. Most of the February rise was accounted for by foods, but average prices of other commodities and of services also advanced.

Commercial bank credit, which had changed little in February, expanded substantially in March. Business loan demands in particular were strong over the corporate tax and dividend payment dates. Finance companies, which had a substantial volume of open market paper maturing in the same period, also borrowed heavily. Banks liquidated a large volume of securities, including municipals, to help finance these loan demands. Some reduction in the rate of growth of bank loans was expected after the April tax date, but underlying credit demands appeared likely to remain strong.

The money supply rose sharply in March, in part reflecting a contraseasonal reduction in Treasury deposits at commercial banks. Growth in time and savings deposits continued at the more moderate February rate. Time deposit inflows at city banks expanded considerably in response to higher offering rates on both negotiable and nonnegotiable certificates of deposit. However, some of the funds probably were withdrawn from savings deposits at these banks, and possibly also from time and savings deposits at country banks, where growth slackened.

In security markets, the declines in yields on Treasury notes and bonds and on new corporate and municipal issues that had begun in early March continued into early April. The month-long rally—in which one-half to two-thirds of the yield advances following the December increase in the discount rate were erased—apparently reflected increasing expectations of a Federal tax increase, a growing belief that earlier yield advances had outpaced economic developments, and some moderation in the flow of new private offerings. Most recently, however, a general note of caution appeared to have returned to security markets, and some yields edged up again. Near the end of April the Treasury was expected to announce the terms on which it would refund securities maturing in mid-May, of which about $2.5 billion were held by the public.

Recent System open market operations had kept bank reserve positions under pressure. Over the three statement weeks ending April 6, net borrowed reserves averaged about $230 million and member bank borrowings about $580 million—in each case slightly higher than the levels of the previous 3-week period. For March as a whole, higher member bank borrowing accounted for all of the increase in total reserves; nonborrowed reserves declined for the first time since September. The effective rate on Federal funds had been 4¾ per cent on most days since the preceding meeting of the Committee, and on one day a small volume of funds traded at a new high rate of 4⅞ per cent. Most other short-term yields remained at the recent highs established after the March 10 increase in the prime loan rate of banks, or they edged up further. The yield on 3-month Treasury bills fluctuated but on balance rose somewhat to 4.59 per cent on the day preceding this meeting.

The Committee agreed that additional stabilization policy measures would be desirable in light of present and prospective inflationary pressures. In the course of the discussion note was

taken of the President's recent request that businesses reduce their planned capital outlays, and also of the possibility that the administration might recommend an increase in Federal taxes. It was pointed out, however, that large cutbacks in actual investment expenditures probably could not be expected quickly because of the long lead-times of most capital projects and the firm commitments already made. As to a tax increase, even if one were recommended soon—and that issue remained in doubt—some time would be required for congressional consideration, and additional time probably would elapse before any increase enacted had substantial effects on aggregate spending.

In the area of monetary policy divergent views were expressed about the appropriate interpretation of recent banking and capital market developments. Some members felt that the recent high growth rates in the money supply and bank credit had been undesirable in light of the objective of resisting inflationary pressures, and a similar view was advanced with respect to the declines in longer-term market interest rates. Of the members who held these views some thought that, in retrospect, the Committee's recent policy directives might better have been formulated in terms calling for greater resistance to such developments, which they considered to be evidences of a relaxation in monetary conditions.

Other members shared the view that monetary relaxation would be undesirable under present circumstances, but thought that there had been no relaxation in the pressure the System was placing on banks nor in the trend toward firmer lending policies at banks. In their judgment the recent developments had to be interpreted in light of the fact that there often were marked short-run fluctuations in banking variables and interest rates—in the latter partly because of the effects of changing expectations.

At the conclusion of the discussion the Committee agreed that its policy of gradually reducing net reserve availability, initiated at the February 8 meeting, should be continued until the next meeting; and that consideration should be given in the conduct of open market operations to the trends in aggregate reserves, with somewhat tauter reserve conditions permitted if the aggregates rose sharply. However, it was felt that at this juncture reserve pressures should not be intensified to the point at which rising market rates would call into question the viability of the current discount rate and the maximum rates permitted to be paid by member banks on time and savings deposits. At the same time it was agreed that the forthcoming Treasury financing should be taken into account although, because of the moderate size and probable routine nature of the financing, it was expected that the requirements for maintaining an "even keel" in the money market would be less than usually was the case during Treasury operations.

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 the domestic economy is expanding vigorously, with industrial prices continuing to creep up and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to help restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining some further gradual reduction in reserve availability, while taking into account the forthcoming Treasury financing.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, and Shepardson. Votes against this action: None.

2. Authority to purchase and sell foreign currencies.

The Committee amended the third paragraph of its continuing authority directive for System foreign currency operations to increase, from $100 million to $200 million, the dollar limit

on spot purchases and concurrent forward sales to the U.S. Stabilization Fund of currencies in which the U.S. Treasury had outstanding indebtedness. With this amendment, the paragraph read as follows:

The Federal Reserve Bank of New York is also authorized and directed to make purchases through spot transactions, including purchases from the U.S. Stabilization Fund, and concurrent sales through forward transactions to the U.S. Stabilization Fund, of any of the foregoing currencies in which the U.S. Treasury has outstanding indebtedness, in accordance with the Guidelines and up to a total of $200 million equivalent. Purchases may be at rates above par, and both purchases and sales are to be made at the same rates.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, and Shepardson. Votes against this action: None.

Transactions of the kind authorized by this paragraph, which involved no risk of loss, were for the purpose of facilitating payment by the Treasury of maturing bonds denominated in foreign currencies. The amendment was approved after the Special Manager of the System Open Market Account reported that a larger sum than previously authorized probably could be usefully devoted to this purpose at present.

May 10, 1966

Authority to effect transactions in System Account.

Economic activity continued to expand in April, following a first quarter in which personal consumption expenditures, business fixed investment, and Federal outlays all increased substantially. For the first quarter, GNP was officially estimated to have been at a seasonally adjusted annual rate $17 billion higher than in the fourth quarter of 1965. This was the largest quarterly rise since the Korean war. About one-third of the advance reflected price increases, but growth in real output was large considering the high rate of plant utilization and the reduced supply of available labor. Some developments in April and early May, including declines in sales of new automobiles and in prices of common stocks, suggested that the economy was somewhat less ebullient than earlier. The over-all outlook, however, was for further substantial expansion and upward pressures on prices.

In April, retail sales weakened somewhat, primarily because purchases of new domestic automobiles declined by about 15 per cent from the advanced first-quarter rate. Nonfarm employment, which was affected by strikes, was unchanged for the month, but the unemployment rate edged down to the February level of 3.7 per cent from 3.8 per cent in March. Incomplete figures suggested that industrial production had increased in April, but by less than in other recent months. Wholesale prices of foodstuffs declined appreciably further, but prices of industrial commodities continued to advance at the accelerated first-quarter rate.

Growth in consumption expenditures seemed likely to moderate in the current quarter from the rapid first-quarter pace, but further substantial advances in Federal outlays and in business capital spending appeared to be in process. In connection with the latter, a private survey taken in March found that business concerns planned to spend 19 per cent more on plant and equipment in 1966 as a whole than in 1965. First-quarter developments were more nearly in line with this finding than with the 16 per cent planned increase reported in the Commerce–SEC survey a month earlier.

Commercial bank credit expanded substantially further in April, at a rate about the same as in March and almost half again faster than in the first quarter as a whole. Growth in business loans was moderate relative to the first-quarter rate, but bank holdings of securities increased markedly as corporations sold securities to help finance Federal tax payments.

Expansion in the money supply, which had been rapid in March, accelerated in April to an annual rate of 13.5 per cent, compared with about 4.5 per cent in the first quarter. Growth in time and saving deposits also accelerated, to more than twice the 7 per cent rate of the first quarter. Earlier in the year inflows of savings funds to commercial banks—as well as to savings and loan associations and mutual savings banks—had been sharply reduced as investors, attracted by rising interest rates on market securities, acquired such instruments in a volume unprecedented in the postwar period. Inflows to commercial banks recovered in late March and April, however, after many banks increased rates paid on time deposits (other than passbook savings) following the rise in their prime lending rates. Partial data suggested that nonbank intermediaries experienced larger than seasonal withdrawals of funds in April.

Despite the reduction of savings flows to depositary-type institutions in the first quarter, total mortgage debt outstanding grew more than in any prior first quarter. Savings and loan associations and mutual savings banks reduced their mortgage acquisitions moderately, but the Federal National Mortgage Association greatly increased its net purchases and banks and other lenders generally maintained their earlier rates of acquisition. Recently, savings and loan associations and mutual savings banks reportedly had become more restrictive in their lending policies, and a future slackening in the rate of growth of mortgage debt appeared probable as outstanding commitments were worked down. In March, yields on mortgages on new homes reached their highest levels in 5 years.

In security markets, average prices of common stocks edged down in late April and then fell more sharply in early May. Yields on new corporate bonds and on State and local government securities had risen since the preceding meeting of the Committee; new issues were marketed in sizable volume in April, and many market participants apparently concluded that prospects for a tax increase were diminished and that those for further firming of monetary policy were enhanced. Treasury note and bond yields also advanced over most of the period, but they subsequently declined again as common stock prices fell and automobile production cutbacks were announced. The 3-month Treasury bill rate was little changed over the interval, closing at 4.61 per cent on the day before this meeting, but yields on a variety of other short-term instruments moved higher. Late in the period Federal funds traded at 5 per cent for the first time, and a few transactions were reported at 5⅛ per cent.

The Treasury's mid-May refunding, involving a new 18-month 4⅞ per cent note priced to yield 4.98 per cent, was accorded a relatively poor reception; of the $2.5 billion of maturing issues held by the public, 43 per cent were redeemed for cash. This refunding reportedly completed the Treasury's financing activity for the current fiscal year. However, large offerings by Federal agencies were scheduled before the end of June, and these were likely to add considerably to pressures in financial markets.

System open market operations since the Commitee's preceding meeting had been aimed at reducing net reserve availability further, while taking due account of the Treasury refunding operation. Net borrowed reserves in April averaged around $275 million, compared with $210 million in March; and average borrowings increased to about $640 million from $545 million. Yet nonborrowed reserves rose at the rapid annual rate of about 13 per cent in April as the System supplied most of the reserves to accommodate the sharp rise in deposits.

The first-quarter deficit in the U.S. balance of payments was estimated at about a $2 billion annual rate on the "liquidity" basis of calculation, after seasonal adjustment. This was somewhat above the rate in the second half of 1965 and higher than had been expected. The surplus on merchandise trade was reduced as imports rose faster than exports, and although there were further reflows of bank credit, the outflow of U.S. capital into new foreign security issues increased.

