



FEDERAL RESERVE

press release

For immediate release

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The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached records of policy actions taken by the Federal Open Market Committee at its meetings on November 27 and December 12, 1967. These records will be published in the Board's Annual Report for 1967 and in the Federal Reserve Bulletin.

Attachments

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on December 12, 1967

1. Authority to effect transactions in System Account.

Evidence was accumulating of a resurgence in economic activity following settlement of strikes in the automobile industry and in other industries. It now appeared highly probable that growth in over-all activity would accelerate in early 1968 and that upward pressures on prices would persist as the effects of higher costs were reinforced by those of rapidly expanding demands.

Preliminary indications were that industrial output had rebounded in November, that employment had risen sharply in both manufacturing and other areas, and that the unemployment rate had declined to less than 4 per cent from 4.3 per cent in October. Retail sales had increased significantly, according to the advance estimate, and residential construction activity had continued to expand. Average prices of industrial commodities had advanced further from mid-October to mid-November, and numerous increases were announced in subsequent weeks. A sizable rise in the consumer price index in October brought its increase since March to an annual rate of over 3.5 per cent.

The business outlook for early 1968 appeared strong despite an anticipated slowing of the advance in Federal expenditures, including defense outlays. Consumer spending was expected to rise in pace with rapidly growing incomes. Although the latest Commerce-SEC survey of business capital spending plans indicated a slightly lower level of outlays in the second half of 1967 than that shown by earlier surveys, it

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suggested that plant and equipment expenditures would rise considerably in the first half of 1968. The rate of business inventory accumulation also was expected to increase substantially after the turn of the year, both because of the heightened pace of over-all activity and because of efforts to rebuild strike-depleted stocks of autos and to accumulate steel against the possibility of a strike in that industry. Outlays for residential construction appeared likely to continue upward for a time, although the pace and duration of the advance was in doubt because of uncertainties regarding prospective supplies and costs of mortgage funds.

With respect to the U.S. balance of payments, available data for October and November suggested that in the fourth quarter the deficit on the "liquidity" basis of calculation would be larger than in the third quarter and that the balance on the "official reserve transactions" basis would revert to deficit from the surplus recorded in the third quarter. Part of the deterioration reflected the conversion in October and November of official British holdings of U.S. securities to assets of more liquid form. Part, however, reflected other factors, including a further weakening of the U.S. merchandise trade surplus in October. Continued large deficits seemed to be in prospect for early 1968.

Gold holdings of the U.S. Treasury were reduced by \$475 million in the week ending December 6, mainly to settle the U.S. share of sales made by the gold pool in London during the first 2 weeks after the devaluation of sterling on November 18 and to

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cover U.S. sales to foreign central banks. Foreign demand for gold subsequently dropped sharply, but it turned up again on the day before this meeting following press reports that possible measures to restrict access to the London gold market were under discussion.

In foreign exchange markets spot sterling remained at its new ceiling rate of \$2.42 until early December, when the rate weakened following a labor dispute involving British railway workers. Subsequently the sterling exchange rate fluctuated below the ceiling. Forward operations by some continental central banks, undertaken in cooperation with U.S. monetary authorities, had helped to minimize speculative movements into continental currencies and to stimulate short-term investment outflows from them.

System open market operations since the preceding meeting of the Committee had been directed at facilitating continuing orderly adjustments to the increase in Federal Reserve discount rates, against the background of the massive international flows of funds that followed the devaluation of sterling. Operations were complicated by the need to offset the effects on member bank reserves of those flows and of the large reduction in the Treasury's gold stock. Money market conditions remained relatively stable, however, with the Federal funds rate fluctuating around the 4-1/2 per cent discount rate. In the 2 weeks ending December 6 free reserves averaged about \$240 million and member bank borrowings about \$105 million, compared with averages of \$210 million and \$125 million, respectively, in the preceding 4 weeks.

