FEDERAL RESERVE

press release

For immediate release September 16, 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 June 18, 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 June 18, 1968

Authority to effect transactions in System Account.

Reports at this meeting indicated that the continued rapid advance in over-all economic activity was being accompanied by persisting inflationary pressures. It appeared likely that Congress would act favorably within a few days on legislation providing for a 10 per cent income tax surcharge and a $6 billion reduction in expenditures from Budget estimates for the coming fiscal year. Such legislation was expected to contribute to a considerable moderation of the rate of advance in aggregate demands.

Staff estimates suggested that both real GNP and average prices--as measured by the "GNP deflator"--were continuing to increase at rapid rates in the second quarter. According to the estimates, however, business inventory accumulation would be considerably larger than in the first quarter and growth in final sales would be smaller. In particular, consumer expenditures were expected to rise substantially but at a pace well below the extraordinary advance of the first quarter; and according to a recent Commerce-SEC survey of business spending plans, outlays on new plant and equipment would change little in the second quarter after increasing sharply in the first. It also appeared that outlays for residential construction would rise moderately further and that defense spending would advance at about the rapid first-quarter rate.

Staff estimates for the third quarter suggested that growth in real GNP would slow sharply if the pending fiscal legislation were enacted. The rate of increase in disposable income was expected to slacken considerably--as a result of both the income tax surcharge and slower growth in employment--and a further slowing of growth in consumer expenditures appeared likely, despite an anticipated decline in the rate of personal saving. Prospects for the third quarter also included a moderate decline in residential construction outlays, a leveling off of the advance in defense expenditures, and little further change in the rate of inventory accumulation after a large second-quarter rise. However, the Commerce-SEC survey suggested that outlays on plant and equipment would increase somewhat in the third quarter. The lower over-all rate of economic growth in prospect seemed unlikely to have an appreciable effect immediately on advances in wage and other costs, and average prices in the private economy were expected to rise almost as rapidly in the third quarter as in the first half of the year.

In May the unemployment rate remained at 3.5 per cent. Nonfarm employment was unchanged from April, as an increase in the number of workers on strike offset employment gains elsewhere. Average hourly earnings continued to rise rapidly. Industrial production was estimated to have increased to a new high, and according to the advance report, retail sales rose moderately from an April level that had been held down by civil disorders in many cities.

Preliminary estimates indicated that average wholesale prices of industrial goods declined somewhat in May, primarily because of further sharp reductions for copper and related products following settlement of the copper strike; average prices of other industrial commodities continued to rise. Prices of foods and foodstuffs increased considerably, and the total wholesale price index edged up further. In April the consumer price index continued upward at about the average rate of other recent months and was 4 per cent above a year earlier.

With respect to the U.S. balance of payments, preliminary data for May suggested that the deficit on the liquidity basis diminished sharply from its high April level, in part because of the favorable effects of various special official transactions. The merchandise trade surplus was expected to increase in coming months from its recent low level, but net outflows of U.S. capital also were expected to rise. Such outflows had been unusually small in the early months of the year, following the introduction of the new restraint program on January 1.

On the official settlements basis, a payments surplus was now indicated for May and possibly for the second quarter as a whole, primarily as a result of an exceptionally large rise in the liabilities of U.S. banks to their branches abroad. The recent massive inflow of foreign liquid funds apparently reflected both increased demands for funds by domestic banks and large additions to the supply of Euro-dollars as a result of movements out of sterling and French francs. It was thought likely that the inflow would subside soon.

In foreign exchange markets, the position of sterling had improved somewhat in recent weeks, but the French franc had remained under severe pressure. The price of gold in the private London market had continued to fluctuate in a range of about $41 to $42 per ounce.

System open market operations since the preceding meeting of the Committee had been directed at maintaining firm conditions in the money market. Early in the period reserves were absorbed temporarily, by means of matched sale-purchase agreements, in order to counter easing tendencies. Late in the period, however, when tendencies toward undue tightness emerged, reserves were supplied by purchases of Treasury bills from foreign accounts and through repurchase agreements with nonbank dealers at a 5-3/4 per cent interest rate. For the period as a whole, effective rates on Federal funds were usually in a range of 6 to 6-1/4 per cent but occasionally were below 6 per cent. Member bank borrowings averaged about $730 million in the 3 weeks ending June 12, little changed from the preceding 4 weeks, but average net borrowed reserves increased to about $445 million from $375 million in the earlier period.

Interest rates on most types of market securities had declined substantially on balance since the preceding meeting of the Committee, primarily because of growing expectations that fiscal restraint legislation would be enacted soon. Yield reductions were more marked on Treasury bonds than on corporate and municipal bonds, for which the calendar of new offerings continued heavy. The market rate on 3-month Treasury bills, at 5.58 per cent on the day before this meeting, was 9 basis points below its level 3 weeks earlier, and rates on longer-term bills were down by 20 to 30 basis points.