It was the consensus of the Committee that recent growth rates

in bank reserves, bank credit, and the money supply were excessive, particularly in the light of prevailing inflationary pressures. While it was noted that April banking developments reflected a number of special factors and were not necessarily indicative of underlying trends, the members agreed that both domestic and balance of payments considerations called for further monetary restraint.

There were differences in view, however, with respect to the manner in which such a policy decision should be implemented. Some members indicated that they would be prepared to accept a relatively large reduction in net reserve availability in the period before the next meeting if that should prove necessary to restrict growth in bank reserves. Other members, noting the stresses evident in various financial markets and the risks of precipitating undesirably large market adjustments, favored a more cautious approach toward reducing net reserve availability. No members recommended increases in the discount rate or in ceiling rates on time and savings deposits at present, although some noted that conditions might develop that would require consideration of an increase in the discount rate.

The Committee concluded that net reserve availability should be reduced gradually further and that the reduction should be greater if growth in required reserves failed to moderate substantially. 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 the domestic economy is expanding vigorously, with industrial prices continuing to rise and credit demands remaining strong. Our international payments continue in deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.
>
> To implement this policy, while taking into account the current Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining some further

gradual reduction in net reserve availability, and a greater reduction if growth in required reserves does not moderate substantially.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

June 7, 1966

1. *Authority to effect transactions in System Account.*

Reports at this meeting indicated that the pace of economic expansion had slowed thus far in the second quarter, mainly because of a sharp decline in sales of new automobiles, but that activity was likely to accelerate again in the third quarter. Experienced labor continued in short supply, although employment rose in May among teenagers and other new entrants to the labor force and the over-all unemployment rate increased to 4.0 per cent from 3.7 per cent in April.

Prices of industrial commodities, which rose on average at an annual rate of about 3.5 per cent in the first 4 months of the year, apparently advanced in May also and were expected to remain under upward pressure. Consumer prices increased further in April to a level 2.9 per cent above a year earlier.

Total retail sales declined again in May, according to preliminary indications, as a result of a further reduction in new-automobile sales. Consumer spending of other types remained strong, however, and renewed strength in demand for autos over coming months was suggested by results of a buying intentions survey conducted by the Census Bureau in mid-April. Also, consumer spending was expected to be stimulated after midyear by inauguration of payments under the medicare program and by pay increases now under consideration in Congress for Federal military and civilian employees.

Both defense expenditures and business capital outlays continued to be strong expansive forces. While the rate of defense spending after midyear was uncertain, available information on new defense orders and on order backlogs through April suggested a further substantial rise in the third quarter. Additional indications that business capital outlays would continue to expand sharply throughout 1966 were contained in a Commerce–SEC survey of spending plans taken in May. For the year as a whole, the survey showed a rise in capital spending of 17 per cent over 1965, compared with 16 per cent shown by the corresponding February survey. An 18 per cent increase was found in a May "recheck" of results of a private survey that had yielded a 19 per cent figure in a March canvass.

Residential construction activity, on the other hand, appeared likely to decline in coming months. Mortgage market conditions continued to tighten through April as many lenders cut back new commitments because of reduced net inflows of savings funds, concern about possible outflows after the midyear interest-crediting date, and uncertainties about prospective market conditions and other factors. The cutbacks, which reportedly were particularly large at savings and loan associations and mutual savings banks, were not as yet fully reflected in current mortgage lending, much of which was based on takedowns of earlier commitments.

Growth in time and savings deposits at commercial banks moderated somewhat in May. The money supply declined sharply following rapid gains in March and April, and bank credit expanded at a rate only half that of the two preceding months. Banks liquidated a substantial volume of Treasury securities but increased by nearly the same amount their holdings of other securities, including Federal agency issues. Business loan demand was strong and was expected to continue so in coming weeks, partly because of large tax payments by corporations.

Interest rates on most types of market securities had increased since the preceding meeting of the Committee as a result of heavy demands for funds. Treasury, corporate, and municipal bond yields all advanced, with yields on new corporate issues moving above the previous postwar highs reached in early March. In short-term markets, rates rose on Federal agency issues, a large volume of which were sold in the period, and on bankers' acceptances, finance company paper, and commercial paper. The effective rate in Federal funds transactions reached 5¼ per cent late in the period. The 3-month Treasury bill rate, however, declined somewhat to 4.54 per cent on the day before this meeting. Contributing to the bill rate decline were reduced market supplies of short-term Treasury issues, heavy demands for bills by corporations and other investors, and Federal Reserve purchases.

Recent System open market operations were directed toward reducing net reserve availability further. In May net borrowed reserves averaged about $340 million compared with about $275 million in April, and member bank borrowings rose slightly to $650 million. Country banks were especially heavy borrowers from the Reserve Banks; for the first time since 1933, their borrowings exceeded their excess reserves. Nonborrowed reserves declined in May, following a large rise in April.

The U.S. balance of payments deficit in April and May together appeared to have been at roughly the same seasonally adjusted annual rate as in the first quarter, now estimated at $2½ billion on the "liquidity" basis of calculation. Most of the increase from the $1½ billion rate of deficit in the fourth quarter of 1965 resulted from a decline in the merchandise trade surplus. The deficit thus far in 1966 would have been larger if a sizable volume of liquid assets held by foreign official and international institutions had not been shifted into long-term time deposits and U.S. Government agency bonds and notes—assets not classified as liquid in the U.S. balance of payments statistics.

The Committee concluded that continuing inflationary pressures in the economy warranted maintaining the lower net reserve availability and tighter money market conditions that had prevailed recently. It was agreed that a further gradual reduction in net reserve availability, such as had been called for at most of the recent meetings, would not be desirable at present unless

required reserves of member banks expanded considerably more than would be expected on seasonal grounds. Several reasons were advanced against deepening the net borrowed reserve position of member banks at this particular time in the absence of unusually large growth in required reserves. These included the tight conditions prevailing in mortgage markets and the uncertainties regarding flows of funds at savings and loan associations and mutual savings banks around the midyear interest-crediting date; the currently slower pace of the domestic economic expansion; and the reduced rate of growth in bank credit. Also mentioned in this connection were the stresses expected in financial markets later in June in association with corporate tax and dividend payments and the large prospective volume of corporate, municipal, and Federal agency financing.

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, while the mortgage market is tight, automobile sales have fallen off, and some concern exists about the liquidity of nonbank financial institutions, the domestic economy is continuing to expand, with industrial prices rising further and credit demands remaining strong. The foreign trade surplus has declined and the international payments deficit has increased. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining net reserve availability and related money market conditions in about their recent ranges; provided, however, that if required reserves expand considerably more than seasonally expected, operations shall be conducted with a view to attaining some further gradual reduction in net reserve availability and firming of money market conditions.

Votes for this action: Messrs. Martin, Brimmer, Clay, Irons, Maisel, Mitchell, Robertson, Shepardson, Scanlon, Treiber, and Wayne. Votes against this action: None.

2. Authority to purchase and sell foreign currencies.

At this meeting the Committee replaced its three previously existing instruments governing System foreign currency operations with two new instruments, primarily for the purpose of simplifying and clarifying its instructions on this subject. The three instruments previously in effect—an authorization regarding open market transactions in foreign currencies, a statement of guidelines for System foreign currency operations, and a continuing authority directive on System foreign currency operations—are set forth in the form in which they were outstanding at the beginning of the year 1966 in the preface to this record of policy actions, and an amendment to the continuing authority directive made on April 12, 1966, is recorded in the entry for that date. The two new instruments adopted by the Committee—an authorization for System foreign currency operations and a foreign currency directive—are shown at the end of this entry.

Votes for these actions: Messrs. Martin, Brimmer, Clay, Daane, Irons, Maisel, Mitchell, Robertson, Shepardson, Scanlon, Treiber, and Wayne. Votes against these actions: None.

With one exception noted below, no changes were made in the substance of the Committee's instructions on foreign currency operations. The main purpose of recasting the instruments was to reformulate their essential content in a clearer and more concise manner by (1) removing duplication of content; (2) drawing together related instructions previously occurring at separate points and clarifying their language; (3) deleting language considered superfluous in light of operating experience; and (4) simplifying language found to be unnecessarily detailed. Other clarifying changes also were made, such as listing in the new authorization all of the reciprocal currency arrangements that had been individually authorized by the Committee.

The one substantive change made in the new instruments related to the authority of the Special Manager for foreign currency operations to engage in market transactions when exchange market instability threatened to produce disorderly conditions. Previously, the Special Manager was required (by the terms of the fourth paragraph of Section 3 of the Guidelines for System Foreign Currency Operations) to consult with the Committee, or in an emergency with the members of the Committee designated for that purpose, prior to engaging in transactions at such times. Experience at the time of the assassination of President Kennedy had demonstrated that in a sudden major crisis it might be impossible for the Special Manager to reach all of the designated Committee members in time to obtain authorization for necessary protective operations, although he might have no doubt that the required authority would have been granted by them. Accordingly, the Special Manager was authorized (by the terms of paragraph 2(C) of the new foreign currency directive) to engage in operations on his own initiative to meet a threat of disorderly conditions, with the requirement that he consult as soon as practicable with the Committee or, in an emergency, with the members of a Subcommittee designated (in paragraph 6 of the new authorization) for that purpose. The new instruction was intended to require advance consultation if practicable, but to permit operations if it were not.

The two new foreign currency instruments approved by the Committee at this meeting were as follows:

AUTHORIZATION FOR SYSTEM FOREIGN CURRENCY OPERATIONS

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:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, and with the Bank for International Settlements:

Austrian schillings
Belgian francs
Canadian dollars
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Netherlands guilders
Swedish kronor
Swiss francs

B. To hold foreign currencies listed in paragraph A above, up to the following limits:

(1) Currencies held spot or purchased forward, up to the amounts necessary to fulfill outstanding forward commitments;

(2) Additional currencies held spot or purchased forward, up to the amount necessary for System operations to exert a market influence but not exceeding $150 million equivalent; and

(3) Sterling purchased on a covered or guaranteed basis in terms of the dollar, under agreement with the Bank of England, up to $200 million equivalent.

C. To have outstanding forward commitments undertaken under paragraph A above to deliver foreign currencies, up to the following limits:

(1) Commitments to deliver to the Stabilization Fund foreign currencies in which the U.S. Treasury has outstanding indebtedness, up to $200 million equivalent;

(2) Commitments to deliver Italian lire, under special arrangements with the Bank of Italy, up to $500 million equivalent; and

(3) Other forward commitments to deliver foreign currencies, up to $275 million equivalent.

D. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

2. 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 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)	Period of arrangement (months)
Austrian National Bank	50	12
National Bank of Belgium	100	12
Bank of Canada	250	12
Bank of England	750	12
Bank of France	100	3
German Federal Bank	250	6
Bank of Italy	450	12
Bank of Japan	250	12
Netherlands Bank	100	3
Bank of Sweden	50	12
Swiss National Bank	150	6
Bank for International Settlements (System drawings in Swiss francs)	150	6
Bank for International Settlements (System drawings in authorized European currencies other than Swiss francs)	150	6

3. All transactions in foreign currencies undertaken under paragraph 1(A) above shall be at prevailing market rates and no attempt shall be made to establish rates that appear to be out of line with underlying market forces. Insofar as is practicable, foreign currencies shall be purchased through spot transactions when rates for those currencies are at or below par and sold through spot transactions when such rates are at or above par, except when transactions at other rates (i) are specifically authorized by the Committee, (ii) are necessary to acquire currencies to meet System commitments, or (iii) are necessary to acquire currencies for the Stabilization Fund, provided that these currencies are resold forward to the Stabilization Fund at the same rate.

4. It shall be the practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating

arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. Such investments shall be in accordance with Section 14(e) of the Federal Reserve Act.

6. A Subcommittee consisting of the Chairman and the Vice Chairman of the Committee and the Vice Chairman of the Board of Governors (or in the absence of the Chairman or of the Vice Chairman of the Board of Governors the members of the Board designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee his alternate) is authorized to act on behalf of the Committee when it is necessary to enable the Federal Reserve Bank of New York to engage in foreign currency operations before the Committee can be consulted. All actions taken by the Subcommittee under this paragraph shall be reported promptly to the Committee.

7. The Chairman (and in his absence the Vice Chairman of the Committee, and in the absence of both, the Vice Chairman of the Board of Governors) is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Secretary;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on such policy matters as may relate to the Secretary's responsibilities; and

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3 G (1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

10. The Special Manager of the System Open Market Account for foreign currency operations shall keep the Committee informed on conditions in foreign exchange markets and on transactions he has made and shall render such reports as the Committee may specify.

Foreign Currency Directive

1. The basic purposes of System operations in foreign currencies are:

A. To help safeguard the value of the dollar in international exchange markets;

B. To aid in making the system of international payments more efficient;

C. To further monetary cooperation with central banks of other countries having convertible currencies, with the International Monetary Fund, and with other international payments institutions;

D. To help insure that market movements in exchange rates, within the limits stated in the International Monetary Fund Agreement or established by central bank practices, reflect the interaction of underlying economic forces and thus serve as efficient guides to current financial decisions, private and public; and

E. To facilitate growth in international liquidity in accordance with the needs of an expanding world economy.

2. Unless otherwise expressly authorized by the Federal Open Market Committee, System operations in foreign currencies shall be undertaken only when necessary:

A. To cushion or moderate fluctuations in the flows of international payments, if such fluctuations (1) are deemed to reflect transitional market unsettlement or other temporary forces and therefore are expected to be reversed in the foreseeable future; and (2) are deemed to be disequilibrating or otherwise to have potentially destabilizing effects on U.S. or foreign official reserves or on exchange markets, for example, by occasioning market anxieties, undesirable speculative activity, or excessive leads and lags in international payments;

B. To temper and smooth out abrupt changes in spot exchange rates, and to moderate forward premiums and discounts judged to be disequilibrating. Whenever supply or demand persists in influencing exchange rates in one direction, System transactions should be modified or curtailed unless upon review and reassessment of the situation the Committee directs otherwise;

C. To aid in avoiding disorderly conditions in exchange markets. Special factors that might make for exchange market instabilities include (1) responses to short-run increases in international political tension, (2) differences in phasing of international economic activity that give rise to unusually large interest rate differentials between major markets, and (3) market rumors of a character likely to stimulate speculative transactions. Whenever exchange market instability threatens to produce disorderly conditions, System transactions may be undertaken if the Special Manager reaches a judgment that they may help to reestablish supply and demand balance at a level more consistent with the prevailing flow of underlying payments. In such cases, the Special Manager shall consult as soon as practicable with the Committee or, in an emergency, with the members of the Subcommittee designated for that purpose in paragraph 6 of the Authorization for System foreign currency operations; and

D. To adjust System balances within the limits established in the Authorization for System foreign currency operations in light of probable future needs for currencies.

3. System drawings under the swap arrangements are appropriate when necessary to obtain foreign currencies for the purposes stated in paragraph 2 above.

4. Unless otherwise expressly authorized by the Committee, transactions in forward exchange, either outright or in conjunction with spot transactions, may be undertaken only (i) to prevent forward premiums or discounts from giving rise to disequilibrating movements of short-term funds; (ii) to minimize speculative disturbances; (iii) to supplement existing market supplies of forward cover, directly or indirectly, as a means of encouraging the retention or accumulation of dollar holdings by private foreign holders; (iv) to allow greater flexibility in covering System or Treasury commitments, including commitments under swap arrangements; (v) to facilitate the use of one currency for the settlement of System or Treasury commitments denominated in other currencies; and (vi) to provide cover for System holdings of foreign currencies.

June 28, 1966

1. Authority to effect transactions in System Account.

Despite the slowdown in the rate of economic expansion in the second quarter, pressures on industrial capacity, manpower, and prices remained strong. And because the pace of expansion was expected to accelerate again after midyear, there appeared to be little prospect for relaxation of these pressures.

Average industrial prices continued to rise in May at an annual rate of 3.5 per cent and were estimated to have increased further in June at about the same rate. Consumer prices advanced only slightly in May following 3 months of rapid increase. In various current labor negotiations unions reportedly were pressing for wage increases well above the administration's guideposts, against a background of strong demands for labor, high corporate profits, and rising consumer prices.

The rate of growth in GNP appeared likely to be higher in the second half of 1966 than in the quarter now ending, although somewhat lower than the exceptionally high rates of the two preceding quarters. Large further gains were anticipated in business capital outlays and Federal defense expenditures, and growth in consumer spending—the lag in which accounted for most of the second-quarter slowdown in GNP—was expected to pick up again as a result of more rapid increases in disposable income. Data for early June suggested that sales of new automobiles were recovering part of their declines of April and May.

Residential construction remained the main weak factor in the outlook; housing starts declined sharply in May, and further declines appeared likely. Interest rates on mortgages on new homes, which had been rising sharply in recent months, reached new highs in May as many lending institutions drastically reduced their commitments to make new loans. Net inflows of funds to savings and loan associations and mutual savings banks were much smaller in May and early June than in comparable periods of other recent years. There was considerable apprehension among such institutions that large net outflows would occur around midyear—after quarterly and semiannual interest accruals were credited—as customers shifted funds to higher-yielding market securities and to commercial bank time deposit instruments.

At commercial banks total time and savings deposits were estimated to be expanding in June at a rate slightly below that of May and well below that of April. Growth in outstanding negotiable CD's moderated sharply at city banks, although major New York banks had recently increased posted rates to 5½ per cent—the maximum permitted under Regulation Q—on negotiable CD's with maturities of 3 months, and some reportedly were willing to negotiate that rate on maturities as short as 30 days. Loan demands were strong, particularly after mid-June when businesses needed funds to finance income tax payments and accelerated payments of withheld individual and social security taxes. The money supply was estimated to be increasing in June about as sharply as it had declined in May.

Long-term interest rates changed little on balance in recent weeks despite heavy flotations of corporate and municipal bonds. A lower volume of such security issues was in prospect for July; and Federal agency offerings, which were at an unprecedented level in June, also were expected to diminish. Most short-term interest rates were stable or somewhat higher. However, yields on 3-month Treasury bills declined by about 20 basis points further, to 4.33 per cent on the day before this meeting, as strong demands continued to press against extremely scarce market supplies.

System open market operations since the previous meeting had been directed toward maintaining net reserve availability in about the range of recent weeks, as required reserves of member banks increased on balance about in line with expectations. Money market conditions were firm throughout the period and had become quite firm in recent days in response to strong loan demands. Bank lending rates to Government securities dealers were raised to new high levels, and the effective rate on Federal funds reached a record 5½ per cent, with some transactions at 5⅝ per cent.

The deficit in the U.S. balance of payments for the first 5 months of 1966 was now estimated to have been at a seasonally adjusted annual rate of $2¼ billion on the "liquidity" basis of calculation. Prospects favored some recovery in the trade surplus from the unusually low levels to which it fell in April and May,

but deterioration seemed probable in other categories of U.S. international payments.

On the day before this meeting, the Board of Governors announced two actions designed to moderate further growth of bank credit and deposits. Reserve requirements were increased from 4 to 5 per cent against time deposits (other than savings deposits) in excess of $5 million at each member bank, effective with the reserve computation period beginning July 14, 1966, for reserve city banks and July 21, 1966, for all other member banks. This action, which would increase required reserves by an estimated $420 million, was expected to exert a tempering influence on issuance of CD's and thereby to apply a moderate additional measure of restraint upon the expansion of banks' loanable funds. At the same time, the Board brought shorter-term bank promissory notes and similar instruments under the regulations governing reserve requirements and payment of interest on deposits, effective September 1, 1966.

In its discussion of policy the Committee agreed that net reserve availability should be reduced if the pace of bank credit expansion led to larger than expected increases in required reserves. At the same time it was agreed that operations might need to be modified to ease reserve conditions if unusual liquidity pressures developed at financial institutions as the result of deposit or share account withdrawals.

Divergent judgments were expressed regarding the appropriate level of net reserve availability if increases in required reserves were not unusually large. Some members felt that deeper net borrowed reserves should be sought. They cited the economic outlook, the strong continuing demands for bank credit, and the undesirability of offsetting the full impact on net borrowed reserves of the Board's action on reserve requirements. Other members favored maintaining net reserve availability around its recent levels, primarily because of the uncertainties with respect to possible financial developments in the period immediately ahead. There was considerable sentiment for giving the Account

Manager latitude to reduce net reserve availability somewhat if and when he thought financial conditions permitted.

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, while there has been some reduction in automobile sales and residential construction, over-all domestic economic activity is continuing to expand, with industrial prices rising further. Mortgage market conditions remain tight and total credit demands continue strong. The foreign trade surplus has declined and the international payments deficit has increased. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.

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 current state of net reserve availability and related money market conditions, except as changes may be needed to moderate unusual liquidity pressures at financial institutions; provided, however, that if such liquidity pressures are not unusually strong and required reserve increases are larger than expected, operations shall be conducted with a view to attaining some further gradual reduction in net reserve availability and firming of money market conditions.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, and Mitchell. Votes against this action: None.

2. Amendment of continuing authority directive.

The Committee amended Section 1(c) of the continuing authority directive to the Federal Reserve Bank of New York regarding domestic open market operations, to remove the 24-month maturity limitation on Government securities that might be held under repurchase agreements with nonbank dealers. As amended, Section 1(c) read as follows:

To buy U.S. Government securities, and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, from nonbank

dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities or acceptances in 15 calendar days or less, at rates not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower; provided that in the event Government securities covered by any such agreement are not repurchasd by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, and Mitchell. Votes against this action: None.

