FIFTY-THIRD

Annual Report

BOARD OF GOVERNORS

OF THE FEDERAL RESERVE SYSTEM

COVERING OPERATIONS FOR THE YEAR

1966

Letter of Transmittal

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, April 19, 1967

THE SPEAKER OF THE HOUSE OF REPRESENTATIVES.

Pursuant to the requirements of Section 10 of the Federal Reserve Act, as amended, I have the honor to submit the Fifty-Third Annual Report of the Board of Governors of the Federal Reserve System. This report covers operations for the year 1966.

Yours respectfully,

WM. McC. MARTIN, JR., *Chairman.*

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PART I

Review of 1966

1966 presented to monetary policy the challenge of coping first with a too-exuberant upsurge in economic activity, and later with a less ebullient economic outlook. The expansionary forces in the economy, which had gathered momentum after mid-1965, accelerated even more rapidly later that year and into 1966—with demands for goods, services, and credit expanding faster than resource availability and financial savings. The convergent pressures on resources resulted in a strong and pervasive rise in costs and prices—a rise that threatened the life of the economic expansion—and in a further larger rise in U.S. imports, which greatly reduced our surplus on international trade transactions.

Before the year ended, however, final demands for goods and services were expanding at a more moderate pace. Monetary policy therefore shifted toward less restraint on bank credit expansion, and interest rates began to decline from the high levels attained during the year.

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In late 1965 and early 1966 total spending had increased at a very rapid pace. An acceleration in defense spending after mid-1965, superimposed on a fast rise in civilian spending—notably by businesses for new investment in plant and equipment—resulted in sharp upward pressures in many markets for goods and labor. Demands for most types of credit soared.

To blunt the inflationary impact of credit-financed spending, the Federal Reserve endeavored to slow the rate of monetary expansion, first, by raising the discount rate in December 1965, and then beginning in February, by reducing the rate at which it supplied reserves to commercial banks through operations of the System Open Market Account. With demands for credit and capital remaining strong, with smaller amounts of nonborrowed reserves being made available to banks, and with bank credit constituting a smaller component of the total credit supply, interest rates rose sharply.

The rise in interest rates and the related structural shifts in credit and capital markets tended to divert flows of the public's savings from financial intermediaries into direct acquisitions of market securities. In this period mutual savings banks and savings and loan associations were not subject to any fixed Federal ceiling rates on deposits and shareholdings. But because most of their holdings were concentrated in long-term assets acquired when interest rates were at lower levels, they could not increase their returns on investments enough to make it possible for them to pay rates on savings that would meet the competition. Insurance companies also experienced financial pressure; a sharp increase in the demand for policy loans absorbed a larger than normal proportion of their already heavily committed cash flows, and there was a slowing down of prepayments on mortgage loans and other credits.

While all depositary institutions were under strong competitive pressure from more direct types of investment in the first half of 1966, commercial banks were able to maintain inflows of savings better than could other types of financial institutions because the maximum permissible rates payable by banks on time deposits and the more rapid turnover of their assets allowed more prompt compensatory upward adjustment in portfolio yields. Banks also benefited from their ability to offer a variety of deposit instruments geared to the needs of a variety of savers. The continued sizable net inflow of new funds enabled commercial banks to continue to expand their loans to businesses rapidly through midsummer.

On the other hand, the reduced flow of savings to financial institutions other than commercial banks—which invest a major share of their resources in real estate mortgages—resulted not only in an increase in the cost of mortgage funds but also in a sharp dropoff in their availability. Thus, the impact of restraint on credit-financed spending during much of 1966 was most evident in residential construction activity and in transfers of existing dwellings.

Other areas of the economy were also affected by restraint on credit and monetary expansion in 1966. Some of the moderation in consumer spending for durable goods—for automobiles in particular—was probably attributable to the higher charges and more stringent lending policies that developed for consumer instalment credit.

State and local government expenditures, too, were affected by monetary restraint. Some units of government postponed bond issues because of higher interest rates and the difficulties they encountered in borrowing, as commercial banks—which as a general rule buy large amounts of municipal issues—became less inclined to buy such securities because of the very heavy demand for loans by nonfinancial businesses and by finance companies.

Through midsummer, the business sector of the economy—considered as a whole—felt the effect of monetary restraint less than other sectors. Although their cost was high and was rising, borrowed funds remained in relatively ample supply to businesses, which in turn furnished some financing to their suppliers and customers. Despite their higher costs, both new corporate security issues and business borrowing from banks rose sharply. As a result, aggregate spending by businesses on plant, equipment, and working capital appeared to be little dampened by financial restraint through the spring and early summer. But by late summer monetary restraint also affected business financing, and total funds raised by corporate borrowers began to decline sharply.

The rapid rise in business spending adversely affected the U.S. balance on international trade. Demands for imported materials rose, and as backlogs of orders of domestic producers of machinery and fabricated products increased, purchases of foreign goods mounted. Although our exports continued to rise, imports showed a much sharper increase, and the result was a significant drop in the trade balance.

However, monetary restraint in 1966 served to retard capital outflows and to stimulate inflows. The changes in capital flows were substantial and they served to offset the decline in the U.S. balance on current account. Overseas branches of U.S. banks attracted funds from foreign money markets and provided a substantial volume of funds to their head offices for lending in this country, especially after midyear. There was also a large inflow of foreign long-term capital to the United States—in part through shifts from shorter- to longer-term assets on the part of international institutions and foreign central banks.

In response to the voluntary foreign credit restraint program (VFCR), U.S. commercial banks in 1965 had brought almost to a halt the rise in their outstanding credits to foreign borrowers. The added pressure of financial market conditions in this country resulted in some reduction in these credits in 1966.

During the summer the Federal Reserve took steps to alleviate the uneven effects of financial restraint among the various sectors of the economy by restraining the rapid growth of business loans at banks and also to dampen the escalation of interest rates. The Board of Governors maintained the ceiling rate on time deposits of commercial banks, fixed in December 1965 at 5½ per cent. However, by early summer the intensification of monetary restraint had caused market rates for financial instruments that are competitive with negotiable time certificates of deposit (CD's) to rise to levels above the CD ceiling rate. During the summer the Federal Reserve took several actions to make it more expensive for banks to compete for large time deposits —twice raising reserve requirements on time deposit holdings in amounts of more than $5 million at each member bank. Further, on September 1 a letter was sent to each Federal Reserve member bank urging moderation in business loan expansion in the interest of achieving a more balanced economic and credit expansion. The letter assured banks losing deposits that they would be able to borrow from the Federal Reserve Banks for longer periods than normal if their adjustments to the deposit losses were achieved through curtailment of lending activity rather than through the sale of securities.

As a continued high volume of credit demands and increased monetary restraint resulted in rising market rates of interest, commercial banks found themselves less able to accommodate business and other credit demands by competing for the liquid funds of corporations. Because of the great pressure for loanable funds, however, there was still the possibility that these banks would intensify their competition for consumer savings being held in nonbank financial institutions and thereby put further pressure on such institutions and indirectly on the homebuilding industry.

Under existing legislation the Federal Reserve could not base any limitation of rate competition by banks on criteria of type of saver or size of saving. But in late September the Congress enacted broader enabling legislation, and promptly thereafter the Federal Reserve and other regulatory authorities acted to limit further, or to reduce, interest rates payable on certain types of deposits and shareholdings in commercial banks, mutual savings banks, and federally insured savings and loan associations. The purpose of this legislation, to be in effect for a year, was to dampen the rate competition for savings among the various types of financial institutions and to reduce the upward ratcheting of interest rates to which such competition contributed. Over-all pressures on financial markets reached their peaks in August and early September.

By the early fall it became evident that monetary policy, aided by certain fiscal restraints, including the suspension of the investment tax credit and accelerated depreciation privileges, was achieving the objectives of curbing excessive aggregate demand and of damping inflationary pressures. Defense spending did continue to rise sharply in the fall. But the rate of expansion in final takings by the private sectors of the economy declined; industrial production, retail sales, and new orders for durable goods leveled off; and the rise in industrial prices moderated over this time period.

In this situation Federal Reserve open market operations, while still directed at maintaining firm money market conditions, were modified in light of the lack of growth in bank credit. Then in November the Federal Open Market Committee shifted its policy so as to stimulate a moderate renewed expansion of bank credit and easier conditions in financial markets. And in late December the Federal Reserve terminated the special discount arrangements of the September 1 letter.

By the end of 1966, pressures in financial markets had eased significantly. Most market rates of interest had declined sharply from their late summer peaks; banks were again able to compete successfully for funds with large negotiable CD's and also to obtain consumer-type time deposits; and mutual savings banks and savings and loan associations were beginning to have larger inflows of funds. Bank credit was again expanding at a substantial rate, and the mortgage market began to reflect an easier availability of funds.

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.

DEMANDS, RESOURCE USE, AND PRICES

During 1966 the economy extended the expansion in output, employment, and incomes that had been under way since the cyclical low in February 1961. Under the impetus of sharp increases in defense spending and in business expenditures for plant and equipment, the economy approached full use of resources. Unemployment declined to the lowest rate in more than a decade, and industrial capacity was more fully utilized than at any time since 1953.

But the achievement of substantially full employment had its costs. As activity pressed harder on resource availability, a pervasive rise in prices and costs threatened a return to inflationary conditions that had been characteristic of earlier postwar upswings, but that had been avoided in the prolonged and balanced expansion from 1961 to 1965. The expansion in domestic demand stimulated a surge of merchandise imports, which rose half again as much as exports; the U.S. foreign trade surplus, which had declined substantially in 1965, fell even further in 1966. And the pressure of defense and business investment demands preempted financial as well as physical resources—forcing a sharp curtailment in homebuilding.

As the monetary and fiscal restraints took hold, the excessively rapid rate of expansion moderated. Industrial production leveled off after August, and the rate of capacity utilization in manufacturing eased slightly. The pace of price increases diminished—led by lower prices for farm products and for industrial materials. Expansion in over-all economic activity was maintained at a fast pace late in the year by the unusually large proportion of output that went into business inventories; in some industries, such as steel and autos, production schedules were being reduced. The prompt easing of monetary policy, however, was giving evidence before the year-end of laying the groundwork for a revival in the homebuilding industry.

DEMANDS

Our gross national product totaled $740 billion (in current dollars) in 1966, an increase of $58 billion, or 8.6 per cent, from 1965. This was a larger increase than had been anticipated by most official and private projections early in the year, in part because prices advanced more than expected. The GNP price deflator rose on average by 3.0 per cent, the largest advance since 1957. The rise in GNP in constant dollars amounted to 5.4 per cent, compared with 5.9 per cent in 1965 and 5.3 per cent in 1964.

Expansion was most rapid in the first quarter. After that, the rate of gain was slower, as declines in some important sectors—particularly residential construction and autos—partially offset continued expansion in other key areas of demand. A stepped-up rate of increase in the fourth quarter represented a bulge in inventory accumulation; Government purchases rose less rapidly than in the third quarter, while expansion in final purchases of goods by the private sector virtually halted.

Industrial production also showed a very large increase in 1966, with the Board's index rising by 9 per cent, to 156 per cent of the 1957–59 average, from 143 per cent in 1965. In 1965 the increase had amounted to about 8.5 per cent. By this measure, too, growth was most rapid early in 1966; after August the index showed little net change.

Defense needs associated with the escalation of military activity in Vietnam exerted a substantial expansive influence on over-all economic activity throughout 1966. Federal spending for defense had begun to rise in the spring of 1965, and it accelerated during most of 1966, with an exceptionally sharp rise in the third quarter. New and unfilled orders for defense rose rapidly until late in the year, and the Armed Forces were expanded in substantial numbers. Defense outlays for the calendar year totaled $60 billion, up $10 billion from 1965 and considerably in excess of the rise contemplated early in the year.

Federal expenditures other than for goods and services also rose sharply in 1966, reflecting mainly increased social security benefits and grants-in-aid to State and local governments. Payments under the new medicare program increased sharply after the program went into effect at midyear. Altogether, total Federal expenditures on the national-income-accounts basis totaled $142 billion in 1966, up almost $19 billion from 1965.

The Federal Government budget as measured in the national income accounts shifted from a moderate surplus in the first half of the year to a sizable deficit in the fourth quarter. For the calendar year as a whole, despite the very large increase in outlays, there was a slight surplus—$0.3 billion. In the calendar year 1965, the surplus had amounted to $1.6 billion. The virtual balance of receipts and expenditures in 1966 was achieved in part by higher tax receipts from sharply increased incomes. But it also resulted from several policy actions in the fiscal area; these included (1) an increase effective at the beginning of the year in social security tax rates and a rise in the taxable wage base; (2) the withdrawal beginning April 1 of excise tax reductions on automobiles and telephone service, which had gone into effect on January 1; (3) the establishment of a graduated schedule for withholding taxes on individual incomes, effective in May; and (4) the institution of taxes at midyear to cover payments under the medicare program.

State and local government purchases rose by almost $7 billion in 1966, the largest dollar increase on record. The sharp increases in grants from the Federal Government were a significant influence. The large expansion in purchases by these governments placed further pressure on available resources, particularly of manpower.

In the private sector, business spending on fixed capital was a major expansive force in 1966. Such outlays increased by $9.6 billion, or almost 14 per cent, to $79.3 billion. For the year such expenditures accounted for 10.7 per cent of GNP, the highest annual ratio of the postwar period, slightly exceeding the previous peak of 10.4 per cent reached in 1948 and again in 1956.

Expenditures on equipment increased sharply throughout the year, but investment in structures declined after the first quarter, as builders of commercial structures—which are more dependent on mortgages than are industrial plants—found increasing difficulty in obtaining credit. Expenditures on fixed capital increased less rapidly in the second half of the year than in the first, and as reported in the Commerce–SEC survey taken in November, nonfarm business concerns significantly scaled down earlier intentions to spend for the first time since 1963. The survey also indicated a marked reduction in the prospective pace of expansion in business spending for fixed capital in the first half of 1967.

Influences contributing to the sharp increase in spending for fixed capital in 1966 included the continued rapid rise in output—particularly in late 1965 and early 1966, when spending plans for the year were largely formulated; the sharp stepup in defense requirements; the high rates of capacity utilization in manufacturing throughout the year; the high levels of profits and flows of internal funds; and the stimulus exerted by the investment tax credit and provisions for accelerated depreciation. Profits both before and after taxes were at record highs in the first half of the year.