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Interest rates on most types of market securities had risen after the increase in Federal Reserve discount rates and the devaluation of sterling. Most recently, many rates had advanced further as the waning likelihood that a tax increase would be enacted this year strengthened market expectations of greater monetary restraint. Since the preceding meeting of the Committee interest rates had increased on such short-term instruments as bankers' acceptances, finance company paper, and CD's; some banks were now offering the 5-1/2 per cent ceiling rate on CD's of relatively short maturity. In early December the market rate on 3-month Treasury bills reached 5.01 per cent--its highest level in 1967--but it subsequently declined and on the day before this meeting was 4.90 per cent, about the same as 2 weeks earlier.

In the capital markets yields on intermediate- and long-term Treasury securities had moved irregularly lower in recent weeks, but those on municipal and corporate bonds, particularly the former, had risen further. The rise in corporate bond yields was moderated by postponements and cutbacks of scheduled new issues, which reduced the November volume of public offerings to little more than half the total expected earlier. Upward interest rate pressures appeared to be persisting on home mortgages.

Commercial bank credit increased less rapidly in November than in other recent months, with bank acquisitions of municipal and Federal agency issues accounting for much of the rise. Holdings of Treasury securities and loans on securities both declined, and

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growth in business loans, while somewhat faster than in the two preceding months, was still moderate. The bank credit proxy--daily-average member bank deposits--increased at an annual rate of about 8.5 per cent in November, compared with average annual rates of 11 per cent in September and October together and 13.5 per cent in the first 8 months of the year. Growth in total time and savings deposits was maintained in November at the 12 per cent average annual rate of the two preceding months by substantial bank sales of short-maturity CD's; expansion in other time and savings deposits moderated further. The pace of growth in private demand deposits and the money supply increased somewhat--the latter to an annual rate of about 7.5 per cent--as Government deposits declined.

With continued expansion in over-all economic activity in prospect, demands for business loans were expected to strengthen in December and January. However, growth in total bank credit was expected to slow further in December; it was anticipated that the funds available to banks would be limited by run-offs of CD's, a large volume of which matured around the midmonth tax date. The bank credit proxy was projected to rise at an annual rate in the range of 2 to 5 per cent in December if prevailing money market conditions were maintained. Faster growth appeared likely in January, when it was anticipated that banks would be the initial purchasers of a large proportion of the tax-anticipation bills the Treasury was expected to issue then. It was thought likely that a slight firming of money market conditions would have relatively little effect on

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bank credit growth in December, but that it would reduce the growth rate in January from what would otherwise be expected, in part by causing some further attrition in outstanding CD's.

The Committee decided that open market operations in the period until its next meeting should be directed at moving slightly beyond the firmer conditions that had developed in the money market partly as a result of the increase in Federal Reserve discount rates. The Committee also agreed that operations should be modified if necessary to moderate any significant deviation of bank credit from current expectations, particularly in an upward direction, or any unusual liquidity pressures that might develop in financial markets.

It was noted in the discussion that events of recent weeks had shifted the balance of conflicting considerations in favor of a firming of monetary policy. Efforts to achieve a measure of fiscal restraint through enactment of a surcharge on income taxes had proved unavailing in the 1967 session of Congress. Prospects for accelerated growth in economic activity and for the continuation of inflationary pressures had heightened following the settlement of major strikes. The balance of payments situation had deteriorated further and pressures on the U.S. gold stock had increased. At the same time, the constraint on monetary policy resulting from the pressures on sterling in foreign exchange markets had been relaxed, although not completely removed, by the devaluation of the pound; and the constraint imposed from time to time by Treasury financing activity was absent for the time being.

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It was for these reasons that the Committee decided to seek firmer money market conditions at present. The decisions to move toward only slightly firmer conditions--and to provide for modification of operations in the event that unusual liquidity pressures developed--reflected in part continuing concerns about possible adverse effects of higher interest rates on financial intermediaries, especially around the year-end dividend and interest crediting periods when such institutions were particularly exposed to withdrawals of funds. Various other considerations were cited as grounds for caution in increasing monetary restraint at this time. These included the fact that the growth rate of bank credit had moderated in November and was expected to decline further in December; the judgment that the current high levels of interest rates were already imposing a considerable degree of restraint on borrowing and spending; and the fact that pressures on sterling had not completely dissipated following the devaluation.