This action was taken after the Account Manager described certain procedures that might prove necessary in supplying reserves to the banking system around the July 4 holiday period, when the usual seasonal rise in currency holdings of the public was expected to result in a large decline in reserves. It appeared that opportunities for outright purchases of bills might be limited because of the very low level of market supplies; and that supplying the needed reserves through repurchase agreements of the usual type—that is, agreements related to the dealers' current needs for financing—might not prove feasible because such needs recently had been minimal and might continue so. The procedure suggested was to arrange repurchase agreements with dealers in the expectation that they would obtain the necessary securities by entering into similar agreements with banks and others seeking a temporary supply of funds over a period of expected money stringency. A temporary removal of the maturity limitation was proposed in order to give maximum flexibility to the operations. The Committee's action was taken on the understanding that operations of the type described would be undertaken only if found necessary to supply needed reserves. It was expected that the continuing authority directive would be amended again to restore the maturity limitation after the current period of reserve need had passed.

July 26, 1966

1. Authority to effect transactions in System Account.

GNP was now officially estimated to have increased by $11 billion in the second quarter. This was considerably less than the $17 billion rise in the first quarter, with the slowdown attributable mainly to lack of growth in consumer spending for goods. Since prices advanced as much in the second quarter as in the first, real GNP rose at an annual rate of only 2.5 per cent, compared with 6 per cent in the first quarter. Growth in industrial production and nonfarm employment also slowed in the second quarter.

Imbalances in the economy appeared to have increased recently. Thus, the rate of business inventory accumulation in the second quarter was the highest in many years—partly because of a build-up in dealer stocks of automobiles—and probably was not sustainable; and the outlook for residential construction remained weak. However, substantial increases appeared in prospect in the third quarter for disposable incomes and consumer spending, and both business capital outlays and defense expenditures were likely to continue their upward trends. As a result, GNP was expected to grow more rapidly in the third quarter than in the second.

In June, industrial production rose moderately further, and retail sales increased following sharp declines in April and May. Nonfarm employment expanded substantially as a record number of teenagers entered the labor force and most of them found jobs. The over-all unemployment rate was unchanged at 4 per cent,

but there was a marked further decline in long-duration unemployment.

The advance in average industrial prices continued in June and apparently also in early July. The consumer price index rose substantially in June, partly for seasonal reasons, and was 2.5 per cent above a year earlier.

Private housing starts, which had dropped sharply in May, edged down somewhat further in June to the lowest rate in 5 years. The recent decline reflected acute pressures in mortgage markets, based in part on uncertainties about the extent of withdrawals from savings and loan associations and mutual savings banks at the midyear dividend-crediting period. As it turned out, withdrawals appeared to have been substantial but smaller than had been widely feared. Nevertheless, mortgage markets continued under great strain.

Commercial banks apparently benefited to some extent from the July withdrawals from competing institutions; total time and savings deposits were estimated to be increasing more rapidly than the May–June average rate of about 10 per cent. The money supply was declining in July after increasing sharply in June, as U.S. Government deposits were rebuilt following a substantial reduction in the preceding month. However, total deposits, including Government deposits, and required reserves of member banks were increasing substantially. Staff projections for August suggested a fairly low growth rate in total deposits and very small growth in required reserves.

Loan demand remained strong, and money markets tightened further in the period since the Committee's previous meeting. Yields on short-term instruments generally continued to increase. Dealer loan rates posted by major New York City banks reached new highs as those banks developed large basic reserve deficiencies and were heavy buyers of Federal funds at rates ranging up to 5¾ per cent. On June 29 the commercial bank prime lending rate was raised to 5¾ per cent from 5½ per cent. In this environment Treasury bill rates moved sharply higher to levels somewhat more in line with other short-term rates. The 3-month bill rate, after rising above 4.90 per cent after mid-July, closed at 4.78 per cent on the day before the meeting, compared with 4.33 per cent 4 weeks earlier. Yields in longer-term securities markets also moved sharply higher in late June and early July, but subsequently tended to stabilize.

The Treasury was expected to announce on July 27 the terms on which it would refund securities scheduled to mature in mid-August. About $3.2 billion of the maturing issues were held by the public.

System open market operations since the preceding meeting had been directed toward maintaining net reserve availability and money market conditions in about the range of recent weeks, while keeping alert to movements in required reserves and also to possible liquidity pressures at financial institutions around the end of the quarterly interest-crediting period. Operations were complicated, however, by a large increase in float stemming from an airline strike that began on July 8 and the resulting delays in transmittal of checks between Federal Reserve Banks. This rise in float led to a sharp increase in net reserve availability in the statement week ended July 13. In the following week surplus reserves were absorbed by sales of Treasury bills with matching forward purchase contracts, in accordance with an understanding reached during a telephone meeting of the Committee on July 11. Weekly average net borrowed reserves fluctuated from about $90 million to $480 million in the first 3 weeks of July and averaged about $340 million, slightly below the June average of $355 million.

The deficit in the balance of payments in the second quarter was estimated at a seasonally adjusted annual rate of about $600 million on both the "liquidity" and "official reserve transactions" bases. The apparent improvement in the liquidity deficit from its first-quarter rate of $2¼ billion was accounted for by an increased flow of funds of foreign official and international institutions out of liquid claims on the United States into certain types of claims classed as nonliquid—specifically, time deposits with original maturities of more than 1 year, and agency bonds or notes of over-1-year original maturity. Since the magnitude of further net shifts of these kinds was not predictable, the reduction in the liquidity deficit provided no guide to current trends, particularly in view of the sharp decline in the merchandise trade surplus.

During the period since the previous Committee meeting there had been an increase from 6 per cent to 7 per cent in the discount rate of the Bank of England, followed by announcement by the British Government of a broad program designed to dampen private and public spending in Britain and to limit overseas expenditures. Nevertheless, strong speculative pressures against the pound sterling persisted.

There was a general desire within the Committee to keep a tight rein on bank credit expansion. However, there was also a recognition that the forthcoming Treasury refunding constituted an important reason for continuing approximately the current state of net reserve availability and money market conditions, in accordance with the customary practice of maintaining an "even keel" during periods of Treasury financing activity. Some members—citing factors such as present and prospective inflationary pressures, the continuing strong business loan demand and the risk of another upsurge in bank credit such as had occurred in March and April, the lack of steps to date toward a more restrictive fiscal policy, and the balance of payments situation and outlook—expressed the view that a good case could be made for a further gradual firming of monetary policy at this time to the extent that the Treasury financing permitted. It was the consensus, however, that even if the Treasury financing permitted, such firming should not be sought unless the rate of growth in required reserves, after seasonal adjustment, was more rapid than the very small rise currently projected by the staff.

Accordingly, 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 over-all domestic economic activity appears to be expanding somewhat more rapidly than in the second quarter despite weakness in residential construction, with industrial prices rising further. Total credit demands continue strong and financial markets, particularly for mortgages, remain tight. Despite the statistical improvement resulting largely from special transactions, the balance of payments situation continues to reflect a sizable underlying deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.

To implement this policy, while taking into account the forthcoming Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the current state of net reserve availability and related money market conditions; provided, however, that if required reserves expand more rapidly than expected and if conditions associated with the Treasury financing permit, operations shall be conducted with a view to attaining some further gradual reduction in net reserve availability and firming of money market conditions.

> Votes for this action: Messrs. Hayes, Bopp, Brimmer, Clay, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

2. Amendment of continuing authority directive.

The Committee amended Section 1(a) of the continuing authority directive to the Federal Reserve Bank of New York regarding domestic open market operations, to raise from $1.5 billion to $2 billion the limit on changes in holdings of U.S. Government securities in the System Open Market Account between meetings of the Committee. With this amendment, Section 1(a) read as follows:

To buy or sell U.S. Government securities in the open market, from or to Government securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government securities with the Treasury or allow them to mature without replacement; provided that the aggregate amount of such securities held in such Account at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $2.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting.

> Votes for this action: Messrs. Hayes, Bopp, Brimmer, Clay, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

This action was taken after the Account Manager reported that the previously existing "leeway" might conceivably prove too small. There was a prospective need for the System to supply a rather large volume of reserves in the period until the next meeting, and in addition the uncertain duration of the airline strike was a complicating factor.

At the meeting of June 28, 1966, as indicated in the entry for that date, the Committee had amended Section 1(c) of the continuing authority directive to remove the 24-month maturity limitation on Government securities that might be held under repurchase agreements with nonbank dealers, in the expectation that the directive would be amended again to restore the maturity limitation after the then-current period of reserve need had passed. Because of the possibility that procedures similar to those described in the preceding entry might again be required in the period before the next meeting, the Committee agreed to continue paragraph 1(c) in its existing form for the time being.

August 23, 1966

Authority to effect transactions in System Account.

The economic outlook remained expansive, and prospects were for continuing high levels of resource use and strong upward pressures on wages and prices. Defense expenditures apparently were rising at an unabated rate, business fixed investment outlays were continuing to grow, and consumer spending was showing renewed strength after lagging in the spring.

Industrial production rose further in July, and nonfarm employment continued to expand vigorously. The unemployment rate, at 3.9 per cent, was little changed from the 4.0 per cent rate of the two prior months. On the other hand, private housing starts declined sharply further to the lowest monthly level in 6 years, as mortgage funds remained quite limited.

The wholesale price index increased appreciably in July, mainly because of a large rise in prices of foodstuffs; average industrial prices advanced only slightly further. Consumer prices continued to rise at a substantial rate, leading to further wage increases in industries with cost-of-living escalator contracts and stimulating demands for higher wages in industries where negotiations were under way or imminent. The settlement of the recent strike of airline machinists involved an increase in wages and other benefits well above administration guideposts.

Commercial banks increased their prime lending rate in mid-August to 6 per cent, from the 5¾ per cent rate that had been established near the end of June. Growth in business loans, which had reached the unusually high annual rate of 30 per cent in the June–July period, was slackening in August, in part because cash needs of corporations were temporarily reduced following the earlier accelerated payments of withheld Federal taxes. Banks reportedly were expecting loan demands to intensify again in September despite the increase in the prime rate. Inflows of private liquid funds through foreign branches of U.S. banks, which had been sizable in the first half of 1966, were exceptionally large in July and early August.