But after midyear profits declined, in part because of rising unit labor costs. For the year as a whole, corporate profits after taxes totaled about $48.5 billion, a rise of nearly $4 billion, or 9 per cent, from 1965. This was a distinct slowdown from the 15 per cent rise in 1965. There was some increase for the year in internal funds—that is, chiefly undistributed profits and depreciation allowances—but it was less than the rise in outlays for fixed capital. At the same time, further steps in the transition to a full pay-as-you-go system for corporate income taxes were taken. This speedup in tax payments did not show in the national income accounts (which are on an accrual basis), but it intensified corporate needs for external financing. Altogether, business concerns early in the year apparently underestimated the extent to which they would have to resort to external financing and did not foresee the difficulty they would encounter in obtaining that financing.

In the manufacturing sector, growth in output early in the year exceeded, and then until late in the year about matched, the exceptionally large rise in capacity, which amounted to around 7 per cent compared with about 6.5 per cent in 1965 and 4 per cent in 1964. The capacity utilization rate for 1966 averaged 91 per cent, with only the fourth quarter—at 90 per cent—slightly below this. The average for the year was 2 percentage points higher than in 1965 and was the highest since 1953. Utilization rates were particularly high in such industries as nonferrous metals, fabricated metals, instruments, nonelectrical machinery, aircraft, and rubber and plastics.

The pressure of rising demands for defense and for business fixed capital, along with expectations that materials would be scarce and that prices would rise, provoked the largest inventory buildup of the expansion period. Almost one-half of the increase in the book value of inventories at the manufacturing level from late 1965 to late 1966 occurred in the business and defense equipment industries.

For manufacturing and trade as a whole, accumulation tended to exceed the growth in sales, which changed little after mid-year, and the stock/sales ratio rose persistently after the first quarter, particularly for durable goods. This development was in contrast to earlier years of this expansion when the over-all ratio of stocks to sales had tended downward. A sharp upward bulge in the rate of accumulation during the fourth quarter appears to some extent to have been involuntary. For consumer durable goods, with sales lagging late in the year, stocks became excessive at both factory and distributive outlets, and production curtailments were instituted by manufacturers of automobiles and some major appliances. Farm stocks decreased slightly for the year as compared with moderate accumulation in 1965.

In contrast to expansion in most other sectors, residential construction activity declined sharply. Nonfarm housing starts, which had shown an irregular downtrend during the previous 2 years, dropped to unusually low levels after midyear and in the fourth quarter were at a seasonally adjusted annual rate of less than 1 million units. The total of 1.2 million starts for the year, the lowest since 1957, compared with 1.5 million in 1965 and a recent peak of 1.6 million in 1963.

The steepness of the drop in housing starts reflected for the most part the restrictive conditions that developed in the mortgage market toward the end of 1965 and the further tightening during most of 1966. But there were other contributing factors, such as overbuilding in the West and in some other regions in earlier years and the dampening effects on demand of continuing increases in costs of land, materials, and wages. While the decline was relatively greater for multifamily buildings, it affected all types of structures and all areas of the country.

Residential construction expenditures, which are far less volatile than starts and which tend to lag them, dropped appreciably after April and were still declining at the year-end. However, the decline over the year was not so pronounced as it was in the case of starts, owing to rising unit prices and a further shift in the mix from multifamily structures to the more expensive single-family units. For 1966 as a whole, the total value of nonfarm residential construction activity approximated $25 billion, only moderately below the record 1964 and 1965 totals.

Consumer spending on goods and services is dependent primarily on after-tax income, but other influences also affect consumer propensity to spend and save. During 1966 some significant fluctuations appeared in the allocation of consumer income between spending and saving, although for the year as a whole the saving rate was close to the 5.4 per cent average of the years 1960–65. A slowdown in consumer spending in the second quarter of 1966 was associated with a relatively slow growth in after-tax income. A renewed upsurge in consumer spending in the summer reflected both a stepped-up rise in after-tax income and a reduction in the saving rate. In the fourth quarter after-tax income showed a sharp increase, but consumer purchases of goods leveled off and the saving rate rose from 4.8 to 5.9 per cent of income.

In total, consumers increased their spending by almost 8 per cent in 1966, compared with 7.5 per cent in 1965. But with consumer prices rising rapidly, the increase of about 5 per cent in the physical volume of purchases, while large, was somewhat less than in 1965. The increase in constant dollars amounted to only 3 per cent when measured from the fourth quarter of 1965 to the fourth quarter of 1966.

Spending for services increased sharply throughout 1966. In current dollars the increase was about 8.5 per cent and in constant dollars 4.7 per cent, a little more than in 1965. Purchases of nondurable goods showed sizable increases for the first three quarters, but virtually leveled off in the fourth quarter. For the year such purchases were up 8 per cent in current dollars; in constant dollars the rise was 4.2 per cent, about the same as in 1965.

In contrast, purchases of durable goods, particularly automobiles, slumped in the spring quarter, in part because of adverse publicity on auto safety and also because of the relatively slow rise in disposable personal income as large final settlements were made on 1965 tax liabilities and the graduated withholding tax went into effect. Subsequently, total purchases of durable goods, but not automobiles, recovered to a level close to that of the first quarter. For the year as a whole, sales of automobiles totaled 9 million units, including imports, compared with the record 9.3 million units sold in 1965.

Substantial increases in output, employment, and wages resulted in an increase of 8.5 per cent in personal income in 1966, more than in 1965. Wages and salaries, as usual, accounted for the bulk of the rise, but all other major types of income were up for the year as a whole. Farm income peaked in the first quarter, as prices received by farmers climbed steeply; and then it declined as prices of farm products came down. Transfer payments showed the largest dollar increase of the postwar period.

Disposable personal income (that is, personal income after taxes) also showed a large increase for the year, but when measured from fourth quarter to fourth quarter the relative rise was considerably smaller than it had been during 1965. Personal tax payments rose sharply throughout 1966, in part because of the introduction of graduated withholding rates. With consumer prices up considerably, the rise in constant-dollar disposable income from the fourth quarter of 1965 to the fourth quarter of 1966 amounted to only 3 per cent, compared with about 7 per cent over the preceding year. In fact, it was the smallest increase for such a period since 1960.

LABOR MARKET

Demands in the labor market were strong in 1966. Employment in nonfarm industries expanded vigorously, and the labor market became very tight. Increased Government expenditures for defense, augmenting already strong demands at the end of 1965 for both capital goods and consumer durable goods, generated the largest annual rise in nonfarm employment since early in the Korean war. Meanwhile, unemployment averaged less than 4 per cent for the first time in more than a decade. In the fourth quarter of 1966 nonfarm payroll employment was 2.9 million persons, or 5 per cent, higher than a year earlier, and the unemployment rate was 3.7 per cent, down 0.4 of a percentage point from a year earlier.

The influence of spending for defense and capital goods was reflected in very large gains in employment in durable goods manufacturing, where employment rose by 8 per cent over the year. The impact of military spending was especially strong in the electrical equipment and aircraft industries. In other durable goods industries, however, employment gains were not nearly so impressive, especially after the spring when employment in the automobile industry leveled off and manufacturers of construction materials began to feel the effect of the reduction in residential building. Employment in the construction industry dipped after the spring, and by the year's end the number of jobs was 140,000 below the March peak.

Employment in the trade and service industries continued to grow at a rapid pace in 1966. Government needs helped to put increased pressure on the labor supply. Government civilian employment expanded by 800,000, or 8 per cent, the most rapid increase since the Korean war; more than two-thirds of the rise was in the State and local government sector. In addition, in the 12 months ending December, the Armed Forces were expanded by about 500,000 men—drawn largely from those 20 to 24 years old who otherwise would have been in the civilian labor force.

The intense demands for labor put pressure on the available supply of skilled and experienced workers during 1966, and the unemployment rate for adult men was reduced to close to 2 per cent—virtually a frictional level. As a result, employers turned more and more to women and to youths to fill their labor needs. Record numbers of teenagers entered the labor force during the summer, and they found jobs readily available. But large numbers were interested only in vacation-time jobs, and they left the labor force when schools reopened in September. Altogether, teenagers provided less than 300,000 of the 1.6 million increase in the labor force between the fourth quarters of 1965 and 1966. Since so few men were available, either among the unemployed or outside the labor force, women contributed most—almost three-fourths—of the increase in the civilian labor force over the year.

Increased manpower requirements were also met through expansion of on-the-job training, upgrading of workers, and additional overtime. For most of 1966, hours of work in manufacturing were higher than during the Korean war.

The decline of about 250,000 in total unemployment from the fourth quarter of 1965 was reflected in lower unemployment rates in a wide range of occupations and industries. But most of the decline occurred early in the year, and after that the unemployment rate remained on a plateau, ranging—with one exception—from 3.7 to 3.9 per cent. Little improvement was evident in the typically high unemployment rates of teenagers. The unemployment rate among nonwhite workers showed virtually no change at an average of 7.3 per cent.

WAGES AND COSTS

Earnings rose substantially during the year in most industries—reflecting upward adjustment of wage rates in a tightened labor market, more overtime work at premium pay, rapid increases in consumer prices, and cost-of-living wage adjustments for some 2 million workers. Many new settlements in the second half of the year provided for annual increases of around 5 per cent. For production workers in manufacturing, average hourly earnings in the fourth quarter of 1966 were 4 per cent higher than a year earlier; the annual increase from 1960 to 1965 had averaged less than 3 per cent. Larger than average increases were reported in construction and trade and in some of the service industries.

In manufacturing, increases in wages exceeded the gains in productivity during 1966, which were smaller than in 1965 and other recent years. As a result unit labor costs, which had been holding steady for several years, rose and toward the end of 1966 averaged 2.6 per cent higher than a year earlier. For the private economy as a whole, gains in productivity were also quite modest; for the year they averaged 2.8 per cent—about equal to the rise in 1965 but substantially below the average of 3.6 per cent for the 5 years from 1960 through 1965.

PRICES

The pressures on resources that had begun to accumulate during the second half of 1965 were followed by an accelerated rise in prices of goods and services in 1966. The consumer price index rose by 3.3 per cent over the 12 months ending December 1966, as compared with 2 per cent the year before; in the period 1961–64 the average annual increase had been about 1.5 per cent.

While the rise in the wholesale price index over the 12 months ending December was only half the increase that had occurred in 1965—1.7 per cent versus 3.4 per cent—the moderation reflected an easing of supply pressures in markets for agricultural products and for some sensitive industrial materials that more than offset in the total index the intensified pressures on industrial products. Wholesale prices of foodstuffs, after rising in 1965 and during much of 1966, turned down in the autumn in response to some improvement in supplies and supply prospects. As a result the net increase over the 12 months ending December was considerably less than that for 1965, when market supplies of some foodstuffs were sharply reduced. In contrast, the increase in wholesale prices of industrial commodities was the largest since 1956.

There were several distinctive features of the behavior of prices in 1966. For one thing, consumer services played an unusually important role in the rise. Secondly, supplies of certain agricultural commodities became short in 1965 for the first time in many years and remained short during much of 1966, with a consequent effect on their prices. Thirdly, the rise in industrial commodity prices, although the largest in a decade, was not especially large for an economy that was expanding as fast as the U.S. economy was in 1966; at wholesale, the December-to-December increase was only around 2 per cent as compared with 1.5 per cent during 1965. At the year-end the industrial average was only about 3 per cent higher than in late 1959 and early 1960, prior to the slight decline that occurred in the 1960–61 business recession.

The increase in prices of consumer services in 1966 amounted to 5 per cent. This was more than twice the average increase in the preceding 4 years. Services included in the consumer price index are diverse, and the acceleration in the price rise in 1966 reflected more rapidly rising wages and labor costs in response to labor market pressures, in addition to continued expansion in consumer demands.

The rise in costs of medical care, led by hospital services, was especially large; the increase—8 per cent—was double that for 1965 and was equal to the increase in 1946 when war-time price controls were removed. Mortgage interest rates, which have a relatively large weight in the consumer index for services, rose sharply in 1966 as a consequence of monetary policies designed to restrain the excessive expansion in aggregate demands and an associated rise in the general price level. Costs of transportation and other groups of services showed average increases of between 4.0 and 5.5 per cent; and rent rose by 1.6 per cent.

The small net increase in wholesale prices of foods and foodstuffs, following the large rise of 1965, reflected substantially offsetting movements for major commodity groups. Prices of livestock and meats, which had accounted for so much of the over-all rise in 1965, advanced somewhat further in early 1966. Later they declined sharply in response to expansion in supplies, and at the end of the year they were considerably lower than at the beginning. Late in the year, improvement in actual and prospective supplies brought about decreases in prices of grains and soybeans, but prices remained well above their levels at the end of 1965. Prices of milk and dairy products and of bakery products, on the other hand, rose substantially.

Increases in prices of industrial products were fairly widespread in 1966—although they were large in relatively few cases—and seemed to reflect a combination of pressures of demands against resources and some increases in labor and other costs. In a few instances, prices were influenced by special supply problems. Prices of machinery and equipment, for example, rose by 5 per cent compared with less than 2 per cent in 1965; booming demands for both business and defense equipment were confronted by the limitations of plant capacity and by shortages of certain labor skills, which resulted in a large buildup of order backlogs and undoubtedly some increases in costs.

Prices of consumer goods other than foods rose by about 2 per cent at both wholesale and retail levels, after rising by about 1 per cent during 1965; increases were more prominent among nondurable goods than among durable goods. Costs and prices of finished goods were subject to some upward pressures because of increases in prices of materials. Reflecting supply problems as well as strong demands, prices of hides, lumber, and copper and copper scrap—and prices of certain intermediate products that embody these materials—rose quite sharply in early 1966. As a result the average for all industrial materials showed a rapid upward trend. Prices of these sensitive or basic materials turned down during the spring and summer—bringing prices of some of the intermediate products down moderately—and the rise in prices of many other materials tapered off. At the year-end average prices of industrial materials were only 1.5 per cent higher than a year earlier; this was the same amount of increase as during 1965.

