FEDERAL RESERVE

press release

For immediate release May 6, 1968

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on February 6, 1968. Such records are made available approximately 90 days after the date of each meeting of the Committee and will be found in the Federal Reserve Bulletin and the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on February 6, 1968

Authority to effect transactions in System Account.

According to reports at this meeting, prospects were for continued rapid growth in over-all economic activity and for persistent inflationary pressures in the period ahead. Preliminary estimates of the Department of Commerce indicated that real GNP had increased at an annual rate of 4.4 per cent in the fourth quarter of 1967, the same as in the preceding quarter, and that average prices, as measured by the GNP "deflator," had advanced considerably. In his January budget message the President had again proposed a 10 per cent surcharge on corporate and personal income taxes, now to be effective on January 1 and April 1, 1968, respectively. The budget estimates indicated that even if the tax surcharge were enacted as proposed the Government would incur a sizable deficit in the calendar year 1968.

Average prices of industrial commodities continued to increase at a substantial rate in January, according to preliminary estimates. Prices of farm products, which had turned up sharply in December, rose somewhat further. The consumer price index again advanced considerably in December, partly because retail prices of food rose after having declined moderately for 3 months.

Growth in real GNP was expected to accelerate in the first quarter of 1968. Prospects favored substantial increases in consumer incomes and spending, a sharp rise in business outlays on plant and

equipment, a small increase in residential construction outlays, and--contrary to earlier expectations--some further growth in defense expenditures. The rate of business inventory accumulation, which now appeared to have increased considerably in the fourth quarter of 1967, was expected to rise only moderately further in the first quarter of 1968.

The worsening of the U.S. payments balance in the fourth quarter, according to newly available information, was due in large part to a marked decline in the surplus on merchandise trade. With imports rising sharply and exports edging down, the trade surplus in the fourth quarter was at a rate only about one-third that in the two preceding quarters and the lowest since the fourth quarter of 1959.

The gold stock of the U.S. Treasury was reduced by $100 million in early February, mainly to cover the U.S. share of sales made by the London gold pool in January. Although the over-all atmosphere in foreign exchange markets had tended to improve in recent weeks, the Canadian dollar had come under heavy pressure. On January 22 the Bank of Canada raised its discount rate for the third time in 5 months, bringing the rate to 7 per cent. Interest rates in the Euro-dollar market had declined further from the unusually high levels they had reached in late November and December, following the devaluation of sterling.

System open market operations since the preceding meeting of the Committee had been directed at maintaining the somewhat firmer

conditions in the money market that had developed earlier, although operations were complicated by large changes in the excess reserves of country banks as reserves first flowed out of money centers and then back again. In adapting operations to these changes in reserve distribution, the net reserve position of member banks was permitted to fluctuate over an unusually wide range--from free reserves of $405 million in the statement week ending January 10 to net borrowed reserves of $70 million in the following week.

The Federal funds rate continued to fluctuate around 4-5/8 per cent, and late in the period interest rates on loans by money center banks to Government securities dealers edged up to a range of 5 to 5-1/4 per cent. On the other hand, interest rates on short-term market securities--including Treasury bills, large-denomination CD's, bankers' acceptances, and commercial and finance company paper--declined on balance during the period, in part perhaps because pressures in credit markets proved to be less intense than many participants had expected. Offering rates on large-denomination CD's maturing in less than 6 months moved down from the 5-1/2 per cent ceiling established under Regulation Q; around the turn of the year banks had been offering the ceiling rate on CD's of all maturities. Although the market rate on 3-month Treasury bills had been rising recently, its level on the day before this meeting--4.91 per cent--was about 10 basis points below that of 4 weeks earlier.