Total time and savings deposits of commercial banks continued to grow relatively rapidly, but most of the recent expansion was outside the major money centers. Large city banks, already paying the ceiling rate of 5½ per cent on negotiable CD's, were finding it increasingly difficult to replace maturing certificates as market interest rates rose. A large volume of such certificates would mature in September, and some run-off seemed likely although its dimensions were highly uncertain. Private

demand deposits were estimated to have shown little net change over the 3 months since May, and Government deposits were estimated to have declined. For August it appeared that both total deposits [2] and required reserves of member banks would fall below the levels projected earlier by the staff. With underlying loan demands remaining strong, however, staff projections for September suggested some acceleration in growth of member bank deposits, perhaps to an annual rate of 6 per cent, although the outlook was clouded by the uncertainties associated with possible run-offs of CD's.

The atmosphere in security markets since the preceding meeting of the Committee was one of marked uncertainty and apprehension. During this period average prices of common stocks declined to new lows for 1966, and yields on Treasury, corporate, and municipal bonds advanced sharply to the highest levels since the 1920's and early 1930's. Short-term interest rates also rose markedly further, with the yield on 3-month Treasury bills reaching 5.10 per cent—more than 30 basis points above its level 4 weeks earlier—before receding somewhat. Money market conditions continued to firm; dealer loan rates posted by major banks again reached new record levels, and Federal funds traded at rates as high as 6 per cent.

The recent pressures, which were evident in all maturity ranges and in all sectors of the financial markets, reflected the extremely large demands currently being made on those markets and concern over the extent of credit demands ahead. Total

[2] In recent months the Committee had been making increased 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. Since 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 recent statistics on daily-average member bank deposits, see the Federal Reserve *Bulletin* for October 1966 (p. 1478) and subsequent months. Some brief comments on the relation between the deposit series and bank credit statistics are given in the note on p. 1460 of the October *Bulletin*.

offerings of new corporate issues in August appeared likely to exceed those of any August on record, and the calendar of municipal issues was sizable. In addition, the Treasury, after completing its mid-August refunding, announced an auction of $3 billion in tax-anticipation bills for payment on August 26. Also contributing to the uncertain atmosphere were concern about inflationary developments and prospective monetary policy and the possibility of a substantial run-off of negotiable CD's.

Recent System open market operations were directed towards keeping continued pressure on bank reserve positions while maintaining an "even keel" in the money market during the Treasury's refunding operation. Weekly average net borrowed reserve figures fluctuated in a range of $300 million to $465 million in three statement weeks ending August 17; over the period they averaged $400 million, compared with $365 million in the preceding 4 weeks. Member bank borrowings averaged about $765 million, up about $25 million from the preceding 4-week period.

The balance of payments deficit on the "liquidity" basis widened to an annual rate of roughly $3 billion in July and early August, twice the rate of the first half of 1966 when the deficit had been held down by large shifts of foreign official funds from liquid to nonliquid claims on the United States. The balance on the "official reserve transactions" basis behaved differently, however. Following a deficit at a rate of nearly $1 billion in the first half of 1966, there was a substantial surplus in July and early August, as private liquid funds in unusually large volume were attracted to the United States from abroad.

On August 17 the Board of Governors announced a further increase in reserve requirements on time deposits in excess of $5 million, from 5 to 6 per cent, effective September 8 at reserve city banks and September 15 at other member banks. The action, which would increase required reserves by an estimated $450 million, was taken for purposes similar to those underlying the increase in such reserve requirements from 4 to 5 per cent that had been announced on June 26; namely, to exert a tempering influence on bank issuance of time certificates of deposit, and to apply some additional restraint upon the expansion of bank credit to businesses and other borrowers.

The Committee agreed that no relaxation in the prevailing degree of monetary restraint would be warranted at this juncture, unless unusual liquidity pressures developed or money market conditions threatened to become disorderly. A substantial number of members thought that, absent such developments, open market operations should be conducted so as to reduce net reserve availability somewhat further, in coordination with the Board's action to increase reserve requirements. Some of these members favored seeking still greater restraint if bank credit appeared to be expanding at a rate in excess of that projected by the staff for September. At the same time it was noted that any move toward further restraint should be implemented gradually and cautiously, in view of current and prospective strains in financial markets.

Other members, who tended to give somewhat greater weight to the risks of placing undue pressures on financial markets and to the recent moderation of bank credit growth, favored reducing net reserve availability only if bank credit were expanding more rapidly than expected. A third view expressed was that the risks of developments disruptive to financial markets and to the economy in general might be sufficiently great to militate against any further increase in credit restraint at this juncture.

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 over-all domestic economic activity is expanding more rapidly than in the second quarter, despite further weakening in residential construction. Recent wage and price developments suggest that inflationary pressures are becoming more intense. Credit demands continue strong, financial markets have tightened further, and interest rates have risen substantially in an atmosphere of great uncertainty. The balance of payments continues to reflect a sizable underlying deficit. In this situation, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore reasonable equilibrium in the country's balance of payments, by restricting the growth in the reserve base, bank credit, and the money supply.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to supplying the minimum amount of reserves consistent with the maintenance of orderly money market conditions and the moderation of unusual liquidity pressures; provided, however, that if bank credit expands more rapidly than expected, operations shall be conducted with a view to seeking still greater reliance on borrowed reserves.

Votes for this action: Messrs. Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

September 13, 1966

1. Authority to effect transactions in System Account.

Economic expansion remained vigorous, according to reports at this meeting, with the main stimuli continuing to come from defense spending and business outlays on fixed investment. On September 8 the President proposed a number of fiscal actions to reduce inflationary pressures, including (1) measures to reduce lower-priority Federal spending and (2) a 16-month suspension of two tax incentives for corporate investment: the 7 per cent tax credit on machinery and equipment investment and the accelerated depreciation allowances on commercial and industrial building.

Defense spending was now estimated to be rising more rapidly in the third quarter than the second. Earlier estimates of the pace of business capital outlays were supported by results of the August Commerce–SEC survey of spending plans. That survey, like the May canvass, indicated that capital spending in 1966 as a whole would be 17 per cent above 1965, but would rise at a slower pace in the second half of the year than in the

first. With respect to consumer spending, a Census Bureau survey taken in mid-July indicated that consumer intentions to buy new automobiles were about as numerous as a year earlier, and that plans to buy household durable goods were considerably stronger.

Industrial production rose substantially further in August, according to preliminary estimates. Nonfarm employment also continued to rise quite vigorously, and the unemployment rate remained unchanged at 3.9 per cent. The gains in employment were somewhat more selective than earlier; in particular, advances in manufacturing were increasingly concentrated in industries oriented to defense and business capital goods. The latest data for manufacturers' inventories—for July—indicated a sharp step-up in the pace of accumulation from the high second-quarter level, with all of the acceleration in durable goods industries.

Estimates suggested that average wholesale prices rose further in August, but by less than in July. It appeared that food price advances were smaller than in the preceding month and that increases in industrial prices were at the reduced July rate. The recent moderation in the rise of average industrial prices was attributable mainly to declines for sensitive materials, which began in June. Price developments in the months ahead seemed likely to be especially influenced by the outcome of wage negotiations, more of which would take place in coming months than earlier in the year. An early-September wage settlement affecting telephone installers—like the August airline-machinists settlement—involved an increase well above administration guideposts.

The money supply declined somewhat further in August, bringing growth for the first 8 months of 1966 to an annual rate of about 1.5 per cent, compared with 4.8 per cent for the full preceding year. Time and savings deposits of commercial banks increased rapidly in the first half of August, but the rate of growth fell off sharply after midmonth when major banks began to experience declines in their negotiable CD's outstanding. Daily averages of both total deposits of member banks—the "bank credit proxy"—and required reserves were weaker in

August than had been expected earlier. Between the last Wednesdays of July and August total commercial bank credit expanded at about a 6 per cent annual rate, but the growth appeared to be attributable wholly to bank acquisitions of tax-anticipation bills issued by the Treasury late in August.

New staff projections for September, which allowed for a substantial further run-off in negotiable CD's, suggested little or no increase in total deposits of member banks, in contrast with an earlier expectation of moderate growth. At the same time, loan demands were expected to intensify, and the conjuncture of heavy loan demands with run-offs of CD's was expected to result in substantial pressures on banks in coming weeks.

On September 1 the Presidents of the Federal Reserve Banks addressed a letter [3] to all member banks indicating that, while the System considered orderly bank credit expansion appropriate in today's economy, it regarded the recent growth in business loans as excessive. The letter went on to indicate that the System believed a greater share of member bank adjustments should take the form of moderation in the rate of expansion of loans, particularly business loans, and it stated that member banks would be expected to cooperate in the System's efforts to hold down the rate of business loan expansion—apart from normal seasonal needs—and to use the discount facilities of the Reserve Banks in a manner consistent with those efforts. The letter added that Federal Reserve credit assistance to member banks to meet appropriate seasonal or emergency needs, including those resulting from shrinkages of deposits or of other sources of funds, would continue to be available as in the past.

The atmosphere of apprehension in security markets that had been evident before the August 23 meeting of the Committee intensified in the week following that meeting. Yields on Treasury, corporate, and municipal bonds rose sharply further and market conditions became increasingly unsettled, requiring special intervention in the market by the Federal Reserve to supply reserves. On August 30, however, following a statement by a

[3] For the full text of the letter, see p. 103.

Treasury official that was generally interpreted as foreshadowing a change in prospects for fiscal policy measures, a sharp, sustained rally began that brought bond yields down by the time of this meeting to levels below those of 3 weeks earlier. The downward tendency of yields was reinforced by the President's announcement concerning fiscal policy measures on September 8; by a Treasury announcement on September 10 that until year-end no additional new money would be raised in the open market by Government agencies and that there would be no sales of participation certificates in that interval unless market conditions warranted; and by the suggestion of the System's September 1 letter that banks would be under less pressure to liquidate securities.

In contrast, markets for short-term securities remained under strain, partly because of expectations that a large increase in Treasury bill financing would be required over the remainder of the year as a result of the change in Federal agency financing plans. Money market conditions became quite taut late in the period as the September tax and dividend dates approached. Banks in the major money centers experienced deep basic reserve deficits. Posted rates on dealer loans again reached new highs and, for the first time, some Federal funds transactions occurred at a rate as high as 6¼ per cent. Yields on 3-month Treasury bills advanced to about 5.30 per cent from a level that was slightly below 5 per cent at the time of the preceding meeting.

System open market operations continued to be directed toward keeping bank reserve positions under pressure, while at the same time giving close attention to the unsettled conditions that pervaded securities markets. Net borrowed reserves averaged $370 million in the three statement weeks ending September 7, compared with a revised figure of about $410 million in the preceding 3 weeks. Member bank borrowing averaged $720 million in the latest period, down about $45 million from the preceding 3 weeks.

The underlying international payments position of the United

States remained one of substantial deficit; in July and August together, the deficit was estimated at an annual rate of roughly \$2½ billion to \$3 billion on the "liquidity" basis. The trade balance continued to deteriorate in July as imports increased sharply further. Inflows of liquid funds through foreign branches of U.S. banks kept U.S. payments in surplus in August on the "official reserve transactions" basis, but the rate of inflow in August was only about half that of July and appeared likely to slacken further. In foreign exchange markets, sterling continued under intermittent pressure.