MONETARY POLICY

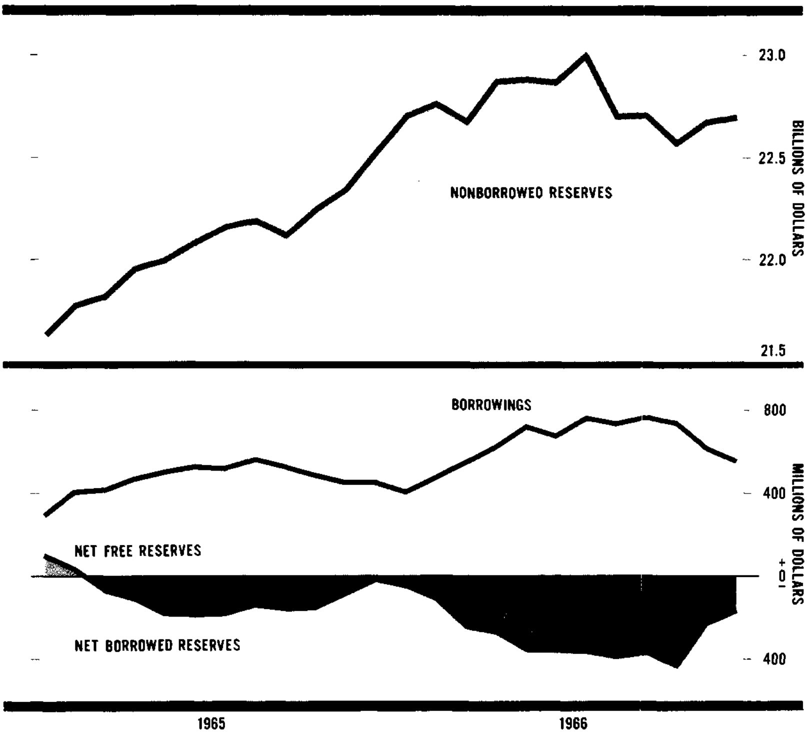
The policy of monetary restraint pursued by the Federal Reserve during most of 1966 was carried out through a wide variety of instruments—including open market operations, discount window administration, reserve requirements, and policy regarding maximum interest rates on time deposits. The intensity of restraint and the mix of monetary policy instruments were adjusted flexibly during the course of the year, as inflationary pressures generated by the business investment boom and expansion in defense spending intensified and then moderated, and as it became necessary to modify the uneven impact of over-all monetary restraint on different sectors of the economy. During the final months of the year, monetary restraint was relaxed as certain additional Federal fiscal actions of a restrictive nature were taken and as evidence of moderating tendencies in economic activity and commodity prices accumulated.

OPEN MARKET OPERATIONS: JANUARY–JUNE 1966

Following the increase in the Federal Reserve discount rate to 4½ per cent and in maximum interest rates payable on time deposits to 5½ per cent in December 1965, short- and long-term market interest rates rose sharply. Credit demands, which had expanded substantially in late 1965, continued to expand in early 1966. Operations for the Federal Open Market Account in that period were conducted so as to smooth the adjustments in credit markets. Because nonborrowed reserves were supplied generously in December 1965 and in January 1966, member banks had no need to increase their borrowings from the Federal Reserve Banks. The 3-month Treasury bill rate, which had closed 1965 at almost 4.50 per cent, generally fluctuated within a range of 4.50–4.65 per cent during the early weeks of 1966.

After the usual year-end ebbs and flows of funds had subsided, and credit markets had adjusted to the new higher level of interest rates, monetary policy gradually exerted further restraint through open market operations. With credit demands strong, prices of goods continuing to rise, and the balance of payments still unsatisfactory, the Federal Reserve began to supply reserves less freely to banks. Over the February–June period, nonborrowed reserves rose by only 1.7 per cent (seasonally adjusted annual rate), as compared with a 4.8 per cent rate of rise from mid-1965 through January 1966. However, around the March–April tax period, and again around midyear, the Federal Reserve supplied nonborrowed reserves to banks in substantial volume to

1 | NONBORROWED RESERVES decline after mid-1966 but rise late in the year as monetary policy eases and member bank borrowings decline



Nonborrowed reserves: Seasonally adjusted monthly averages of daily figures for all member banks, adjusted to eliminate effects of changes in reserve requirement ratios. Series reflects current percentage requirements effective Sept. 15, 1966. Borrowings and net borrowed and net free reserves: Monthly averages of daily figures, not seasonally adjusted, for all member banks.

help moderate the additional money market pressures being generated by the enlarged temporary needs of corporations for funds to meet accelerated tax payments. Banks borrowed increasingly more from the Federal Reserve Banks' discount window as the first half of the year progressed, and these borrowings rose from an average of about $400 million in January to about $675 million by June. With the rise in borrowed reserves, total reserves of banks rose at a rate of about 4 per cent in February–June, little different from the pace of aggregate reserve expansion of the previous 7 months.

Over-all, during the February–June period the increased restraint in the provision of nonborrowed reserves and the continued large demands for credit were reflected in generally rising money market rates—including those on Federal funds, dealer loans, commercial and finance company paper, and short-term Federal agency issues. Banks raised their prime loan rate during this period; and there were marked increases in most long-term interest rates in conjunction with a surge of security issues, especially of corporate bonds and of issues by the Federal Government of participation certificates. Despite the pressure being exerted on financial markets, however, the 3-month Treasury bill rate generally remained within its early-in-the-year range, as market pressure from bank liquidations of U.S. Government securities was offset by a very sizable decline in the volume of Treasury tax bills outstanding.

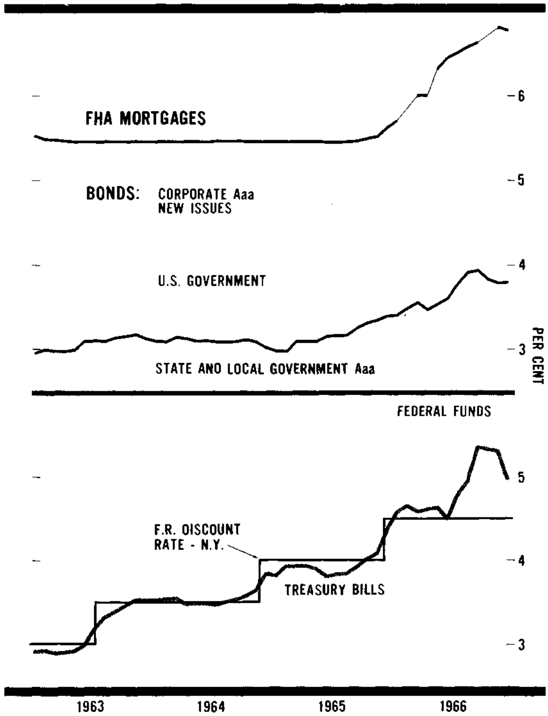
As a result of the advances in interest rates on a variety of short- and long-term market instruments, both banks and nonbank financial institutions found it difficult to hold and attract funds of individuals and other investors, who increasingly placed their funds directly in relatively high-yielding market instruments. In March, after the prime loan rate was raised, banks bid much more actively to attract funds into time deposits. They sought funds from corporations by raising rates on negotiable CD's toward the ceiling rate of 5½ per cent; they also increased their efforts to attract time deposit money from consumers through the issuance of a variety of savings instruments. With increased competition for savings flows not only from market instruments but also from banks, other depositary institutions (savings and loan associations and mutual savings banks) found it especially difficult to attract savings funds, and in consequence the availability of new mortgage commitments from these lenders was severely restricted.

ADAPTATIONS IN THE MIX OF POLICY INSTRUMENTS: JULY–SEPTEMBER 1966

The problem of retaining savings funds was particularly acute for savings and loan associations around the midyear interest-crediting period, and in July savings shares outstanding at these institutions declined, after seasonal adjustment. Bank credit, meanwhile, had expanded fairly fast during the spring, and the pace of expansion accelerated around midyear. Borrowings from banks by businesses grew very rapidly in June and July, in part to finance the large accelerated tax payments that businesses had to make in that period but also to finance their increased capital outlays.

With business loan expansion adding to inflationary pressures and with the impact of tighter credit conditions falling heavily on nonbank institutions and therefore on mortgage markets, the Federal Reserve adapted the mix of policy instruments to help redistribute the impact of financial restraint. On June 27 the Board of Governors announced an increase in reserve requirements from 4 per cent to 5 per cent on time deposits in excess of $5 million to be effective in mid-July. In mid-August it announced another increase in such requirements to 6 per cent, to be effective around mid-September. Also, promissory notes of banks maturing in less than 2 years were made subject to regulations governing reserve requirements and payment of interest on deposits. In addition, in mid-July the Board of Governors had lowered the maximum rate of interest payable on new multiple-maturity time deposits to 5 per cent on such deposits maturing in 90 days or more and to 4 per cent on such deposits maturing in less than 90 days in order to help forestall excessive interest rate competition among financial institutions. At the same time the Board supported legislation containing broader authority for itself and for the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board to govern the interest rate practices of banks and savings and loan associations.

2 | INTEREST RATES hit new highs in late summer, then decline



Federal funds, effective rate. For other notes see p. 71.

Under a program authorized by the Board of Governors, the Federal Reserve also instituted procedures whereby emergency credit facilities could be provided through the Federal Reserve

Banks under specified conditions to nonmember depositary-type institutions, including mutual savings banks and savings and loan associations. While no actual use was made of these emergency credit facilities, their availability provided a safeguard against the possibility of additional pressures on mortgage and securities markets resulting from exceptional deposit losses at nonmember financial institutions.

Open market operations during the summer complemented the changes in reserve requirements and in time deposit rates—by limiting the availability of reserve funds to banks to the extent consistent with orderly market conditions. Nonborrowed reserves declined during the third quarter, and banks were forced to rely somewhat more heavily on borrowed reserves and on funds attracted from abroad. With restraints on the supply of funds intensifying and with loan demands still basically strong, banks raised the prime loan rate further to 6 per cent by midsummer, continued to reduce their portfolios of U.S. Government securities, and sharply curtailed their participation in the market for State and local government securities.

As the summer progressed, commercial banks found that negotiable time CD's, with interest rates limited by the 5½ per cent ceiling, were no longer competitive with other short-term market instruments. The rate on 3-month Treasury bills rose to around 5½ per cent and in the third week of September reached its peak for the year of 5.59 per cent (on a discount yield basis). Yields on longer-term bills and other types of money market paper, including Federal agency issues, rose further to levels consistently well above 5.50 per cent. With rates at such levels, banks were unable to roll over all maturing negotiable CD's after mid-August, and their holdings of such deposits began to decline. As this source of funds dried up, large banks sought money elsewhere. They obtained more funds in the Euro-dollar market through their foreign branches; and they bid more aggressively in the Federal funds market—at times paying 6 per cent or more for such 1-day money.

Upward pressure on money market rates was exerted not only by the cumulative impact of restraint on the banking system but also by the financing needs of the U.S. Government. In addition to a large offering of tax bills in midsummer, there were sizable offerings of Federal agency issues in the 6-month to 2-year maturity range in the late spring and summer. These agency issues included a large amount of funds raised by the Federal home loan banks and the Federal National Mortgage Association to help ease pressures on savings and loan associations and on the mortgage market.

Money market rates were also influenced by a larger volume of commercial and finance company paper offered, as borrowers sought alternatives to bank loans. And finally U.S. Government securities dealers kept their bill positions unusually low, as expectations of rising interest rates intensified and dealers' borrowing costs rose further.

Bond yields also rose markedly in the summer and reached a peak in late August. The new-issue rate on high-grade corporate bonds (with 5-year call protection) briefly touched 6 per cent; 20-year U.S. Government bonds for a few days yielded more than 5 per cent; and seasoned high-grade tax-exempt municipal issues averaged just over 4 per cent. The sharpness of the rise in yields reflected strong demands in capital markets. But it was also influenced by expectational forces generated by the gathering of pressures on banks and other financial institutions, by the high yields that had been required to sell participation certificates mainly in FNMA and Small Business Administration assets, by the prospect of additional issues of certificates, and by uncertainties about the course of the conflict in Vietnam and about Federal fiscal policy.

During the summer the Board of Governors disapproved discount rate increases that had been proposed at various times by several of the Federal Reserve Banks. An attempt to avoid further escalation of interest rates was among the reasons for the Board's decisions.

The late summer rise of yields in short- and long-term markets was the culmination of financial market pressures during the year; interest rates in the mortgage market, however, continued to rise into the autumn. A number of fiscal and monetary policy developments contributed to the moderation of adverse market expectations and of credit market pressures after late August.

The administration's announcement in early September of a program of fiscal restraint had a tonic effect on market psychology, especially in long-term markets. The program included measures to reduce relatively low-priority Government expenditures, a recommendation for suspension of the investment tax credit and of accelerated depreciation, postponement of sales of participation certificates, and a limitation on Federal agency issues to the public to no more than the amounts that would be needed to roll over maturing debt.

Meanwhile, on September 1 the Board of Governors released a letter that was sent by the Federal Reserve Banks to all member banks. In an attempt to moderate financial pressures on securities markets the letter urged moderation in bank extensions of loans to business. The letter indicated the desirability of banks' reducing business loan expansion and of avoiding further substantial liquidations of municipal securities or other investments. It was recognized that banks that adjusted their positions by tightening lending standards further rather than by selling securities might require accommodation at the discount window for longer periods than usual.

Finally, in late September the Board of Governors reduced to 5 per cent from 5½ per cent the maximum rate of interest member banks might pay on time deposits of less than $100,000. This action was taken under temporary authority granted by the Congress that broadened the basis for setting interest rate ceilings on time and savings deposits. Rate ceilings were also established for insured nonmember banks, mutual savings banks, and savings and loan associations under parallel authority granted to the

FDIC and to the Federal Home Loan Bank Board. The rate ceilings established by the three agencies had the objective of limiting further escalation of interest rates paid for consumer savings.

MOVE TOWARD LESS MONETARY RESTRAINT: OCTOBER–DECEMBER 1966

Federal Reserve open market operations in the early fall were directed at maintaining orderly and generally steady conditions in the money market. With market interest rates remaining high, though below their peak levels, the decline in bank credit that had begun in late summer continued into the autumn. This was partly the result of reductions in negotiable CD's outstanding, which dropped by $2.7 billion from mid-August through the end of October. Concurrently, the rate of business loan expansion at banks was sharply reduced. This slower expansion was the result in part of restrictive lending policies of banks and in part of a reduction in loan demands, following the very large increase in bank loans related to the speed-ups in tax payments around mid-year. The money stock did not show any tendency to rise following its summer decline.