In the course of the Committee's discussion a number of members expressed the view that serious consideration should be given to an increase at an early date in member bank reserve requirements against demand deposits, as a further step in a gradual and orderly firming of monetary policy. At the conclusion of the discussion the following current economic policy directive was issued to the Federal Reserve Bank of New York:

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The information reviewed at this meeting indicates that industrial output and employment have rebounded following strike settlements in the automobile and other industries, and that prospects have heightened for more rapid expansion of over-all economic activity in the months ahead. Both industrial and consumer prices have continued to rise at a substantial rate. The imbalance in U.S. international transactions has worsened, partly because of weakening in the export surplus since midyear. Foreign purchases of gold have been large following the devaluation of the pound sterling. Bank credit expansion has lessened, with diminished bank buying of Government securities and continued moderate loan growth. Most interest rates have risen further in reaction to the British devaluation and Bank rate increase, the rise in Federal Reserve discount rates, and waning expectations of enactment of the President's fiscal program. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures 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 moving slightly beyond the firmer conditions that have developed in money markets partly as a result of the increase in Federal Reserve discount rates; provided, however, that operations shall be modified as needed to moderate any apparently significant deviations of bank credit from current expectations or any unusual liquidity pressures.

Votes for this action: Messrs.
Martin, Hayes, Brimmer, Francis,
Mitchell, Robertson, Scanlon, Sherrill,
Swan, and Wayne. Vote against this
action: Mr. Maisel.

Mr. Maisel dissented from this action in part because he thought the directive was susceptible to an interpretation under which growth in member bank reserves and bank deposits would be slowed too abruptly, and perhaps succeeded by contraction. He favored seeking growth rates in reserves, deposits, and bank credit

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considerably below the average rates thus far in 1967, but still high enough to facilitate expansion in GNP at a somewhat faster rate than had prevailed on average in the first three quarters of the year. He noted that whether or not interest rates would rise further under the course he advocated would depend upon the strength of market demands for funds in relation to the supplies that would be available under such a Committee policy.

Mr. Maisel also thought that the statement of the Committee's general policy stance contained in today's directive had far too narrow a focus; in particular, he objected to the omission of reference to the basic policy goal of facilitating sustainable economic expansion. This omission resulted from the substitution of language stating that it was the Committee's policy "to foster financial conditions conducive to resistance of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments" for the language of other recent directives stating that it was the Committee's policy "to foster financial conditions, including bank credit growth, conducive to sustainable economic expansion, recognizing the need for reasonable price stability for both domestic and balance of payments purposes."

2. Amendments to authorization for System foreign currency operations.

At this meeting the Committee ratified the action taken by members on November 30, amending paragraph 2 of the authorization for System foreign currency operations to change the size of the swap arrangement with the Bank of Canada from \$500 million to \$750 million equivalent.

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Votes for ratification of this action: Messrs. Martin, Hayes, Brimmer, Francis, Maisel, Mitchell, Robertson, Scanlon, Swan, and Wayne. Votes against ratification of this action: None.

Subsequent to this meeting, on December 14, 1967, the Special Manager recommended that paragraph 2 of the authorization be further amended to change (1) the size of the swap arrangement with the Bank for International Settlements providing for System drawings in Swiss francs, and (2) the size of the arrangement with the Swiss National Bank, each from \$250 million to \$400 million equivalent, effective immediately, to supplement the enlargements of the System's swap network that had been approved on November 27 and November 30. The recommendation was unanimously approved by available members of the Committee, namely, Messrs. Martin, Hayes, Brimmer, Daane, Francis, Maisel, Mitchell, Robertson, Scanlon, Swan, and Wayne. (This action was ratified by the Committee at its following meeting, on January 9, 1968.)