One view expressed in the course of the Committee's discussion was that recent trends in bank credit and other monetary aggregates suggested that the degree of restraint resulting from the Committee's earlier policy actions was substantially greater than might have been thought, and that operations now might well be directed toward seeking more nearly normal growth rates. On the other hand, it was argued that a slowdown in bank credit expansion that simply reflected the process of financial "disintermediation" at banks (that is, shifts of depositor funds out of bank time deposits and into credit market instruments in response to relatively more attractive rates on the latter) need not importantly affect total credit availability, even though the distribution of total credit would undoubtedly be altered.

The Committee concluded that the current degree of monetary restraint should be maintained unless unusual liquidity pressures developed or there were significant deviations of bank credit from its expected course. An overt change in policy toward greater ease was considered undesirable at present in light of the persistence of inflationary pressures. At the same time, a number of factors were cited as militating against further intensification of restraint; these included the fiscal measures proposed by the President, the cumulating evidence that past monetary policy actions were having substantial impact, the continuing strains in markets for short-term securities, and the special pressures expected in financial markets over coming weeks.

It was noted that widely different levels of member bank borrowings and net borrowed reserves might be consistent with the current degree of monetary restraint, depending on the intensity of strains in financial markets and the extent to which banks chose to make reserve adjustments with or without recourse to the discount window under the terms of the System's September 1 letter. For this reason the Committee agreed that measures of net reserve availability should be given subordinate importance in operations and that the degree of restraint should be judged primarily by general money market conditions.

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 over-all domestic economic activity is expanding vigorously, despite the substantial weakening in residential construction, with inflationary pressures persisting. Aggregate credit demands continue strong and short-term financial markets remain under strain. The balance of payments continues to reflect a sizable underlying deficit. In this situation, and in light of the new fiscal program announced by the President, it is the Federal Open Market Committee's policy to resist inflationary pressures and to strengthen efforts to restore 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 firm but orderly conditions in the money market; provided, however, that operations shall be modified in the light of unusual liquidity pressures or of any apparently significant deviations of bank credit from current expectations.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

2. Ratification of amendment to authorization for System foreign currency operations.

At this meeting the Committee ratified an action taken by members on September 9, 1966, amending paragraph 2 of its authorization for System foreign currency operations to 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 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)	Maximum period of arrangement (months)
Austrian National Bank	100	12
National Bank of Belgium	150	12
Bank of Canada	500	12
Bank of England	1,350	12
Bank of France	100	3
German Federal Bank	400	6
Bank of Italy	600	12
Bank of Japan	450	12
Netherlands Bank	150	3
Bank of Sweden	100	12
Swiss National Bank	200	6
Bank for International Settlements (System drawings in Swiss francs)	200	6
Bank for International Settlements (System drawings in authorized European currencies other than Swiss francs)	200	6

Votes for ratification of this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, and Shepardson. Votes against ratification of this action: None.

This action increased the authorized amounts of the System's swap arrangements with most of the foreign banks with which such arrangements were maintained, for the purpose of providing a broader margin of safety for the stability of the international monetary system. The increases raised the aggregate size of the network to $4.5 billion from $2.8 billion.

At its preceding meeting the Committee had authorized the Special Manager of the System Open Market Account to undertake negotiations looking toward an enlargement of the swap network, subject to notification by the Secretary of the Treasury to the Chairman or Acting Chairman of the Board that the proposed program was fully consistent with U.S. international financial policy at this time. Following receipt of such notification by the Acting Chairman of the Board and advice from the Special Manager that preliminary discussions had been completed with the foreign banks involved, Committee members approved the amendment to the authorization. In addition to the revisions of the dollar amounts of individual arrangements, shown in the second column of the table contained in the affected paragraph, the caption to the third column was modified by adding the word "maximum" before the words "period of arrangement." This change was made to permit different maturities, not exceeding those indicated, to be employed for different portions of individual arrangements.

October 4, 1966

Authority to effect transactions in System Account.

GNP rose more in the third quarter than in the second, according to tentative staff estimates, as defense expenditures accelerated sharply. About half of the third-quarter rise in GNP apparently reflected higher prices. Further sizable increases in both defense spending and business capital outlays appeared probable in the fourth quarter—suggesting another large gain in GNP and continuing pressures on available manpower and plant resources. Wage rates were advancing more rapidly than earlier, and rising costs seemed likely to reinforce the effects of strong demands on prices.

While business activity continued to expand vigorously, sentiment appeared less ebullient than earlier, and signs of growing economic imbalance raised some uncertainties about the longer-run outlook. Average prices of common stocks, which had rallied in early September, later declined again. Residential construction activity continued to contract in August as the supply of mortgage funds remained highly limited; private nonresidential building also had declined appreciably in recent months. Some of an unusually large increase in manufacturers' inventories in July and August was probably involuntary; stock–sales ratios rose abruptly, and a Commerce Department survey of anticipations suggested a sharp drop in the growth of inventories in the fourth quarter.

The money supply, which had declined in July and August, was estimated to have risen at an annual rate of about 7 per cent in September. Total time and savings deposits of commercial banks increased much less than in preceding months as a substantial run-off occurred in negotiable CD's outstanding. Estimates indicated that growth in business loans was smaller than expected and considerably below the average rate of recent months—perhaps because of both restrictive lending policies of banks and lighter demands than anticipated. Daily-average figures on member bank deposits implied little change in total bank credit in September, and required reserves appeared to have declined slightly.

Business loan demand was expected to be strong in October, partly because cash needs would again be increased by accelerated payments of withheld Federal taxes. Reflecting this expectation, staff projections suggested resumed growth in daily-average member bank deposits—the "bank credit proxy"—at an annual rate of perhaps 5 or 6 per cent, and a more rapid increase in

required reserves. The projections allowed for a rise in Government and private demand deposits, the former as a result of an anticipated Treasury financing. Little or no increase was anticipated in total time and savings deposits, however, partly because further substantial run-offs of negotiable CD's were expected. Also, it appeared that banks would be in a slightly less favorable position than formerly in competing for other time deposits under the new ceiling rates that had been established for various depositary institutions in late September, following enactment of new legislation.

The strains evident in short-term financial markets at the time of the preceding meeting of the Committee continued through the mid-September tax and dividend dates, and the yield on 3-month Treasury bills rose by about 30 basis points further to a peak of 5.59 per cent. Subsequently, however, the atmosphere improved considerably, and the 3-month bill yield fell below 5.35 per cent. Federal funds rates and posted rates on dealer loans also moved down.

Yields on long-term securities had fluctuated widely in recent weeks, first rising and then declining in response chiefly to shifting expectations regarding fiscal and monetary policy and changing assessments of the buoyancy of the economy and the prospects for peace in Vietnam. On the whole, however, long-term yields remained significantly below their late-August levels and showed little net change over the interval. The volume of new corporate bond flotations in September was somewhat lower than had been anticipated, and the calendar for October was smaller than offerings in September, although larger than those of October 1965. On the other hand, the Treasury was expected to be making heavy demands on capital markets over the rest of the year, with gross new borrowings of perhaps $8 billion. An announcement of an auction of $3 billion to $3½ billion in tax-anticipation bills, to be held around mid-October, was anticipated shortly; and the terms of the Treasury's November refunding, in which some new money probably also would be raised, were expected to be announced near the end of October.

System open market operations over most of the recent period were directed toward absorbing reserves supplied by movements in market factors, but day-to-day operations were conditioned by the shifting market atmosphere. Thus, only a moderate amount of reserves was absorbed early in the period, when short-term markets were under strain, but reserve absorption was stepped up later when market conditions became more comfortable. As a result, weekly-average figures for net borrowed reserves fluctuated over a wide range—from about $190 million to $570 million—with the bulk of the fluctuation occurring in excess reserve positions of country banks. For September as a whole, net borrowed reserves averaged about $375 million, a little less than the August average; member bank borrowings, at $765 million, were slightly above those of August.

The U.S. balance of payments in the third quarter was tentatively estimated to have been in deficit at a seasonally adjusted annual rate of about $2 billion on the "liquidity" basis of calculation. However, a substantial surplus was recorded on the "official reserve transactions" basis. The divergence in the two measures was a consequence primarily of the substantial inflows of liquid funds through foreign branches of U.S. banks. The surplus on merchandise trade, which had declined markedly in the second quarter, fell further in the third quarter as imports increased more rapidly than exports.

Committee members differed somewhat in their assessments of the various elements in the economic outlook. Some stressed the implications of rising defense expenditures for the course of over-all developments and the persistence of inflationary pressures, while others placed greater emphasis on the evidences of recent and prospective weakening in the expansion of aggregate private demands.

The Committee agreed, however, that no change in policy should be made at this time, both because the economic situation at present did not appear to warrant an overt move in either direction and because Treasury financing activity was imminent. The desirability of encouraging moderate expansion in bank credit was noted, and it was agreed that account should be taken in open market operations of any apparently significant deviations of bank credit growth from current expectations.

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 over-all domestic economic activity is expanding vigorously, despite the substantial weakening in residential construction, uncertainties in equity markets, and a sharp increase in business inventories. Inflationary pressures are persisting and aggregate credit demands still remain strong. The balance of payments continues to show a sizable liquidity deficit. In this situation, and in light of the new fiscal program announced by the President, it is the Federal Open Market Committee's policy to resist inflationary pressures and to continue efforts to restore reasonable equilibrium in the country's balance of payments.

To implement this policy, and taking account of forthcoming Treasury financings, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining firm but orderly conditions in the money market; provided, however, that operations shall be modified in the light of unusual liquidity pressures or of any apparently significant deviations of bank credit from current expectations.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

November 1, 1966

1. Authority to effect transactions in System Account.

Reports at this meeting indicated that economic activity was continuing to expand under the stimulus of rising defense expenditures, although moderating tendencies were appearing in some sectors of the private economy. The outlook was clouded by uncertainties relating to Vietnam and to prospects for fiscal policy actions in addition to the temporary suspension, approved by Congress in late October, of the 7 per cent investment tax credit and accelerated depreciation allowances.

Preliminary figures of the Commerce Department indicated that growth in GNP had stepped up to about a $14 billion rate in the third quarter from $11 billion in the second, despite the sharp contraction in residential construction that brought housing starts in September down nearly to the recession trough of December 1960. The capacity utilization rate in manufacturing remained high, shortages of skilled workers persisted, and the unemployment rate continued low—3.8 per cent in September, little changed from the August figure of 3.9 per cent. A large increase in orders to defense-related industries in September implied that defense spending would continue to rise rapidly, and tentative staff estimates suggested that the faster pace of GNP growth of the third quarter would be maintained in the fourth.