The behavior of bank credit, money stock, and aggregate reserves was even weaker than might have been expected under the prevailing money market conditions. Under the circumstances, and with excessive credit demand pressures in the economy appearing to abate, open market operations were conducted so as to lessen somewhat the restraint on banks. Member bank borrowings began to decline after reaching a peak of $878 million on the average during the first two statement weeks in October. Treasury bill rates began to decline again, and banks' net losses of CD money in November were only about one-third of the amounts in each of the previous 2 months.

As moderating tendencies in the economy became more widespread, the Federal Open Market Committee moved in late November and December to attain a further easing in money market conditions through open market operations. As a result of these actions, member bank borrowings at Federal Reserve Banks declined to an average of $557 million in December; the Federal funds market eased, with most trading in a 5–5½ per cent range; and the 3-month Treasury bill rate dropped to around 4.80 per cent by the year-end.

Long-term interest rates also declined sharply during the final months of the year. Investor receptivity to long-term issues was enhanced by the gradual realization that monetary policy had shifted to a stance of less restraint; by the apparent tapering of the investment boom, as indicated by various surveys of business plans for capital spending; and by various other indications that the economic outlook was no longer so buoyant as earlier in the year. By the year-end yields on U.S. Government, new high-grade corporate, and municipal bonds were 40 to 60 basis points below their late summer peaks, and there were signs of an easing in mortgage market conditions. On December 27, with business loan expansion at banks having moderated substantially and with security markets showing renewed strength, the Board of Governors issued a statement terminating the special discount arrangements announced in the September 1 letter.

Growth in bank credit—as indicated on a weekly basis by data for total member bank deposits—resumed in the latter part of November, and the money supply also rose during the last few weeks of the year. In December banks actually experienced a modest increase in outstanding negotiable CD's, despite record maturities during the month.

Over the year 1966, outstanding bank credit expanded by 6 per cent—reflecting mainly the relatively rapid growth in the first half of the year; such credit had risen by 10 per cent in 1965. With open market operations generally exerting restraint throughout the year, nonborrowed reserves of banks grew by less than 1 per cent, compared with a rise of more than 4 per cent in 1965. Member bank borrowings from the Federal Reserve first rose and then fell during the year and were a relatively minor source of reserve funds for the year on balance.

With reserve growth very restrained, the 6 per cent expansion of bank credit was made possible by a rise in time and savings deposits and by the increased use of funds obtained through branches abroad. Time and savings deposits grew by 8 per cent in 1966, while demand deposits expanded by less than 1 per cent. And the money supply—demand deposits and currency in the hands of the public—rose by less than 2 per cent, a rate of growth less than half that in 1965.

OPERATIONS IN FOREIGN CURRENCIES

During 1966 the Federal Reserve—in cooperation with the U.S. Treasury, foreign central banks, and the Bank for International Settlements (BIS)—continued to engage in operations in foreign currencies for the purpose of alleviating temporary strains in foreign exchange markets and curbing speculative developments.

The sterling crisis during the summer provided the main focus of these operations. Early in the year sterling was relatively strong in foreign exchange markets, and the Bank of England repaid the $475 million of drawings that had been outstanding at the end of 1965 under its reciprocal currency arrangement with the Federal Reserve. But during the spring the pound weakened again as Britain's economic problems persisted and were aggravated by a prolonged maritime strike. As confidence in sterling waned during the summer, Britain experienced very large outflows of capital, and the Bank of England drew heavily on its credit facilities with the Federal Reserve and the U.S. Treasury and also borrowed from the central banks of other countries. At the end of September its outstanding drawings from U.S. authorities totaled $575 million.

Some of the funds converted from sterling into dollars flowed to the United States, as foreign branches of U.S. banks bid actively for Euro-dollar deposits and placed them at the disposal of their head offices. But there were also substantial flows of dollars into continental European currencies, and the dollar came under pressure in foreign exchange markets. As a result, the United States was called upon to make use of its own credit lines. The Federal Reserve made swap drawings of $570 million during the third quarter—$325 million in lire and the remainder in Swiss francs, Dutch guilders, and Belgian francs. Of the lira drawings, it repaid $225 million in August with the proceeds of a U.S. Treasury drawing of $250 million of lire from the International Monetary Fund (IMF).

The tensions and uncertainties that developed in foreign exchange markets during the spring and summer prompted the Federal Reserve to initiate discussions aimed at increasing its reciprocal currency facilities with partner central banks. In mid-September the Federal Reserve announced a general increase in these swap lines from $2.8 billion to $4.5 billion. At the same time the Bank of England announced an increase in its credit facilities with a number of other central banks as well as with the Federal Reserve.

Meanwhile the sweeping measures adopted in July by the British Government to check inflation and correct the payments deficit began to take effect. Also, financial markets became less strained. As a result of these developments as well as of the announcement of expanded international credit facilities, financial markets and foreign exchange markets began to calm. During the fourth quarter of 1966, the Bank of England was able to make repayments on its outstanding credits. The Federal Reserve, too, reduced its liabilities during this period.

In the closing weeks of the year the System joined in efforts to moderate year-end pressures in the Euro-dollar market that threatened to disturb foreign exchange markets. The System intervened moderately in the New York market for German marks and pounds sterling; and it agreed to drawings by the BIS on its swap line for the purpose of placing funds in the Euro-dollar market. At the same time several continental European central banks acted either to reduce commercial bank withdrawals from that market or to rechannel official reserve accruals to that market. Also in December, the Federal Reserve drew $140 million on its reciprocal currency arrangements with the German Federal Bank to absorb some of that bank's large reserve gains.

During 1966, drawings of foreign currencies by the Federal Reserve under reciprocal currency arrangements totaled $710 million, of which $280 million were outstanding at the year-end. Drawings by foreign central banks and the BIS, which also involve acquisitions of foreign currencies by the Federal Reserve, totaled $928 million, $550 million of which remained outstanding on December 31.

A detailed review of Federal Reserve operations in foreign currencies during 1966 is found on pages 269-90.

VOLUNTARY FOREIGN CREDIT RESTRAINT PROGRAM

During 1966 the Federal Reserve System continued to coordinate that part of the President's balance of payments program applicable to banks and other financial institutions in accordance with revised guidelines announced on December 6, 1965.

By December 1965 an increasing scarcity of loanable funds in the face of rapidly rising demands for credit from domestic borrowers clearly had begun to supplant the voluntary program as the dominant factor affecting the foreign lending activity of U.S. financial institutions. At the same time a narrowing of the differences between interest rates in the United States and those abroad, associated with the increasing tightness of the U.S. domestic money market, reduced foreign demand for credit in the U.S. markets. Outstanding foreign credits of the reporting commercial banks trended downward during 1966, as shown by Table 1, to $9,496 million at the year-end. This was $156 million below the total on December 31, 1965, $864 million below the

TABLE 1

U.S. BANKS: FOREIGN CREDITS SUBJECT TO VOLUNTARY PROGRAMS

Item	1965, Dec. 31	1966				
		Mar. 31	June 30	Sept. 30	Dec. 31, calculated on guidelines for	
					1966[1]	1967[2]
Number of reporting banks	161	161	161	159	[3] 148	[3] 148
	Millions of dollars					
Total foreign credits subject to ceiling	9,652	9,367	9,429	9,142	9,496	9,496
Target ceiling	9,973	10,076	10,179	10,290	10,360	9,640
Net expansion of credit since December 1964	156	−134	−77	−369	−3	−3
Net leeway for expansion within target ceiling up to specified date	319	709	751	1,148	864	144

[1] Target ceiling generally 109 per cent of December 1964 base.
[2] Interim target ceiling generally the amount outstanding on Sept. 30, 1966, plus 40 per cent of the difference between that amount and 109 per cent of the December 1964 base.
[3] Beginning with Dec. 31, 1966, data exclude banks with foreign credits of less than $500,000 on the reporting date.

109 per cent ceiling suggested by the 1966 guidelines, and $144 million below the interim ceiling for the end of 1966 suggested by the 1967 guidelines, described below.

This decline in foreign credits may be compared with the substantial further expansion in total bank loans outstanding during 1966. Total loans of U.S. banks increased by 8.4 per cent in 1966, while their foreign credits declined by 1.6 per cent. At the end of the year credits reported under the voluntary program were equivalent to 4.4 per cent of total commercial bank loans outstanding as compared with 4.9 per cent on December 31, 1965.

The number of banks having foreign loans in excess of their individual target ceilings and the aggregate amount of such excess continued to decline for the year as a whole, as shown in Table 2, although there was some increase in the last quarter from the low reached on September 30. However, a large number of banks had foreign credits in excess of the interim target calculated in accordance with the 1967 guidelines, owing to the fact that these guidelines were not announced until mid-December 1966.

TABLE 2

BANKS WITH FOREIGN CREDITS IN EXCESS OF TARGET CEILING

Item	1965, Dec. 31	1966				
		Mar. 31	June 30	Sept. 30	Dec. 31, calculated on guidelines for	
					1966[1]	1967[2]
Number of banks	35	22	24	13	18	51
Aggregate credit in excess of target (millions of dollars)	114	18	26	17	31	155

[1] Target ceiling generally 109 per cent of December 1964 base.
[2] Interim target ceiling generally the amount outstanding on Sept. 30, 1966, plus 40 per cent of the difference between that amount and 109 per cent of the December 1964 base.

Foreign assets of nonbank financial institutions declined slightly over the first 9 months of 1966, as shown in Table 3. Liquid assets, which had been reduced substantially during 1965, were reduced by an additional $59 million or 22 per cent. Loans and investments with maturities of 10 years or less and net financial investments in foreign financial branches, subsidiaries, and affiliates rose by 1 per cent, but on September 30, 1966, they were still 3 per cent below the target ceiling that applied to

TABLE 3

FOREIGN ASSETS OF REPORTING NONBANK FINANCIAL INSTITUTIONS

(Amounts shown in millions of dollars)

Guideline, and area	Amount Sept. 30, 1966	Change from Dec. 31, 1965: Amount	Change from Dec. 31, 1965: Per cent
All countries—total	**13,049**	**− 72**	**− .5**
Guideline 1 (Liquid investments)	208	− 59	−22.2
Guideline 2 (Credits with maturities of 10 years or less and net investment in financial subsidiaries)	1,280	13	1.0
Guideline 3 (Credits with maturities of more than 10 years and equity securities)—total	11,561	− 25	− .2
By type of asset:			
Bonds of international institutions	842	− 16	− 1.8
Other bonds and credits	8,525	443	5.5
Stocks	2,193	−452	−17.1
By area and type of asset:			
Canada—total	8,561	293	3.5
Bonds and credits	7,284	423	6.2
Stocks	1,277	−130	− 9.3
Other developed countries—total[1]	1,373	−271	−16.5
Bonds and credits	580	− 22	− 3.6
Stocks	794	−250	−23.9
All other countries—total[2]	1,626	− 47	− 2.8
Bonds and credits	1,504	26	1.7
Stocks	122	− 72	−37.2

[1] Excluding Japan.
[2] Japan, less developed countries, and international institutions.

such assets. Investment in longer-term foreign assets was about unchanged, as an increase of $427 million in bonds and other long-term loans—largely to Canadian borrowers—was more than offset by reductions in the reported value of holdings of foreign corporate stocks. Total long-term loans and investments in developed countries other than Canada and Japan declined by $270 million and on September 30, 1966, were 10 per cent below the target ceiling suggested for these assets.

Despite the reduction in holdings of foreign assets achieved by banks and other financial institutions, the U.S. balance of payments deficit as measured on the liquidity basis remained at about the 1965 level for reasons discussed later in this REPORT. On December 12, 1966, the President, in a memorandum addressed to the Secretary of the Treasury, stated that the nation's objective was to continue to move toward balance of payments equilibrium as fast as the continuing foreign exchange costs of Vietnam would permit. The President accepted the appraisal of the Cabinet Committee on the Balance of Payments that achievement of the objective would require continued restraint of both Government overseas expenditures and private capital outflows, and he accepted the recommendation of the Committee that the voluntary programs be continued in 1967. The Board of Governors issued revised guidelines for banks and nonbank financial institutions on December 13, 1966.

The bank guidelines for 1967 remain substantially in the form in use since 1965. The ceiling for outstanding credits to foreigners remains at 109 per cent of the end-of-1964 base (the same as in the last quarter of 1966); no increase was provided in view of the fact that on October 1, 1966, there existed a potential leeway under the voluntary ceiling for an outflow of bank credit in excess of $1.2 billion. To guard against the possibility of a large-scale outflow of funds in any short period of time, in the event of a shift in international credit conditions and interest rates, the banks were requested to restrain their foreign credits so as to use not more than 40 per cent of the leeway available on October 1, 1966, before April 1, 1967; not more than 60 per cent before July 1, 1967; and not more than 80 per cent before October 1, 1967.

The priorities suggested in the guidelines for 1965 and 1966 were continued for 1967 and were reinforced by a request that banks in the last quarter of 1966 and in 1967 use not more than 10 per cent of the leeway available on October 1, 1966, for nonexport credits to developed countries. This request was made to give utmost emphasis to the importance attached to meeting requirements for priority credits—that is, credits to finance exports of U.S. goods and services, and credits to meet the needs of developing countries.

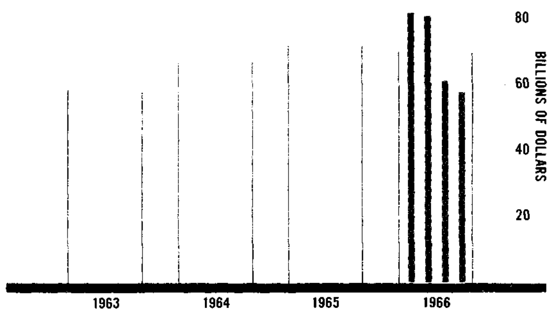
Banks with bases between $500,000 and $10 million were permitted to use the 1964 base plus $900,000 as their ceiling rather than 109 per cent of the 1964 base, and provision was made for banks with bases lower than $500,000, or no base, to discuss with their Federal Reserve Banks the possibility of adopting a special ceiling. These provisions reflected a continuing effort to minimize the inequities inherent in any program based on a state of affairs existing at a particular moment in time, and to insure that these smaller banks would be in a position to meet requirements for priority credits arising in their trade areas.