Preliminary data for May suggested an increase in net inflows of savings funds to mutual savings banks and savings and loan associations. But with demands for mortgage funds continuing strong, and with uncertainties increasing about prospects for savings flows at thrift institutions around the midyear interest-and-dividend-crediting period, conditions in mortgage markets remained fairly tight. Contract interest rates on conventional new-home mortgages, which had been at a postwar high in April, rose sharply further in May.

At commercial banks, demands for business loans strengthened after a mid-April to mid-May lull. There was some improvement in net inflows of time and savings deposits in the latter part of May, but for the month as a whole such deposits grew at an annual rate of only about 3 per cent, roughly the same as in April and less than half the first-quarter pace. With U.S. Government deposits declining further, private demand deposits and the money supply expanded considerably; growth in the money supply was now estimated at an annual rate of 11 per cent in May, compared with 6.5 per cent in April. Bank credit, as measured by the bank credit proxy--daily-average member bank deposits--expanded at an annual rate of 1.5 per cent in May, after declining at a 4.5 per cent rate in April. Allowance for changes in the daily average of U.S. bank liabilities to foreign branches, which are among the nondeposit liabilities of banks omitted in calculating the credit proxy, would have served to reduce the decline in April by about 1 percentage point and to have increased the rise in May by about 3.5 percentage points.

New projections suggested that if prevailing money market conditions were maintained the bank credit proxy would rise at an annual rate of 3 to 6 per cent in June and somewhat more slowly in July; and that if money market conditions were less firm, growth in July would continue at about the rate projected for June.

Allowance for a further increase in average liabilities to foreign branches, expected to occur in June, would have added about 3 percentage points to the limits of the range of growth projected for that month. The projections for July assumed that the Treasury would raise a substantial amount of new cash--about $4 billion--early in the month through a sale of tax-anticipation bills. Further declines in the average level of Government deposits were anticipated in both June and July, and were expected to contribute to continued vigorous expansion of the money supply.

The Committee's policy discussion at this meeting was conducted against the background of the widespread expectation that Congress probably would act affirmatively within a few days on the pending fiscal legislation. It was thought likely that such action would be followed by further declines in Treasury bill rates and other short-term market interest rates. The possibility was recognized, however, that short-term rates might subsequently come under renewed upward pressure, partly as a consequence of the sizable cash financing the Treasury was expected to undertake in early July.

The Committee agreed that open market operations should be directed at maintaining firm conditions in the money market in the period before Congress acted on the pending legislation, and at countering any tendencies toward disorder that might result if such action were negative or delayed. As to the appropriate course if fiscal legislation were enacted soon, there was some sentiment for seeking less firm money market conditions on the grounds that over-all economic restraint otherwise was likely to prove excessive. At the same time, however, concern was expressed in the course of the discussion about the risk that premature monetary easing would offset the effects of fiscal restraint.

The Committee concluded that if Congress acted affirmatively on the pending fiscal legislation open market operations should seek to accommodate any resulting declines in short-term interest rates and to cushion any upward pressures on such rates that might emerge subsequently. The proviso was added that this course should be followed only so long as bank credit growth in June, and also in July, did not appear to be developing at a rate above the range projected for June.

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

> The information reviewed at this meeting indicates that the very rapid increase in over-all economic activity is being accompanied by persisting inflationary pressures. Enactment of fiscal restraint measures now under consideration in Congress, however, would be expected to contribute to a considerable moderation of the rate of advance in aggregate demands. Growth in bank credit and time and savings deposits has been relatively small on average in recent months, although the money supply has expanded considerably as U.S. Government deposits have declined. Both short- and long-term interest rates have receded from the advanced levels reached in May, mainly in reaction to enhanced expectations of fiscal restraint. The U.S. foreign trade balance and over-all payments position continue to be a matter of serious concern. In this situation, it is the

policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures and attainment of reasonable equilibrium in the country's balance of payments, while taking account of the potential impact of developments with respect to fiscal legislation.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining generally firm but orderly conditions in the money market; provided, however, that if the proposed fiscal legislation is enacted operations shall accommodate tendencies for short-term interest rates to decline in connection with such affirmative congressional action on the pending fiscal legislation so long as bank credit expansion does not exceed current projections.

Votes for this action: Messrs. Martin, Brimmer, Daane, Galusha, Hickman, Kimbrel, Maisel, Mitchell, Robertson, Sherrill, Bopp, and Treiber. Votes against this action: None.

Absent and not voting: Messrs. Hayes and Ellis. (Messrs. Treiber and Bopp voted as their alternates.)