The evidences of moderating tendencies in private demands included slight declines in retail sales in September and early October and lack of growth in both industrial production and nonfarm employment in September. In addition, recent private surveys of business plans suggested a marked slowing of growth in spending on plant and equipment in 1967.

Prices of industrial commodities remained generally stable in September, as further declines in prices of sensitive materials and some consumer appliances continued to offset increases in machinery and equipment and other metal products. Consumer prices rose slightly more than seasonally, partly because of continued rapid increases in the prices of services. Average hourly earnings of manufacturing employees were advancing faster than they had earlier, reflecting cost-of-living adjustments and the larger wage increases provided by contracts recently negotiated.

Both the money supply and total time and savings deposits of commercial banks appeared to have declined in October, the latter partly because of another sizable run-off in negotiable CD's. Commercial bank credit was estimated to have changed

little between the last Wednesdays of September and October; the step-up in business loan growth was smaller than expected, and banks liquidated a large volume of Government securities. With both demand and time deposits weaker than anticipated, the "bank credit proxy"—daily-average member bank deposits—declined at an annual rate of about 3 per cent in October in contrast with the earlier expectation of growth. Required reserves of member banks also fell short of expectations.

Staff projections for November suggested some further decline in member bank deposits—at perhaps a 2 per cent annual rate—and a slight reduction in required reserves. The projections allowed for continued run-offs in outstanding CD's, but at a slower rate than in September and October. Some reduction in the rate of business loan expansion was expected, mainly because corporate payments of withheld taxes normally made in November had been shifted into October.

Recent System open market operations were directed at maintaining generally steady but somewhat less firm conditions in the money market, in view of the lack of growth in bank credit. Net borrowed reserves averaged about $340 million in the last 2 weeks of October, compared with $495 million earlier in the month and $390 million (revised) in September. Member bank borrowings also declined in the second half of October, although the average for the month was about the same as in September. Yields on 3-month Treasury bills declined by about 10 basis points on balance to 5.22 per cent on the day before this meeting, and various other short-term rates had edged down since the preceding meeting. Yields on long-term securities had also declined, with those on Treasury bonds reaching their lowest levels since June.

The Treasury raised $3.5 billion of new cash in mid-October through an auction of tax-anticipation bills, and subscription books for the November refunding were open on the day of this meeting. The refunding involved a cash offering of $2.5 billion of 5⅝ per cent 15-month notes and $1.6 billion of 5⅜ per cent

5-year notes, to replace $4.1 billion of maturing obligations, of which $3.2 billion were held by the public.

The third-quarter deficit in the U.S. balance of payments on the "liquidity" basis was now estimated to have been at an annual rate of less than $1 billion. The revision from the earlier estimate of about $2 billion reflected special receipts at the end of September—consisting of foreign official debt prepayments and purchases of nominally nonliquid assets—rather than any fundamental change in underlying payments conditions. The inflows of liquid funds through foreign branches of U.S. banks, which had been extremely large in the third quarter, continued in October on a reduced, although still sizable, scale.

Committee members agreed that the recent tendency towards somewhat less firmness that had been allowed to develop in the absence of bank credit expansion was appropriate. The Committee concluded that the current Treasury financing precluded a marked shift in policy at present and that generally steady conditions in the money market should be sought. Most members felt that a significant change in policy was not warranted pending clarification of the outlook for the Federal budget and further evidence on the likely strength of private demands, although some members expressed concern about the risks of overstaying a policy of restraint in view of recent moderating tendencies in some sectors of the private economy. The Committee agreed that it would be desirable to foster expansion in bank credit at a moderate pace and that open market operations should be modified, insofar as feasible given the Treasury financing, if bank credit were either declining further or rising at an unduly rapid rate.

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 over-all domestic economic activity is continuing to expand with sharply rising defense expenditures but some evidences of moderating tendencies in sectors of the private economy. While prices of some materials have declined recently, upward demand and cost pressures persist for many finished goods and services. Bank credit expansion has slackened. Earlier strains in financial markets have abated and certain fiscal policy measures have recently been enacted by the Congress. The balance of payments remains a serious problem. In this situation, it is the Federal Open Market Committee's policy to maintain money and credit conditions conducive to the restraint of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, and taking account of the current Treasury financing, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining generally steady conditions in the money market; provided, however, that operations shall be modified, insofar as the Treasury financing permits, in the light of bank credit developments during the month.

> Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

2. Amendment of continuing authority directive.

The Committee amended Section 1(c) of the continuing authority directive to the Federal Reserve Bank of New York to authorize repurchase agreements in obligations of U.S. Government agencies. Previously, repurchase agreements had been authorized only in U.S. Government securities and bankers' acceptances. With this amendment, Section 1(c) read as follows:

To buy U.S. Government securities, obligations that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, and prime bankers' acceptances with maturities of 6 months or less at the time of purchase, from nonbank dealers for the account of the Federal Reserve Bank of New York under agreements for repurchase of such securities, obligations, or acceptances in 15 calendar days or less, at rates not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower; provided that in the event Government securities or agency issues covered by any such agreement are not repurchased by the dealer pursuant to the agreement or a renewal thereof, they shall be sold in the market or transferred to the System Open Market Account; and provided further that in the event bankers' acceptances covered by any such agreement are not repurchased by the seller, they shall continue to be held by the Federal Reserve Bank or shall be sold in the open market.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

Section 6 of Public Law 89-597, enacted in late September, amended Section 14(b) of the Federal Reserve Act to authorize the Reserve Banks "To buy and sell in the open market, under the direction and regulations of the Federal Open Market Committee, any obligation which is a direct obligation of, or fully guaranteed as to principal and interest by, any agency of the United States." The amendment of the continuing authority directive was made pursuant to that legislation, after the Account Manager indicated that he would consider repurchase agreements in agency issues to be a useful addition to the tools presently available for reserve management. It was agreed to postpone a decision regarding authorization of outright transactions in agency issues pending further study of their potential value in implementing monetary policy objectives.

November 22, 1966

1. Authority to effect transactions in System Account.

Evidences of moderating tendencies in the pace of business expansion were increasing. The Commerce Department had reduced its estimate of GNP for the third quarter and now indicated an increase only about $1 billion larger than that for the second quarter. Staff projections of fourth-quarter growth in GNP also had been lowered somewhat, primarily because of a downward revision in the estimate for consumer expenditures. Substantial gains in defense spending and business fixed investment were still projected for the fourth quarter.

Industrial production rose relatively little in October after remaining stable in September, and with manufacturing capacity continuing to expand, the plant utilization rate apparently edged down. Total retail sales were about unchanged in October as declines at automobile dealers and other durable goods stores offset advances at nondurable goods stores. Housing starts dropped sharply further to the lowest level since World War II. Expansion in nonfarm employment resumed, however, and labor market conditions continued tight. The unemployment rate, at 3.9 per cent, was little different from the 3.8 per cent rate of September, and the average workweek in manufacturing continued close to the postwar peak.

The wholesale price index declined in October as a result of a substantial drop for foodstuffs. Average prices of industrial commodities, which had been stable for several months, continued unchanged in October and were about 2 per cent above a year earlier. The progressive decline in sensitive materials prices, which offset increases in prices of finished industrial products, seemed to be tapering off, however, and labor costs were rising as the pattern of larger wage increases continued. For both reasons average industrial prices appeared likely to begin rising again, although perhaps at a slower pace than early in the year.

The money supply declined in October by somewhat more than had been estimated earlier. Since April the money supply had fallen on balance at an annual rate of about 1.5 per cent. Commercial bank credit, on a last-Wednesday-of-the-month basis, was now estimated to have contracted further in October after declining on balance over the two preceding months. Growth in business loans slackened to an annual rate of about 7 per cent in the 3 months ending in October, from 21 per cent in the first 7 months of the year and more than 18 per cent in 1965 as a whole.

New staff projections for daily-average member bank deposits —the "bank credit proxy"—suggested a decline at an annual rate of 3 per cent in November, slightly more than anticipated

3 weeks earlier. Private demand deposits appeared to be expanding less rapidly than expected as loan growth weakened, and Government deposits at banks appeared to be declining somewhat more rapidly than anticipated. Some further decline in member bank deposits seemed likely in December, if money market conditions remained unchanged, as a result of continuing run-offs of negotiable CD's and reductions in Government balances. Treasury deposits at both commercial banks and Federal Reserve Banks were expected to reach relatively low levels by midmonth, perhaps requiring the Treasury to borrow directly from the Federal Reserve for short periods.

Yields on long-term bonds moved higher over the first 3 weeks of November, partly as a result of substantial additions to the calendar of prospective new corporate and municipal bond offerings. Long-term yields also were affected by press reports that the Federal National Mortgage Association might resume sales of participation certificates before the end of the year and by continuing uncertainties regarding the prospects for further fiscal measures.

System open market operations since the preceding meeting of the Committee had been directed at maintaining steady conditions in the money market while the distribution of securities issued in the Treasury's November refinancing was under way. Pressures on reserve positions of central money market banks developed early in November partly as a result of a marked shift in reserves toward other banks. Rates on Federal funds and dealer loans advanced, and 3-month Treasury bill yields rose by about 20 basis points to around 5.45 per cent at midmonth. In view of the pressures in the central money market and of the relatively weak performance of bank credit, the Federal Reserve provided a large volume of reserves through open market operations early in the period, expanding net reserve availability somewhat. Net borrowed reserves averaged about $230 million in the two statement weeks ending November 16, compared with $340 million in the two preceding weeks and $430 million in October.

The pressures eased after midmonth, and by the date of this meeting Treasury bill yields and money market rates had fallen back to about their levels of 3 weeks earlier.

The U.S. balance of payments in the first 9 months of 1966 was estimated to have been in deficit at an annual rate of about $1.2 billion on the "liquidity" basis, and to have been in surplus at a rate of $0.8 billion on the "official reserve transactions" basis. Preliminary data suggested that the liquidity deficit in October and early November was at a rate of roughly $2 billion, about the same as would have been recorded earlier in the year in the absence of shifts of foreign official funds from liquid to nonliquid form. Inflows of liquid funds through foreign branches of U.S. banks accelerated sharply in late October and early November; in the 4 weeks ending November 9 they were at a rate approaching the July peak, although some reflow occurred in the following week. With net inflows of liquid funds thus continuing large, the balance on the official reserve transactions basis apparently remained near zero early in the fourth quarter. A cessation, and possibly a reversal, of those flows seemed likely in coming weeks as a result of year-end seasonal pressures in the Euro-dollar market.