The program for nonbank financial institutions has been considerably simplified for 1967. A single guideline ceiling has replaced the three different ones in effect in 1966, and several types of assets are no longer subject to a ceiling. Under the 1967 program each nonbank institution is requested to limit its total holdings of "covered assets" to not more than 105 per cent of its "base date" holdings. Such base-date holdings are equal to the lesser of (1) covered foreign assets held as of September 30, 1966, or (2) the amount of such assets that could have been held on that date in compliance with the 1966 guideline ceilings.

FINANCIAL FLOWS IN 1966

Until the final months of 1966, financial markets were placed under pressures by the record volume of credit demands and an increasingly restrictive monetary policy. In the late fall, easing of demands permitted the Federal Reserve to reduce the degree of restraint, and by the year-end a good part of the increase that had occurred in interest rates earlier in the year had been erased.

3 | CREDIT FLOWS rise sharply in first half, decline in second half

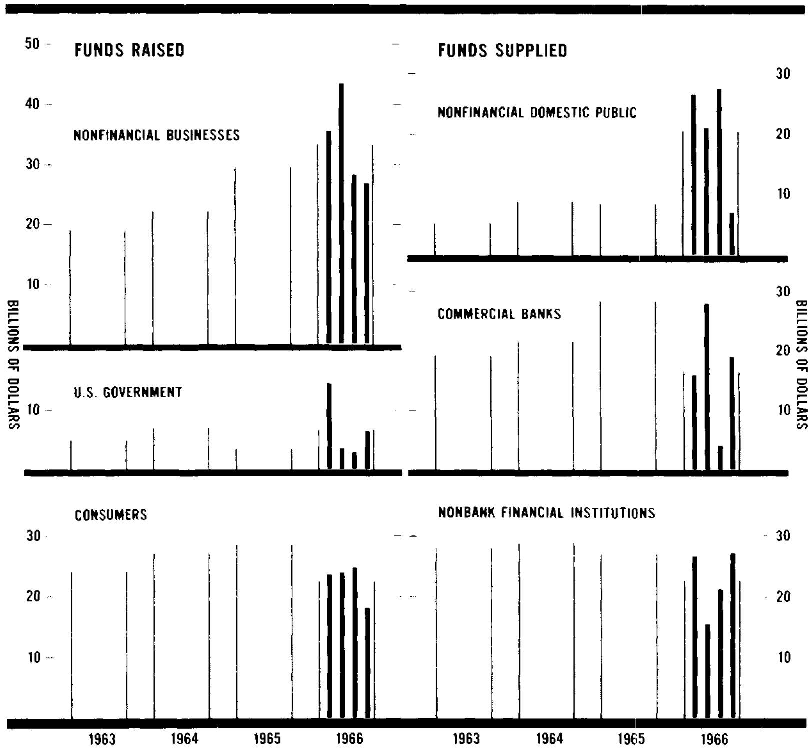


Flow of funds data. Net funds raised by consumers, nonfinancial businesses, foreigners, and all levels of government. Quarterly totals for 1966 are at seasonally adjusted annual rates. Data for fourth quarter of 1966 are preliminary.

The stresses and strains created by financial market pressures in the first 6 months of 1966 were reflected not only in interest rate movements but also in the composition and volume of credit flows. In the first half of the year the total of funds raised by the nonfinancial public rose to a record rate about one-eighth more than in 1965. All of this increase, however, reflected greater reliance of businesses on external financing and an increased demand for funds by the Federal Government. The expanded credit demands of these sectors—in conjunction with monetary policy—led to rising interest rates on securities. These higher rates induced the public to increase sharply its direct investment in credit and equity market instruments and to reduce the rate at which it was acquiring deposits and shares at financial intermediaries.

In the summer and early fall, strains on financial markets became more intense. Deposit inflows to financial institutions slackened further, as market interest rates continued to advance, and the flow of bank credit to businesses contracted.

4 | BUSINESSES and U.S. GOVERNMENT raise more funds, and PUBLIC increases sharply its purchases of securities



Flow of funds data. Nonfinancial businesses are corporate and noncorporate concerns, including farm. U.S. Govt. borrowing is net of official purchases by Treasury investment accounts. Consumer borrowing includes that of nonprofit institutions, but excludes security credit. The nonfinancial public is made up of consumers, businesses, and State and local governments; its supply of funds is net of its security credit borrowing. Credit supplied by commercial banks and by nonbank financial institutions is net of their security and other credit market issues. Data for fourth quarter of 1966 are preliminary.

In the late fall the relaxation of monetary policy that accompanied reduced demand pressures contributed to a sizable reduction in market interest rates and to a sharp increase in deposits at nonbank financial institutions in the fourth quarter. However, efforts of banks and nonbank financial institutions to rebuild their depleted liquidity, as well as reduced demands for credit, held total credit flows to the reduced third-quarter pace. Total funds raised in the second half of the year consequently were only three-fourths as large as in the first half of 1966.

BORROWERS AND LENDERS

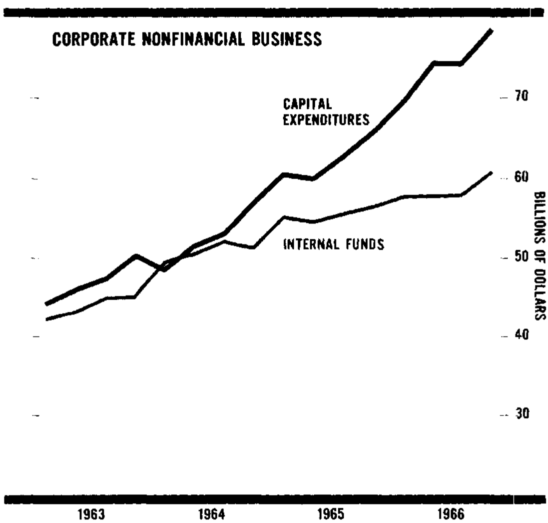
For the year as a whole, total funds raised in credit and equity markets by the nonfinancial sectors—businesses, consumers, foreigners, and all levels of government—amounted to $70 billion, somewhat less than in 1965. Businesses and the U.S. Government were the only sectors that increased their borrowing in 1966.

With securities becoming more attractive because of rising market rates of interest, the nonfinancial public supplied directly to the market almost 30 per cent of the total funds raised—well above the average from 1961 through 1965. Financial institutions, on the other hand, with their deposit inflows reduced, contributed a smaller proportion of the total funds supplied.

Nonfinancial business. Demands by businesses for credit to fill the widening gap between their capital outlays and their internally generated funds were a dominating element in credit and equity markets in 1966. This gap had begun to widen in mid-1965, and in the corporate sector it rose to a record $15 billion in 1966. To bridge the gap, businesses sought more external financing at a time when the supply of funds was being reduced by monetary policy.

Despite the slowing in multifamily housing and commercial construction, nonfinancial corporations spent $12 billion more for fixed investment and inventories than in 1965. Meanwhile their internal funds—primarily retained earnings and depreciation allowances—rose by only $3 billion. Noncorporate businesses too needed a large volume of external financing. As a result, corporate and noncorporate business together raised more than $33 billion in credit and equity markets, one-eighth more than in 1965.

5 | CORPORATE external financing needs increase sharply in 1966

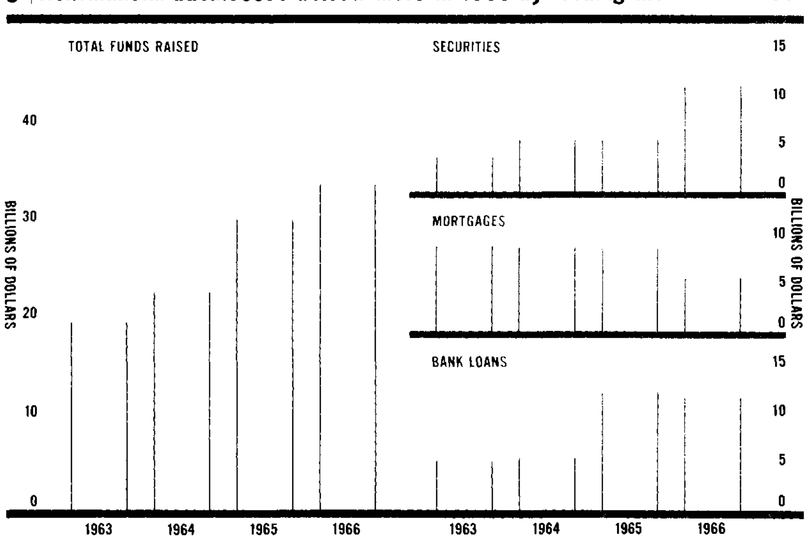


Flow of funds data; quarterly totals at seasonally adjusted annual rates. Capital expenditures are outlays for plant, equipment, and construction, and changes in inventories. Internal funds are retained earnings, inventory valuation adjustment, and capital consumption allowances. Data for fourth quarter of 1966 are preliminary.

Business external financing grew at a fast rate in the first half of the year, and especially in the second quarter when such financing reached a seasonally adjusted annual rate of over $43 billion. Some of this unprecedented volume undoubtedly reflected efforts to meet prospective as well as current needs before credit supplies became even more costly and restricted. Moreover, the expanded corporate tax payments required under the revised schedules for payment of Federal income and withheld taxes increased the cash needs of business firms. These accelerations are estimated to have amounted to $4 billion, more than one-half of the year-over-year increase in tax payments in the second quarter. Corporations apparently met their enlarged tax payments by increased borrowing rather than by reducing liquid assets, since such holdings declined only a little more than seasonally in the quarter.

External financing slowed considerably in the second half of the year, to a rate about 10 per cent below that in 1965. The gap between capital expenditures and internal funds continued to widen, but with the increasing restraint being applied by monetary policy, businesses found it more difficult to obtain external financing, particularly from banks and other institutional lenders whose liquidity had been sharply reduced over most of the year. By the fourth quarter of 1966, the volume of funds raised in credit and equity markets by businesses had declined to a seasonally adjusted annual rate of less than $27 billion, and cor-

6 | Nonfinancial businesses borrow more in 1966 by issuing more securities



Flow of funds data. Includes domestic corporate and noncorporate (including farm) nonfinancial businesses. Funds raised exclude trade debt and miscellaneous liabilities. Bank loans include acquisitions of commercial paper and domestic acceptances. Data for 1966 are preliminary.

porations resorted to drawing heavily on their low stock of liquid assets. The sharp reduction in seasonally adjusted liquid asset holdings in the second half more than wiped out the increase in holdings over the first half. This was the first time since 1956 that holdings of liquid assets by corporations were reduced significantly in a year of economic expansion.

All of the 1966 increase in external financing by nonfinancial business was accounted for by issues of corporate bonds and stocks, which rose to a record $11 billion. Earlier in the expansion, bank loans and mortgages had provided the predominant share of funds raised by business in credit and equity markets. But the increased volume of external financing in 1966, coupled with reduced availability of credit at financial institutions, shifted a greater share of business credit demands into the securities market. Bond issues were nearly double the 1965 volume, and net stock issues—despite some large retirements—provided considerably more funds than in most other recent years.

For 1966 as a whole, businesses borrowed less at banks than they had in 1965, when bank borrowing had accounted for all of the increase in external financing. In the first half, already heavy business demands on banks were inflated by accelerated tax payments, and banks were able to grant loans to businesses at a rapid rate by liquidating securities, reducing credit supplied to other borrowers, and by aggressively seeking time deposits. After midsummer, however, business loans of banks expanded less rapidly as demands abated and as the availability of bank credit to businesses shrank in consequence of the drying up of time deposit inflows, the erosion of bank liquidity, and the continuing pressures on bank reserve positions.

Federal Government. The Federal Government increased pressures on financial markets in 1966 both directly and indirectly. By accelerating tax payments and increasing defense orders, this sector contributed greatly to the increased financing needs of businesses. And by expanding issues of direct and agency securities and of participation certificates, it sharply increased its own borrowing in credit markets. On the other hand, the Federal Government also expanded the amount of funds it supplied to credit markets, mainly by increases in its acquisitions of mortgages.

The Government's cash deficit rose to $5.7 billion in the calendar year 1966, the highest level since 1961. The step-up of $12 billion in defense outlays accounted for more than one-half of the $23 billion increase in total Federal cash payments.

Tax receipts also rose to a record level during the year. The rapid growth of the economy accounted for a large share of this increase, but an estimated $6 billion of the almost $22 billion rise in receipts resulted from the acceleration in tax payments. The January 1 increase in social security taxes and institution of medicare taxes at midyear accounted for another $5.5 billion.

The types of securities issued by the Government and the size of its borrowings were affected by the legal limits on the size of the debt, the rate ceiling on U.S. Government bonds, the pattern of receipts, and the increasing tension in financial markets that developed in the spring and culminated in the late summer and early fall. The 4¼ per cent interest ceiling on Treasury bonds maturing in over 5 years precluded the issuance of any direct long-term debt, and a substantial part of the lengthening in average maturity of the debt that had been achieved during the previous 6 years was erased. Late in the year the outstanding debt approached its statutory ceiling, and at times the Treasury's operating balance reached low levels. In early December the Treasury borrowed $169 million directly from the Federal Reserve over one weekend.

During 1966 the Federal Government was a net seller of $10.0 billion of securities, more than twice as much as in 1965. This borrowing included a moderate amount of marketable direct debt—$3.4 billion, all with maturities of less than 5 years; a record volume of direct agency issues—$5.1 billion; and unusually large net sales of participation certificates in pools of Government financial assets—$1.5 billion.