Conditions in markets for longer-term securities had been generally buoyant in recent weeks, despite deferral of congressional action on the President's proposed income tax surcharge and new tensions in the Far East. Yields on long-term Treasury and corporate bonds fluctuated irregularly below the peaks they had reached in late 1967, and yields on State and local government issues declined. On January 31 the Treasury announced that it would offer a new 7-year, 5-3/4 per cent note in exchange for Treasury notes and bonds maturing in February, August, and November 1968, with settlement on February 15. Initial market reactions to the offering were favorable. The Treasury also announced that $4 billion of a 15-month note would be offered for cash subscription later in the month.

In mortgage markets yields rose further in December--reattaining the highs they had reached in November 1966--and growth in mortgage commitments outstanding continued to moderate. Preliminary data suggested that net inflows of funds to nonbank depositary institutions slackened further in December and January, but that withdrawals of savings around the year-end interest- and dividend-crediting period were not as large as many in the industry had feared.

Commercial bank credit expanded at a relatively fast pace in January after slowing markedly in late 1967. Contributing to the expansion were rapid growth in business loans early in the month and bank acquisitions of tax-anticipation bills sold by the Treasury at

midmonth. The bank credit proxy--daily-average member bank deposits--rose from December to January at an annual rate of about 9 per cent, near the upper end of the range that had been projected earlier. Private demand deposits and the money supply increased sharply before turning down after mid-January; on the average the money supply rose at an annual rate of 8 per cent, in contrast to the expectation of little or no change. However, Government deposits rose less than had been anticipated, and total time and savings deposits--instead of growing relatively slowly on the average--declined slightly. Despite the reductions in offering rates on large-denomination CD's of shorter maturity, the volume of CD's outstanding increased over the course of January by nearly as much as it had declined in December.

Business loans at banks were expected to grow moderately in February--at a rate that was below the rapid pace of December and early January but that, as a result of enlarged business needs for inventory financing, was above the slow rate of the preceding autumn. Mainly because of Treasury financing operations, however, it appeared likely that total bank credit would continue to expand at roughly the January pace; growth in the bank credit proxy was projected at an annual rate in the 7 to 10 per cent range if prevailing money market conditions were maintained. It was expected that the money supply would change little, and might possibly decline somewhat, but that growth in time and savings

deposits would resume. A rather sharp expansion was anticipated in Government deposits as a result of the Treasury's forthcoming cash financing.

Considerable concern was expressed in the course of the Committee's discussion about recent and prospective inflationary pressures in the domestic economy and about the sharp decline in the nation's foreign trade surplus. Against this background, a number of members indicated that they had been disturbed by various financial developments in January--including the unexpectedly sharp growth in the money supply and the general decline in short-term interest rates other than day-to-day money market rates--which suggested that monetary conditions had become less restrictive. There also was widespread sentiment to the effect that the growth in bank credit projected for February on the assumption of unchanged money market conditions was larger than desirable in the current environment. At the same time, it was recognized that the forthcoming Treasury financing operations imposed an important constraint on monetary policy at present.

The Committee concluded that it would be desirable to maintain firm money market conditions at this time and to seek firmer conditions, to the extent permitted by Treasury financing, if bank credit appeared to be expanding as rapidly as projected. The following current economic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting indicates that over-all economic activity has been expanding rapidly, with both industrial and consumer prices rising at a substantial rate, and that prospects are for continuing rapid growth and persisting inflationary pressures in the period ahead. The imbalance in U.S. international transactions worsened further in late 1967, primarily because of a sharp reduction in the surplus on merchandise trade. Although day-to-day money market rates have remained firm, rates on other short-term instruments have declined recently; meanwhile, long-term bond yields have fluctuated irregularly below the peaks reached late last year. Growth in bank credit resumed in January, reflecting both loan expansion around the year-end and Treasury financing. The money supply expanded sharply following earlier slackening, but flows into time and savings accounts at bank and nonbank financial intermediaries have continued to moderate. 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, while taking account of Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining firm conditions in the money market, and operations shall be modified to the extent permitted by Treasury financing if bank credit appears to be expanding as rapidly as is currently projected.

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