In the Committee's discussion it was noted that the appropriate course for monetary policy over the coming months would depend importantly on the nature of fiscal policy actions. The Committee concluded, however, that an overt, although modest and gradual, lessening of monetary restraint was warranted at present in view of the evidences of moderating tendencies in private demands and the recent lack of expansion in bank credit and money. Accordingly, it was agreed that somewhat easier money market conditions should be sought unless bank credit expansion became unduly rapid.

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 over-all domestic economic activity is continuing to expand, with sharply rising defense expenditures but with evidences of moderating tendencies in various sectors of the private economy. While there has been some slowing in the pace of advance of broad price measures, upward price pressures persist for many finished goods and services. Bank credit and money have shown no expansion in recent months. Long-term interest rates have again risen somewhat after declining from their late summer peaks. The balance of payments remains a serious problem. In this situation, it is the Federal Open Market Committee's policy to maintain money and credit conditions conducive to noninflationary economic expansion and progress toward 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 attaining somewhat easier conditions in the money market, unless bank credit appears to be resuming a rapid rate of expansion.

Votes for this action: Messrs. Martin, Bopp, Brimmer, Clay, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: Messrs. Hayes and Daane.

In dissenting from this action, Messrs. Hayes and Daane, recognizing the less rapid pace of expansion in the private sector of the economy, indicated that they would have preferred to maintain the somewhat easier money market conditions already prevailing at the time of this meeting and to resolve doubts on the side of ease. In their judgment, with defense expenditures apparently continuing to rise rapidly, inflation—both demand-pull and cost-push—remained a serious threat to both the domestic economy and the U.S. balance of payments in which the trade balance was a crucial element. Furthermore, they felt that any premature pronounced easing could bring about adverse effects on capital outflows. Hence, they deemed it unwise to shift more overtly to a posture of less monetary restraint at this time, particularly in advance of more concrete information on Federal taxes and expenditures.

2. Amendment of continuing authority directive.

The Committee amended Section 2 of the continuing authority directive to the Federal Reserve Bank of New York to increase, from $500 million to $1 billion, the dollar limit on special short-term certificates of indebtedness purchased directly from the Treasury that might be held by the Federal Reserve Banks at any one time. With this amendment, Section 2 read as follows:

The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York to purchase directly from the Treasury for the account of the Federal Reserve Bank of New York (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the rate charged on such certificates shall be a rate ¼ of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed $1 billion.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Daane, Hickman, Irons, Maisel, Mitchell, Robertson, and Shepardson. Votes against this action: None.

This action was taken after the Account Manager reported that the amount the Treasury might have to borrow directly from the Federal Reserve Banks in December was highly uncertain and that it appeared at least possible that the amount might be somewhat in excess of the $500 million limit previously specified.

December 13, 1966

Authority to effect transactions in System Account.

Additional indications that the pace of economic expansion was moderating were reported at this meeting. Growth was slowing in business capital expenditures and apparently in Federal defense outlays. Expansion in consumer spending also was slackening, despite continued rapid gains in nonfarm employment through November and a dip in the unemployment rate to 3.7 per cent from 3.9 per cent in October. Staff projections of

GNP growth in the fourth quarter had again been reduced somewhat.

A Commerce Department–SEC survey taken in late October and November indicated that business expenditures on plant and equipment had been somewhat lower in the third quarter than estimated earlier, and that outlays planned for the fourth quarter had been reduced appreciably—the first significant downward revision in capital spending plans in 3 years. Plans for the first half of 1967 implied an increase less than one-third the size of the large gain actually recorded in the corresponding half of 1966. While estimates of current and prospective defense expenditures were conjectural, the best available evidence suggested continued sizable increases in the fourth quarter of 1966 and the first quarter of 1967, but at rates progressively slower than the extraordinarily rapid rate of the third quarter of 1966.

The proportions of consumers planning to buy automobiles and major appliances within 6 months were significantly lower in mid-October than a year earlier, according to a Census Bureau survey. Retail sales, which had changed little in September and October, declined by 1 per cent in November according to preliminary data, mainly because of a 5 per cent reduction in sales at automobile dealers. Retail inventories rose sharply in October, and manufacturers of automobiles and some other consumer durable goods subsequently announced production cutbacks. With output of steel and construction materials also declining, the industrial production index for November was tentatively estimated at only slightly above its August–September average.

The rate of housing starts was likely to be lower in the fourth quarter as a whole than in the third, although not so low as in October. It appeared that the extended decline in residential construction might taper off in the first quarter of 1967; if so, this would provide some offset to the slowing of growth foreseen for other categories of demand.

The consumer price index rose in October at the substantial pace of the preceding 4 months, with prices of services continuing to increase rapidly. It was likely that a smaller increase would be shown in the consumer index for November, as earlier declines in wholesale prices of foodstuffs carried over to retail prices. At the wholesale level, on the other hand, the declines in prices of both foodstuffs and sensitive materials appeared to be leveling off after the end of October, and industrial commodities were under upward pressure from rising labor costs.

The money supply declined further on the average from October to November, but turned up after mid-November as Government deposits were drawn down. With the run-off of negotiable CD's at banks slackening to less than half the September–October rate, total time and savings deposits increased slightly. Daily-average member bank deposits—the "bank credit proxy"—declined at an annual rate of about 5 per cent from October to November, somewhat more than expected earlier. On a last-Wednesday-of-the-month basis, bank credit rose slightly in November because of bank acquisitions of tax-anticipation bills issued by the Treasury late in the month. Bank holdings of other securities declined, and loan volume was unchanged on balance.

New staff projections for December suggested that member bank deposits would show relatively little increase from November if money market conditions remained unchanged. Total time and savings deposits were expected to grow slightly, despite anticipated further attrition in outstanding CD's at a rate probably somewhat above that of November. Private demand deposits and the money supply were expected to continue rising as Government deposits were reduced further. On Friday, December 9, the Treasury replenished its cash balances by selling a special certificate of indebtedness in the amount of $169 million to the Federal Reserve. The certificate was redeemed 3 days later.

System open market operations since the preceding meeting of the Committee had been directed at attaining somewhat easier conditions in the money market. A substantial volume of reserves was provided through outright purchases of Treasury bills and through repurchase agreements with nonbank dealers, including some repurchase agreements involving obligations of Federal agencies as authorized by the Committee on November 1. Various money market rates moved lower, partly as a result of System operations and of market interpretations that these operations reflected a shift of monetary policy in the direction of less restraint. The 3-month Treasury bill rate declined by nearly 20 basis points, to 5.03 per cent on the day before this meeting. Long-term interest rates also edged down, despite increased current and prospective borrowing by corporations and State and local governments and market expectations of a sale of participation certificates by the Federal National Mortgage Association.

The deficit in the U.S. balance of payments on the "liquidity" basis was relatively large in October and November, and the balance on official reserve transactions reverted to deficit from the surplus recorded in the third quarter. It was likely that the liquidity balance would improve in December, particularly if British debt service payments were not waived—as they had been in the two prior years—and if an expected payment under the German military offset agreement were made before the end of the year. The December balance on official reserve transactions could depend heavily on the changes in liabilities of U.S. banks to their foreign branches; if these liabilities declined toward the year-end, as they had in earlier years, the deficit incurred in the fourth quarter could be enlarged. Such liabilities had fluctuated widely in November and early December, but had increased on balance.

Guidelines and targets for 1967 in the President's voluntary program to improve the nation's balance of payments were announced on the day of this meeting by the Board of Governors and the Department of Commerce. The Federal Reserve guidelines for banks retained the existing ceiling for outstanding foreign assets, but banks were asked to limit the rate at which they used their leeway under the ceiling. Nonbank financial institutions were asked to limit the increases in covered assets to 5 per cent over the period from September 1966 through December 1967. The new target formula set by the Department of Commerce for corporations' direct investment transactions was designed to keep the total net outflow on direct investments in 1967 close to the volume presently expected for 1966.

The Committee concluded that the additional evidence of moderation in the pace of the business expansion confirmed the appropriateness of the decision at the preceding meeting to relax monetary restraint somewhat, and a majority of the members thought that some further relaxation would be desirable at present in light of both the outlook for slower economic growth and the persisting lack of expansion in bank credit. While it was agreed that the balance of payments continued to pose a serious problem, the view was expressed that the voluntary program in that area, as extended, would serve to enlarge the scope for adaptation of monetary policy to developments taking place in the domestic economy.

Within the majority favoring further relaxation of monetary restraint there were divergent views regarding the manner in which the goals for open market operations over the next 4 weeks might best be specified in the current economic policy directive to be issued to the Federal Reserve Bank of New York. One group suggested specifying the objective of operations in terms of attaining moderate expansion in the money supply and bank credit, noting that relatively vigorous operations might possibly be required to achieve that goal under present circumstances. Another group favored continuing the approach initiated at the preceding meeting, by calling again for somewhat easier conditions in the money market unless bank credit expansion became unduly rapid. At the conclusion of the discussion, however, the members of both groups joined in voting for the following current economic policy directive:

The economic and financial developments reviewed at this meeting indicate that over-all domestic economic activity is continuing to expand, with rising defense expenditures but with additional evidences of moderating tendencies in the private economy. While there has been some slowing in the pace of advance of most broad price measures, upward price pressures persist for many finished goods and services. Bank credit and money have shown no net expansion in recent months. Although demands on bond markets have increased, upward pressures on long-term interest rates have moderated. The balance of payments remains a serious problem. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions conducive to noninflationary economic expansion and progress toward 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 attaining somewhat easier conditions in the money market, unless bank credit appears to be resuming a rapid rate of expansion.

Votes for this action: Messrs. Martin, Brimmer, Clay, Hickman, Maisel, Mitchell, Robertson, and Wayne. Votes against this action: Messrs. Hayes, Daane, Irons, and Shepardson.

The members dissenting from this action favored maintaining the easier money market conditions achieved under the approach initiated at the preceding meeting, but not actively seeking further easing of conditions at this time. While the emphasis on particular factors varied, they generally stressed the underlying strength of the economy and their continuing concern about the balance of payments situation. They also voiced concern about recent and prospective cost and price developments. Despite the recent evidences of slower growth, the private sector of the economy did not appear to them as fundamentally weak and there were expansionary forces in the public sector. They thought, therefore, that the possibility of a reappearance of general strength and resurgence of pressures could not be ruled out.

Dissenting members were skeptical that defense spending would decelerate and emphasized that the continuing uncertainties regarding fiscal policy were grounds for proceeding cautiously in making monetary policy changes. Caution was particularly called for, in their view, because of the possible threat to the balance of payments from any deterioration in the capital account. The voluntary guidelines did not appear to provide full safeguard against such outflows.

Furthermore, it was noted that there were indications that the money supply had begun growing again in recent weeks. Efforts of banks to improve their liquidity positions before expanding loans and investments might have accounted for the seeming lack of response of bank credit thus far to the easing of monetary restraint already accomplished. The latter view was shared by some members of the majority.