TABLE 4

U.S. TREASURY FINANCE AND TRANSACTIONS IN MARKETABLE OBLIGATIONS

(In billions of dollars)

Item	Calendar year 1965					Calendar year 1966				
	I	II	III	IV	Total	I	II	III	IV	Total
U.S. TREASURY FINANCE										
Cash receipts	30.7	37.7	29.2	25.8	123.4	33.3	46.2	34.6	31.1	145.1
Cash payments	28.3	32.6	33.1	34.0	127.9	34.6	36.2	41.3	38.8	150.9
Cash surplus, or deficit (−)	2.4	5.1	−3.9	−8.1	−4.5	−1.3	10.0	−6.7	−7.7	−5.7
Less: Change in cash balance	2.0	3.1	−4.3	−2.3	−1.4	−.1	6.6	−4.1	−2.5	−.1
Equals: Net cash borrowing, or repayment (−) [1]	−.5	−2.0	−.4	5.7	2.9	1.0	−3.7	2.4	5.1	4.8
TRANSACTIONS IN U.S. GOVERNMENT MARKETABLE OBLIGATIONS										
Net issues of:										
Direct marketable debt	.1	−3.8	−.3	6.2	2.2	.5	−6.0	2.6	6.3	3.4
Direct agency debt	*	1.1	.4	.2	1.7	.9	2.6	.8	.8	5.1
Plus: Net issues of participation certificates [2]	.....	−.2	.5	.1	.4	.4	1.7	−.6	.....	1.5
Less: Official purchases, or sales (−):										
By Government agencies and trust funds:										
Direct marketable debt	.5	−.3	.8	.2	1.2	.1	−.1	.5	.7	1.2
Direct agency debt	.....	.....	.....	.....	.....	.....	.....	.5	.8	1.3
By Federal Reserve System [3]	1.0	1.4	.9	.7	4.0	.3	1.4	.7	.7	3.2
Equals: Net Federal marketable and agency obligations acquired by public	−1.4	−4.0	−1.1	5.6	−.9	1.4	−3.0	1.1	4.9	4.3

[1] Net cash borrowing is less than the cash deficit minus the change in cash balance by the amount of seignorage. Net cash borrowing or repayment is made up of issues of direct marketable and agency debt and of nonmarketable debt, less purchases (or plus sales) of direct marketable and agency debt by Government agencies and trust funds.

[2] Included in cash payments of the Federal Government as a negative expenditure. Data include Export-Import Bank certificates, which are not as broadly marketable as other participation certificates.

[3] Excludes repurchase agreements.

* Less than $50 million.

NOTE.—Data are not seasonally adjusted.

Sales of these types of securities were relatively large in the first quarter of the year. But with the expanded receipts resulting from acceleration of tax payments and the seasonal rise in tax receipts, the Federal Government reduced its outstanding debt in the second quarter. The entire decline, however, was in direct marketable debt; agency and PC debt rose sharply. The unprecedented volume of new issues of PC's and agency securities contributed importantly to the rise in money market rates and the congestion in capital markets. To ease these conditions, Treasury investment accounts began after midyear to make large purchases of agency securities, and after September the Government refrained from selling new PC's. With sales of agency securities and PC's reduced, the Treasury drew down its cash balance in the second half and stepped up its sales of direct securities as shown in Table 4.

Purchases by Treasury investment accounts and the Federal Reserve absorbed more than one-half of all net new issues of U.S. Government direct, agency, and PC debt during 1966. However, private financial markets still had to absorb over $4 billion of Federal obligations, a considerable turnaround from the liquidation of almost $1 billion of such securities by the public in 1965. In addition, many large institutional investors were heavy net sellers of Federal Government obligations during 1966. As a result consumers absorbed, at rising yields, a record amount of U.S. Government securities—over $7.5 billion.

The Federal sector sharply increased its extensions of credit to financial markets in 1966, mainly to alleviate pressures in mortgage markets. It purchased record amounts of mortgages in the secondary market as shown in Table 5 and increased its lending to savings and loan associations, a major source of mortgage credit to the public. While increased inflows of funds to nonbank institutions in late 1966 sharply reduced the need for these operations, credit extensions of the Federal Government for all of the year exceeded its net demand on private financial markets by a substantial margin. However, while Federal credit operations served mainly to make funds available to one particular market, Government borrowing tended to add considerable pressure to financial markets in general, with the result that the Federal Government remained an important factor in the general upward movement in interest rates over most of 1966.

TABLE 5

ACQUISITIONS OF CREDIT MARKET INSTRUMENTS BY U.S. GOVERNMENT
(In billions of dollars)

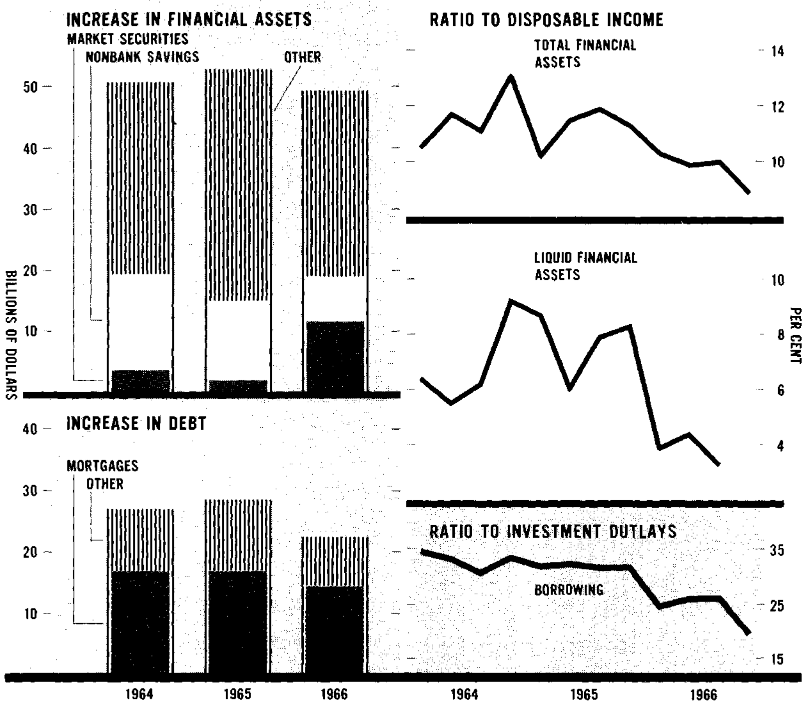
Item	Calendar year			1966, by quarters[1]			
	1964	1965	1966	I	II	III	IV
Mortgages	.3	1.0	3.5	4.6	4.1	3.1	2.4
Loans—Total	3.5	3.7	3.9	6.7	5.8	3.3	−.1
To savings and loan assns.	.5	.7	.9	2.8	2.3	1.1	−2.5
To all businesses	.9	1.0	1.0	1.7	1.0	.9	.7
To others[2]	2.1	2.0	2.0	2.2	2.5	1.3	1.7

[1] Quarterly totals at seasonally adjusted annual rate.
[2] Loans to consumers, State and local governments, and foreigners.
NOTE.—Flow of funds data. Data for fourth quarter of 1966 are preliminary.

Consumers. The increased volume of securities offered by corporations and the Federal Government, the reduced pace of acquisitions of Treasury issues by financial institutions, and restrictive monetary policy led to a sharp rise in the yields on market securities over the first three quarters of 1966. Reacting to these higher yields, consumers purchased a record $11.5 billion of securities over the year, more than four times the amount they acquired in 1965. Most of the increase represented purchases of Federal, State, and local government obligations.

The larger purchases of open market securities by consumers apparently were made at the expense of their money holdings and their acquisitions of deposits and shares at financial institutions. The increase in their time and savings deposits at commercial banks was somewhat less rapid than in 1965, and the increase in their deposits and shares at nonbank institutions was only a

7 **CONSUMERS increase their purchases of securities, while acquiring fewer financial assets and borrowing less**



Flow of funds data. Consumer sector includes nonprofit institutions. Increase in total financial assets excludes investment in noncorporate business and net security credit, with security credit subtracted from market security acquisitions. Mortgages are 1- to 4-family and other. Liquid financial assets are money, deposits at commercial banks and other financial institutions, U.S. savings bonds, and short-term marketable U.S. Govt. securities, all less security credit. Borrowing/investment ratio is consumer borrowing by mortgages, consumer credit, and bank and other loans (except security credit) divided by value of residential construction, nonprofit plant and equipment outlays, and outlays for consumer durable goods. All ratios based on quarterly totals at seasonally adjusted annual rates. Data for fourth quarter of 1966 are preliminary.

little more than half that of the previous year. Indeed, the proportion of financial asset acquisitions allocated by consumers to nonbank deposit-type claims was the smallest in the postwar period. In the last quarter of the year, however, when market yields began to decline and many financial institutions took advantage of new regulations to raise their offering rates, consumers stepped up their acquisitions of nonbank deposits and shares and reduced their purchases of market securities. Their acquisitions of time and savings deposits at banks continued to slow, in part because many banks were required to lower their deposit rates in compliance with the lower rate ceilings on time deposits enacted in September.

Despite record purchases of market securities, total acquisitions of financial assets by consumers declined in 1966. One reason was that their disposable income grew at a slower rate. Personal incomes continued to mount as fast as in 1965, but higher social security taxes and increased withholdings of income taxes cut deeply into this growth. Another factor was that the supply of consumer credit—particularly mortgage credit—was reduced and consumers had to finance a larger share of their outlays out of income; they were thus left with smaller amounts of surplus funds to put into financial assets. Indeed, the proportion of consumer expenditures for durable goods and housing financed on credit was the smallest since 1961.

Instalment credit outstanding increased by $6.1 billion, or about three-fourths of the record amount in 1965. Much of the reduction in growth was in automobile credit, but the expansion in personal loans and repair and modernization loans was also more moderate. The slowdown was most noticeable in the spring and fall, times of relative weakness in consumer demands for automobiles and other durable goods. In addition, as the supply of credit available to them became more limited and the cost greater, consumer credit lenders adopted increasingly restrictive lending policies; they screened credit applications more carefully, and they raised charges on many types of consumer loans.

State and local governments. In 1966 net new issues of securities of State and local governments rose somewhat less than in 1965. Their gross issues of long-term bonds were about the same as in the previous year—the first time since 1960 that the volume of such issues did not register a significant year-to-year increase—and their short-term issues contracted. The failure of long-term issues to exceed the 1965 pace reflected the higher level of interest rates; some interest-sensitive borrowers voluntarily postponed issues, while others were forced to defer financing because of statutory and other interest rate limitations. However, funds raised to finance new construction actually rose by 5 per cent in 1966, and only the much smaller volume of refunding issues kept total gross long-term issues from rising above the 1965 level.

The sharp cutback in short-term financing by State and local governments reflected chiefly the rapid increase in tax receipts and Federal grants-in-aid, which not only sharply increased the surplus of these governments but also reduced their need to borrow in anticipation of tax revenues. The increased revenues also help to explain why State and local government postponements of long-term borrowing did not appear to necessitate the substitution of short-term funds for financing construction projects under way.

The increase in financial assets administered by State and local governments, including those related to employee retirement systems, was only moderately larger than in 1965. However, in response to higher yields, these funds were used mostly to buy corporate securities, providing support to the market in a year of record offerings.

Rest of the world. Pressures on domestic financial markets in 1966 tended to restrain outflows of U.S. private capital, to increase inflows of foreign funds to U.S. financial markets, and to change the composition of assets acquired by foreigners.

The reflow of bank funds from abroad was an important factor in holding down net outflows of U.S. private capital. Bank credits to foreigners in the form of loans and acceptances, after expanding by a record $2.1 billion in 1964 and by $300 million in 1965, declined by more than $200 million in 1966. Long-term foreign credits by U.S. banks fell substantially, as repayments and amortization of earlier credits exceeded new disbursements; short-term credits to foreigners showed a small increase.

Relatively unfavorable terms available in this country to foreign borrowers in 1966 reinforced the cooperative efforts of U.S. banks under the VFCR program. When new guidelines for banks were issued in late 1966—as described on pages 37–42—outstanding foreign credits by U.S. banks were more than $1 billion below the target ceiling that had been established in December 1965. In addition, foreign private investors increased their purchases of securities offered abroad by U.S. companies to finance foreign direct investments in a manner consistent with the voluntary program of the Department of Commerce.

The net total inflow of foreign capital, liquid and nonliquid, amounted to almost $3 billion in 1966. Foreign official holders' claims on the United States were reduced. But dollar borrowings by U.S. banks through their foreign branches from foreign depositors exceeded $2½ billion. These borrowings reflected efforts by large domestic banks to supplement their financial positions by drawing on the Euro-dollar market, particularly at those times when they faced slow growth, and then declines, in their total time deposits after midyear.

The composition of foreign dollar asset acquisitions in the United States changed considerably in 1966. In part as a result of changes in yield relationships, foreign holders and international institutions liquidated more U.S. Government obligations than in any other postwar year and increased their holdings of other credit market instruments—mainly time deposits with maturities of more than 1 year and Federal agency issues—at a record rate.

The U.S. gold stock declined by $571 million in 1966—of which foreign purchases accounted for $430 million net, about one-third as much as in 1965. The gold outflow was held down by the high yields available on dollar assets—both in this country and in the Euro-dollar market—which induced foreign private investors to hold dollars that might otherwise have accrued to foreign central banks.

FINANCIAL INTERMEDIATION

In 1966, the public's increased purchases of market securities and reduced acquisitions of claims on financial institutions limited the ability of these institutions to extend credit. As a result, the share of all credit supplied by financial institutions declined sharply.

Nonbank financial institutions. Financial institutions other than commercial banks added about one-fifth less to their assets in 1966 than they had in 1965, and their share of total funds supplied to credit markets declined to the lowest level of the postwar period. Virtually all of the reduction in asset growth occurred at depositary-type institutions—chiefly savings and loan associations, but also mutual savings banks. At life insurance companies, changes in interest rate relationships influenced the composition of assets acquired, but because of the contractual nature of their net savings inflows, their total asset growth was little affected. For the same reason, growth of assets in pension funds was not significantly affected.

Depositary institutions. The much smaller inflows to nonbank depositary institutions in 1966 reflected, on the one hand, high and rising yields on market instruments and continued aggressive competition of commercial banks, and on the other, a general reluctance or inability on the part of these institutions to raise rates on their own deposits and shares. The latter stemmed largely from the relatively fixed returns and long-term character of their investment portfolios—which had been acquired when rates were generally appreciably lower and which inhibited these institutions from raising rates paid on claims. In addition, during much of the year savings and loan associations were further constrained from raising rates by regulatory restrictions on Federal home loan bank advances. Under these circumstances, claims on nonbank institutions became increasingly less attractive than market instruments during the first three quarters of the year, and public acquisitions of savings and loan shares and mutual savings bank deposits were sharply reduced.

