FIFTY-THIRD

Annual Report

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1966

Digest of Principal Federal Reserve Policy Actions in 1966

Period	*Action*	*Purpose*
January	Reduced System holdings of U.S. Government securities, on balance, by about $650 million. Member bank borrowings averaged about $400 million.	To continue to moderate money and credit market adjustments to the December 1965 discount rate increase early in the month, and then to offset seasonal reflow of funds and maintain about the same money market conditions that had prevailed in early January.
February–early June	Limited the increase in System holdings of U.S. Government securities to about $1.5 billion. Average member bank borrowings rose to nearly $600 million.	To effect gradual reduction in net reserve availability and thereby to restrain the growth in the reserve base, bank credit, and the money supply.
June	Raised from 4 to 5 per cent the reserve requirements against time deposits, other than savings deposits, in excess of $5 million at each member bank, effective July 14 and 21 for reserve city and country member banks, respectively, thereby increasing required reserves by about $420 million.	To exercise a tempering influence on the issuance of time certificates of deposit by larger banks and to apply some additional restraint on the expansion of banks' loanable funds, thus reinforcing the operations of other instruments of monetary policy in containing inflationary pressures.
	Made shorter-term bank promissory notes and similar instruments issued after June 26, 1966, subject to regulations governing reserve requirements and payment of interest on deposits, effective September 1, 1966.	To prevent future use of these relatively new instruments as a means of circumventing statutory and regulatory requirements applicable to bank deposits.

DIGEST OF PRINCIPAL FEDERAL RESERVE POLICY ACTIONS IN 1966—Continued

Period	*Action*	*Purpose*
Early June–September	Limited the increase in System holdings of U.S. Government securities to about $800 million. Average member bank borrowings rose to $750 million.	To continue to restrain bank credit expansion while maintaining about the same state of net reserve availability and/or money market conditions and taking account, at various times, of scheduled financings by the Treasury, any unusual liquidity pressures, and any significant deviations of required reserves or bank credit from current expectations.
July	Lowered from 5½ to 5 per cent the maximum rate payable by member banks on new multiple-maturity time deposits of 90 days or more, and from 5½ to 4 per cent the maximum rate payable on such deposits with maturities of less than 90 days.	To help forestall excessive interest rate competition among financial institutions for consumer-type time deposits.
	Granted temporary authority to the Federal Reserve Banks to provide emergency credit facilities, under certain conditions, to nonmember depositary-type institutions, including mutual savings banks and savings and loan associations. No lending was necessary under this authority.	To assure that funds could be provided to assist in meeting unusual withdrawals that might develop at nonmember depositary institutions and to safeguard against the possibility of additional pressures on mortgage and securities markets resulting from such exceptional withdrawals.
August	Raised reserve requirements from 5 to 6 per cent against time deposits, other than savings deposits, in excess of $5 million at each member bank, effective September 8 and 15 for reserve city and country banks, respectively, thereby increasing required reserves by about $450 million.	To exert a tempering influence on the issuance of certificates of deposit by the larger banks and to apply some additional restraint upon the expansion of bank credit to businesses and other borrowers.
September	Requested member banks to moderate their rate of expansion of loans, particularly business loans; indicated that bank use of Reserve Bank discount facilities would be expected to be in a manner consistent with this objective; and noted the continuing availability of discount facilities to cushion deposit shrinkages.	To moderate excessive expansion of business loans at banks and at the same time to avoid additional pressure on financial markets resulting from further substantial liquidation by banks of municipal securities and other investments to obtain loanable funds; also to reaffirm availability of Federal Reserve credit assistance in case of deposit shrinkages.
	In exercise of authority given by new temporary legislation, reduced from 5½ to 5 per cent the maximum interest rate payable on any time deposit under $100,000, other than savings deposits, effective September 26.	To limit further escalation of interest rates paid in competition for consumer savings, and to help keep the growth of commercial bank credit to a moderate pace.
October–late November	Increased System holdings of U.S Government securities by nearly $500 million. Average member bank borrowings declined to $680 million.	To permit somewhat less firm conditions in the money market in view of the recent lack of growth in bank credit.
Late November–December	Increased System holdings of U.S. Government securities by about $970 million, including about $660 million in repurchase agreements. Average member bank borrowings declined to $550 million.	To relax monetary restraint somewhat in the light of both the outlook for slower economic growth and persisting lack of expansion in bank credit.
December	Issued new 1967 guidelines for banks and other financial institutions as part of broader governmental program of voluntary foreign credit restraint.	To continue, and in some respects to intensify, the voluntary effort to restrain the outflow of private capital.
	Terminated special discount arrangements announced on September 1 when member banks were asked to curtail their business loan expansion.	To eliminate discount arrangements that were no longer needed, since expansion in business loans had been reduced to a moderate rate and banks were no longer unloading securities in unreceptive markets to obtain loanable funds.

taken 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.