As investors shifted to higher-yielding financial assets, dollar inflows at savings and loan associations in 1966 dropped to the lowest volume since 1952, and inflows at mutual savings banks dropped to the smallest level since 1961. Inasmuch as these two types of institutions generally account for more than one-half of all new residential mortgage credit, this reduction in their net inflows of funds caused a sharp reduction in supplies of mortgage credit and a consequent further marked increase in interest rates on mortgages. While other factors were also involved, these unfavorable financial conditions contributed to a substantial decline in the volume of new mortgage commitments and in housing starts in 1966.

During the first quarter of 1966 seasonally adjusted net inflows of funds to savings and loan associations declined to the lowest amount in almost 10 years. Then in April there was a very large net withdrawal of share capital following the crediting of March dividends. Until this point, the associations had generally maintained loan commitments at their earlier levels despite the decline in first-quarter inflows. However, the April experience caused them to reduce new loan activity abruptly, for it indicated not only that the associations were overcommitted in relation to current savings flows but also that net inflows were likely to deteriorate further, particularly in July when share capital withdrawals normally reach a seasonal peak.

At midyear—subsequent to a Federal Home Loan Bank Board decision to relax its earlier restrictions on advances to associations that raised their rates—some associations raised their dividend rates. But in spite of this action, competitive pressures on interest rates led to a record volume of aggregate withdrawals of share capital in July. Because of the April withdrawals and the generally reduced pace of new inflows, share capital at savings and loan associations showed the smallest seasonally adjusted second-quarter increase since the late 1940's; and in the third quarter, which included large withdrawals in July, the increase was the smallest postwar quarterly expansion experienced by the industry.

In the face of heavy gross withdrawals, savings and loan associations increased their borrowing at the Federal home loan banks to a record amount. However, to avoid adding to pressures in capital markets by further increases in its own borrowing, the Federal Home Loan Bank Board felt constrained to husband the banks' lending power so that they would be in a position to cover withdrawals at member associations. For this reason, advances for purposes of expanding mortgage credit had to be dis-

TABLE 6

NONBANK DEPOSITARY INSTITUTIONS:
NET INFLOWS AND NET MORTGAGE ACQUISITIONS
(In billions of dollars)

Item	Calendar year			1966, by quarters[1]			
	1964	1965	1966	I	II	III	IV
Mutual savings banks:							
Savings deposits	4.2	3.6	2.6	2.8	1.0	3.0	3.8
Mortgage acquisitions	4.4	4.1	2.8	3.0	2.0	3.0	3.1
Savings and loan assns.:							
Savings shares	10.6	8.4	3.5	5.7	1.7	1.2	5.6
Mortgage acquisitions	10.4	8.9	3.6	8.3	5.1	.5	.7
Memo: Borrowing from FHLB	.5	.7	.9	2.8	2.3	1.1	−2.5

[1] Quarterly totals at seasonally adjusted annual rates.

NOTE.—Flow of funds data. Mortgages are 1- to 4-family and other. Data for fourth quarter are preliminary.

continued after early spring; in addition, member associations were required to draw down their liquid assets before they could borrow from the system against share capital withdrawals. With loanable funds from both the public and the home loan banks thus constricted, new loan commitments by savings and loan associations were at very low levels throughout the summer and early fall. By the end of the third quarter, with the backlog of outstanding commitments worked down, new mortgage acquisitions by savings and loan associations were no larger than the amounts received as repayments.

Like savings and loan associations, the nation's mutual savings banks experienced sharp declines in deposit growth during 1966. However, reduced inflows were neither so severe nor so prolonged. Growth in seasonally adjusted savings deposits slowed sharply in the first quarter, and a record net outflow in April, followed by slow growth in May and June, reduced the seasonally adjusted second-quarter net inflow to the lowest level since late 1959 and early 1960. Early in July, however, most large savings banks increased their dividend rates to 5 per cent, and net inflows of funds increased.

While reduced net inflows at savings banks led to some reduction in mortgage commitments and acquisitions, these declines were less severe than at savings and loan associations. The ability of the mutual savings banks to better maintain their mortgage acquisitions reflected not only their deposit experience but also their more diversified portfolios, which permitted them to liquidate other securities in order to limit the reduction in their mortgage lending.

In late September the Federal Home Loan Bank Board, operating under new legislative authority, and the Federal Deposit Insurance Corporation established ceiling rates on deposits and shares for the first time. These ceilings, by modifying previous regulations on Federal home loan bank advances, permitted many savings and loan associations to raise their dividend rates. By that time market rates of interest had reached their peaks and had begun to decline, and rates on consumer-type time deposits at a number of the more aggressive commercial banks had been rolled back from 5½ to 5 per cent. As a result of these developments, growth of share capital at the savings and loan associations improved substantially during the fourth quarter, and savings bank deposits also increased more rapidly.

At first, savings and loan associations used their enlarged savings flows mainly to repay borrowings from the Federal home loan banks and to rebuild liquid assets. Savings banks also added to their depleted liquid assets. By the year-end, however, some savings and loan associations were beginning to make new loan commitments more freely, and savings banks had resumed a more nearly normal mortgage lending pattern, thus contributing to a generally improved tone of the mortgage market.

Other institutions. Insulated by the contractual nature of their cash inflows, life insurance companies acquired as many financial assets in 1966 as in the previous year, despite the pressures on financial markets. However, the effects of higher interest rates and general credit restraint caused some unexpected drains on the supply of lendable funds available to these companies.

For example, most life insurance companies are committed to extend policy loans at rates no higher than 5 per cent. Thus, as rates on other forms of credit were increased and the availability of credit was reduced, policy loans became an attractive means of borrowing. These loans grew from less than 5 per cent of the lendable funds at life insurance companies in the fourth quarter of 1965 to nearly 20 per cent in the third quarter of 1966; at some institutions the rate of expansion was even more rapid. Because these companies generally make loan commitments far in advance, on the basis of normally predictable projections of cash availability, the rate of increase in policy loans in 1966, and the large potential for still further increases, created widespread concern among life insurance company officials.

A decline in mortgage prepayments also reduced the volume of cash available to meet commitments below expected levels. This change reflected the reduced turnover of existing homes and the smaller volume of refinancings caused by the tight mortgage market. In addition, withdrawals of policy proceeds that had been left on deposit with life insurance companies increased as the public took advantage of the higher yields available on market securities. Life insurance companies were thus forced to draw down cash balances, liquidate securities, reschedule mortgage acquisitions, borrow at banks, and stretch out new commitments to prepare themselves for meeting takedowns on large outstanding obligations.

The easing of tensions in financial markets in the fourth quarter also reduced these pressures on life insurance companies. Increases in policy loans tapered off, and the supply of funds immediately available came into better balance with takedowns on outstanding commitments. By the year-end some companies had again begun to increase loan commitments.

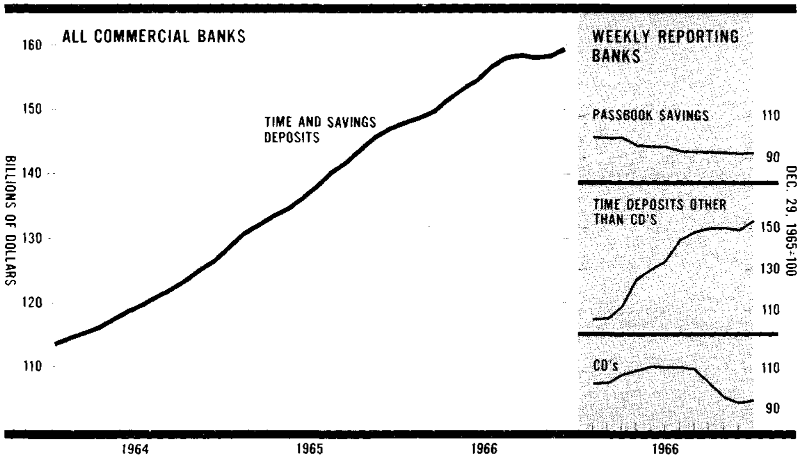
As would be expected, inflows to other types of insurance companies and to pension funds were not greatly affected by rising interest rates. However, finance companies—confronted with record borrowing costs and reduced availability of bank credit, as well as some cutback in consumer demands for credit—added only a little over $3 billion to their loans, considerably less than the record increase in 1965. For 1966 as a whole, finance companies reduced their bank debt for the first time since 1960, and they raised a record $3.2 billion through the sale of open market paper.

Commercial banks. In 1966, commercial banks provided almost $17 billion of credit, or less than one-fourth of total funds supplied to credit and equity markets—their smallest share since 1959. The decline in the bank share from an average of more than one-third in the 1961–65 period reflected mainly the reduced demand by the public for time and savings deposits associated with their increased purchases of securities.

Time deposits. From the end of 1961 through 1965 net inflows of time and savings deposits to banks had increased at an average annual rate of 15 per cent, in large part because four increases in Regulation Q ceilings permitted banks to maintain relatively attractive offering rates on such deposits. During the first 8 months of 1966, as banks took advantage of the higher rate ceilings on time deposits established in December 1965, their time and savings deposits continued to increase, but at a somewhat slower annual rate—11 per cent.

While the slowing of inflows was modest during January–August, the composition changed dramatically. After the prime rate was raised to 5½ per cent in March, large banks began aggressively to seek negotiable CD's in large denominations. During the first half of 1966, banks increased their outstanding CD's by $1.6 billion, most of which occurred after mid-March. But with the cost of CD's rising sharply and with the ceiling rate on passbook savings accounts unchanged, banks turned increasingly to other forms of time deposits—especially those designed for consumers.

8 | **TIME DEPOSIT** growth slows in '66 and **COMPOSITION OF NET INFLOWS** changes sharply



Total time and savings deposits are seasonally adjusted monthly averages of daily figures and exclude domestic interbank and U.S. Govt. deposits. Data have been adjusted to eliminate the effect of a reclassification of deposits in June 1966. Data for weekly reporting banks are as of the last Wednesday of each month, and are not seasonally adjusted. The effect of a change in the reporting panel of weekly reporting banks at the end of June 1966 has been eliminated by subtracting from figures for each of the last 6 months the difference between the two sets of data at midyear.

At the large weekly reporting banks, consumer-type CD's began to rise sharply in early 1966 as banks offered higher rates on small-denomination time deposits. Passbook savings accounts, on the other hand, with their less attractive yields, declined abruptly because the more interest-sensitive depositors shifted their funds to other financial assets. Indeed, a large proportion of the growth of consumer time deposits resulted from shifts out of passbook savings accounts. Banks were not able to maintain their share of the consumer savings market by issuing time deposits, however, because consumers increasingly shifted their savings flows to direct purchases of market securities; at large weekly reporting banks the combined inflow of savings deposits and consumer-type time deposits generally remained below the pace of 1965.

In the late summer, inflows of interest-bearing deposits to banks slowed considerably, particularly at the large banks, which had been large issuers of CD's. As early as midyear, typical offering rates on 90-day CD's had reached the 5½ per cent ceiling, and CD growth ceased as banks replaced their maturing paper with 30- to 90-day maturities. However, by early August, rates on these shorter-term deposits had also reached 5½ per cent, and with yields on other money market instruments above the ceiling rate, banks found themselves unable to replace all of their maturing paper. Between mid-August and mid-December banks lost $3.2 billion of large-denomination CD's, mainly in September and October. It was to supplement their resources and to help offset this outflow that large banks in the second half of 1966 borrowed more than $2 billion through their foreign branches—mainly in Euro-dollars.

Over the period that large banks were losing negotiable CD's, inflows of consumer-type time deposits slowed—and some banks had net outflows. The development reflected both the late September rollback to 5 per cent of ceiling rates on time deposits below $100,000 and the movement of some funds into longer-term market instruments with higher yields.

As a result of outflows of negotiable CD's and the moderation in other time deposit inflows, the seasonally adjusted annual rate of growth of total interest-bearing deposits at all commercial banks (excluding the funds obtained through foreign branches) slowed. Growth during the 3 months September–November was at an annual rate of less than 1 per cent; in fact such deposits declined in October—for the first time since 1960. Large banks lost deposits during the 3 months. But the smaller country banks —with fewer interest-sensitive depositors—continued to attract total time and savings deposits at the 10 to 11 per cent rate prevailing earlier in the year—only slightly below the 1965 pace.

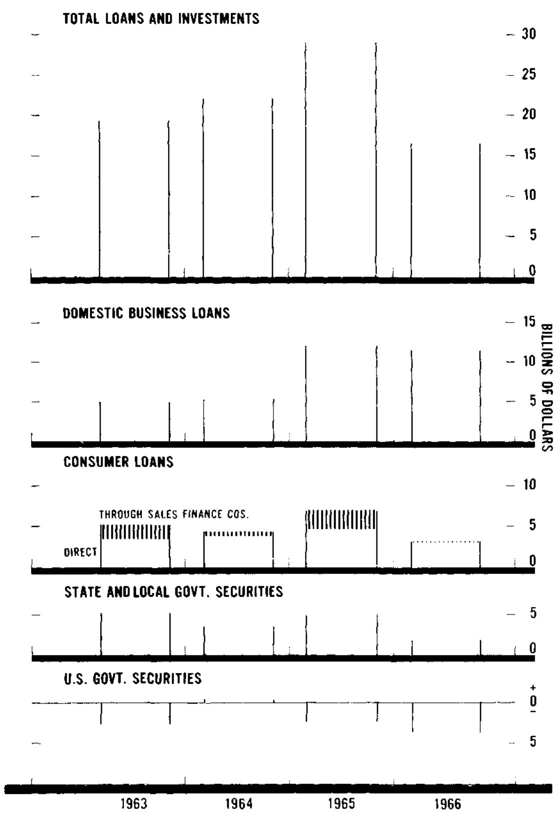
In December, rapidly declining market yields restored the relative attractiveness of time deposits, and these deposits rose at a seasonally adjusted annual rate of 9.1 per cent. Despite a record $5.6 billion of CD maturities during the month, banks were able to add to their outstanding negotiable CD's; their consumer-type time deposits also rose somewhat.

Bank credit. Continued relatively large inflows of time deposits permitted banks in the first half of 1966 to expand credit at a rate only slightly below their postwar record pace of over 10 per cent in 1965. In the second half of the year, as time deposit inflows moderated—and monetary policy became more restrictive until fall—bank loans and investments expanded at a much slower pace. For all of 1966, bank credit expanded about 6 per cent, a little more than half the pace in 1965, and banks reduced their total holdings of securities for the first time since 1959.

Over the first 7 months of the year, with business demands for credit large, and with time deposit inflows relatively well maintained, banks increased their business loans at an annual rate of more than 20 per cent, despite three increases in the prime rate over this period. These demands for credit reflected the large and rising external financing requirements of businesses, and borrowing in anticipation of more severe credit stringencies and to help finance acceleration in tax payments. Demands were generally broad-based but were particularly strong on the part of manufacturers of machinery and transportation equipment—a group under great pressure from the accelerated pace of capital outlays and/or defense expenditures.

Despite the large inflows of time deposits, banks found it increasingly necessary to cut back on additions to other parts of their portfolios in order to maintain this rate of business loan expansion. Treasury issues were liquidated, but requirements that these securities be held against public and other deposits and the already low levels of holdings of Government securities limited the ability of many banks to liquidate enough of these issues to accommodate the intense business loan demands. Consequently, large banks reduced the rates at which they were acquiring State and local bonds and expanding nonbusiness loans; they also raised their standards for business and other credits.

9 | BANK CREDIT expands less rapidly in 1966



Flow of funds data. Business loans are to all domestic nonfinancial businesses and include commercial paper and domestic acceptances. Consumer credit includes loans to, and purchases of commercial paper issued by, finance companies. U.S. Govt. securities include nonguaranteed debt of the U.S. Govt. and loan participation certificates.

After midyear, business demands for loans apparently remained large, and with time deposit inflows leveling off, banks again raised the prime rate—to 6 per cent—in August. In addition, large banks became sellers of tax-exempt and agency securities and reduced their loans to finance companies. Large money market banks also cut back on their loans to security dealers by raising interest charges to very high levels. Bank loans to foreigners were also reduced over the year.

These adjustments in bank portfolios had a large impact on key credit markets. For example, banks' net acquisitions of State and local government bonds—which on the average had equaled about 75 per cent of the net volume of new issues in 1962–65—declined to 40 per cent of new issues in the first half of 1966 and to less than 20 per cent in the second half. Furthermore, reductions in credit extended by banks to sales finance companies had a significant effect on the banks' share of the total consumer credit market. In terms of their direct loans to consumers, the banks' share of the consumer credit market declined only slightly—from about 50 per cent in 1965 to less than 45 per cent in 1966. But when their credits to finance companies are included, their share of total consumer credit financing declined from almost three-fourths in 1965 to less than one-half in 1966. Banks also reduced somewhat the rate at which they acquired mortgages in 1966. Nonetheless, with total mortgage financing declining, banks accounted for slightly more than the nearly one-fifth of the mortgage market they had in 1965.

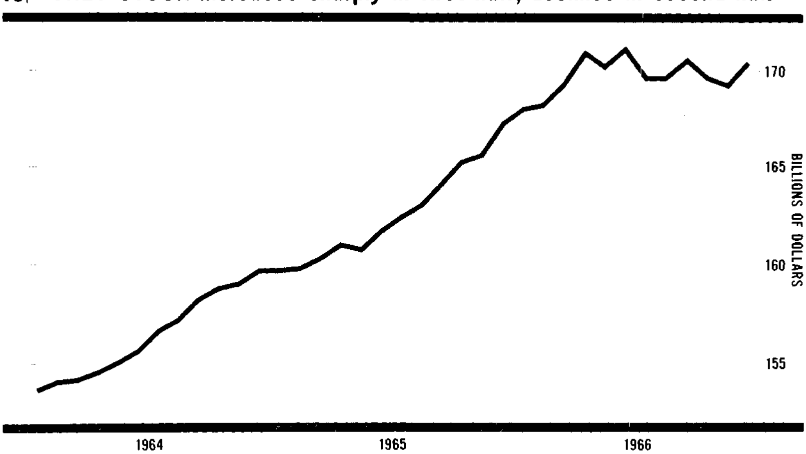
These portfolio adjustments contributed to intense financial pressures in some credit markets, particularly during the summer. It was in an effort to reduce these pressures that the Federal Reserve Bank Presidents on September 1 sent letters to member banks requesting them to rely more on curtailment of business loans—and less on other parts of their portfolios—in adjusting to liquidity pressures.

During the late summer and early fall, bank credit declined. As the cumulative impact of monetary policy curtailed deposit inflows and eroded bank liquidity and as business demands for credit—including loans to meet tax payments—abated, growth in business loans also slowed substantially. In the final 5 months of the year growth in such loans moderated to an annual rate of less than 5 per cent, compared with more than 20 per cent earlier in the year.

With demands for credit reduced and with signs that the pace of economic expansion was moderating, monetary policy was eased in the late fall. Business loans did not expand, however, and banks began to rebuild their liquidity, an adjustment that is typical of early stages of relaxation of monetary restraint. After mid-November, bank holdings of securities rose sharply. In December, with time deposit inflows rising faster and reserve availability increased, bank loans and investments increased by $2.3 billion, seasonally adjusted—the largest monthly increase since midsummer.

Money stock. In the first half of 1966 the private money stock increased at a seasonally adjusted annual rate of 4.7 per cent—

10 | MONEY STOCK increases sharply in first half, declines in second half



Seasonally adjusted monthly averages of daily figures. Money stock consists of demand deposits and currency outside the Treasury, the FR System, and the vaults of commercial banks. Demand deposits exclude those due to domestic commercial banks and the U.S. Govt., cash items in process of collection, and FR float, but include foreign demand balances at FR banks.

the same as for the year 1965. Reflecting the increased pace of economic activity, the turnover of demand balances at banks outside of New York also rose sharply because of increased efforts to economize on cash in response to rising interest rates.

As interest rates continued to increase after midyear, and then later as industrial production moderated, the money stock declined and the rate of growth of the turnover of demand deposits slowed. From midyear through mid-November the money stock declined at an annual rate of 2.4 per cent. About mid-November the money stock began to increase again—due in part to the downturn in market yields, and in part to a sharp decline in Treasury cash balances; late in the year it rose at a rate of more than 7.0 per cent.

CREDIT MARKETS AND INTEREST RATES

Interest rates rose sharply in the first 8 months of the year and many would-be borrowers—especially in mortgage markets—found their ability to obtain credit reduced. Most interest rates reached their peaks in late summer and then turned down. By the year-end a large share of the year's rise had been erased. Within this general profile, however, interest rate movements were not continuous but showed important temporary deviations from the dominant trend in accordance with variations in supply–demand pressures and expectations.

Early in the year market yields rose steeply. Heavy business demands for credit caused an increase in the number of offerings scheduled in capital markets and contributed to an acceleration in sales of securities by banks. Borrowing by Federal and State and local governments was also large. At the same time, the pace of the rate upswing was intensified by expectations of greater monetary restraint.

Expectations ran ahead of the more basic demand–supply forces until near the end of the first quarter when rates turned down. Much of this decline stemmed from the presumption that

TABLE 7

SELECTED INTEREST RATES, 1966
(Per cent per annum)

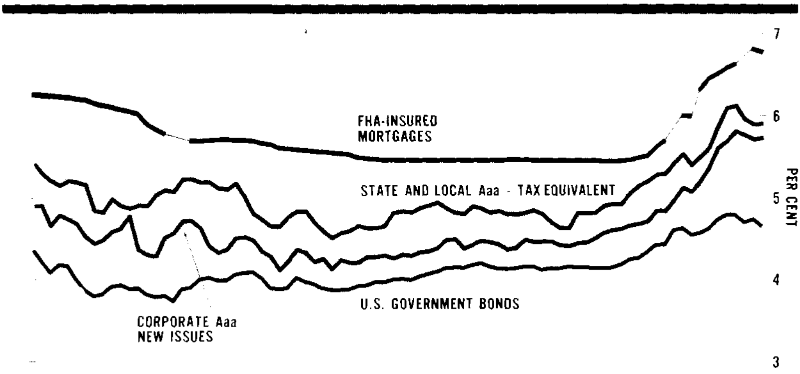
Type of rate[1]	Net change: 12/31/65 to 1966 high	Net change: Date of high	Net change: 1966 high to 12/31/66	Level on 12/31/66
Short-term				
3-mo. Treasury bill	+1.05	9/23	− .72	4.80
6-mo. Treasury bill	+1.26	9/23	−1.00	4.92
Finance company paper	+1.13	{10/22 to 12/31}	.00	5.88
Federal funds	+1.33	11/16	− .39	5.57
Medium-term				
3–5-year U.S. Govt	+ .93	9/2	− .97	4.86
Long-term				
U.S. Govt	+ .43	9/2	− .33	4.54
Corporate (new issues)[2]	+1.12	9/2	− .47	[3]5.51
Municipal (Moody's Aaa)[4]	+1.00	8/26	− .47	5.83
Conventional mortgages (FHA series, new homes)	+ .70	Oct.-Nov.	− .05	6.65

[1] Weekly averages except for conventional mortgage rate, which is monthly.
[2] Adjusted to an Aaa basis.
[3] Week of Jan. 6, 1967.
[4] Tax-equivalent yield calculated for individuals in the 36 per cent personal income tax bracket.

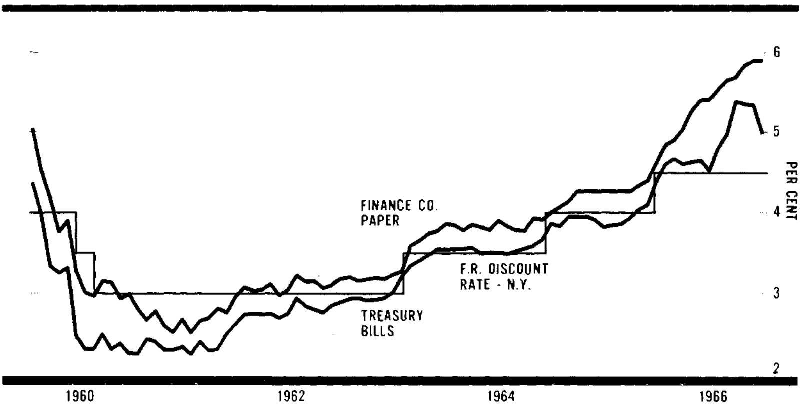
the administration would ask for a Federal tax increase by mid-year. But rate pressures also moderated because of a brief pause in demands for long-term funds and because of scattered signs of slower economic expansion—notably in the auto industry—which led to some readjustment of expectations about the pace of the economic boom.

As the second quarter progressed it became evident that slackness in the economy was limited chiefly to autos and housing and that substantial further growth in aggregate spending could be expected in the third quarter. With business credit demands at new records and with a growing consensus that no tax increase was forthcoming, upward pressures on interest rates were renewed. Efforts of banks to accommodate expanded business loan demands—by selling assets, rationing other types of credit, and competing more actively for savings—put special pressures on rates in money and securities markets and spread the effects of growing policy constraints to other types of lenders.

11 | **INTEREST RATES in 1966 rise steeply until September and then decline in both LONG-TERM**



and SHORT-TERM markets



Monthly averages of daily figures except for mortgages (based on quotations for 1 day each month). Yields: FHA-insured mortgages, weighted averages of private secondary market prices of certain new-house mortgages converted to annual yield; State and local Aaa—tax-equivalent, from Moody's Investors Service, adjusted to a tax-equivalent basis assuming a 36 per cent individual income tax rate; Corporate Aaa new issues, calculated from bonds rated Aaa, Aa, and A by Moody's Investors Service and adjusted to an Aaa basis; U.S. Govt. bonds, due or callable in 10 years or more; U.S. Treasury bills, market yields on 3-month issues; and finance company paper, 3- to 6-month directly placed paper.

While the major impact of these influences on other lenders was centered in mortgage markets, there was also a substantial shrinkage in the amount of funds insurance companies had available for private placements. Businesses were thus forced to finance a larger share of their total needs through public offerings of longer-term securities. In addition, the shrinkage in flows to mortgage markets increased pressures on the resources of the Federal Home Loan Bank System and the Federal National Mortgage Association, and in turn greatly expanded the volume of security offerings by these two agencies.

Treasury bill rates, on the other hand, declined during the spring. The resultant widening of spreads between bill rates and other short-term rates—particularly on newly issued short-term offerings of Federal agencies—reflected the very large net reduction—$7 billion—in Treasury bills from March through June. This reduction was possible because normal seasonal inflows of funds were augmented by accelerated tax payments and by sales of PC's.

From the end of June to the end of September, however, Treasury bill rates rose more than 100 basis points. To a large extent, the advance was caused by the expansion in actual financing needs of the U.S. Government—including a $3.5 billion increase in outstanding bills—and in its anticipated needs. As bill rates rose relative to the 5½ per cent ceiling rate on bank CD's, the resulting constraints on bank credit availability caused a further increase in the prime rate to 6 per cent and reinforced the general advance in other short- and long-term rates. In addition, costs of financing made it more difficult and expensive for dealers and underwriters to take positions and thus impeded secondary market trading in securities markets as well as the distribution of new securities. Moreover, with large city banks facing a sizable net runoff of their near-dated CD's and with new loan commitments at some life insurance companies being drastically curtailed, many market participants began to wonder whether a serious imbalance might not develop between available funds and prospective credit demands during the autumn.

In these circumstances, money market banks attempted to anticipate expected net runoffs of their CD's in September by liquidating large blocks of municipal securities. At the same time, some large corporations moved to float new security issues in the capital markets in what is usually a slack period of financing. Both actions accentuated interest rate increases and contributed to market fears of a severe credit squeeze.

Expectations again ran ahead of basic supply–demand factors, however, and by early September the steep summer advance in long-term rates began to be reversed. Some of the decline reflected the response of administration policies to the August upsurge in rates—for example, the request for temporary suspension of the investment tax credit, the announcement that non-military Federal spending would be cut, and that Federal agency borrowing from the public as well as further PC sales would be postponed until market pressures abated, and indications that further tax action might be requested to balance potential increases in spending for the Vietnamese war.

After early September several factors reinforced the general decline in bond yields, which by late September began to influence the most sensitive short-term rates as well. These included the reduction in credit demands due in part to previous anticipatory borrowing and evidence suggesting that economic and financial developments in the private sector might not meet earlier market expectations. Some of the decline in rates was temporarily offset in November when a heavy year-end buildup in capital market financing by businesses and State and local governments threatened to combine with usual year-end money market pressures to create renewed financial market stringency. But evidence suggesting that the pace of economic activity might be slowing, and that the Federal Reserve's policy of monetary restraint had been moderated, subsequently created market expectations that interest rates would decline further.

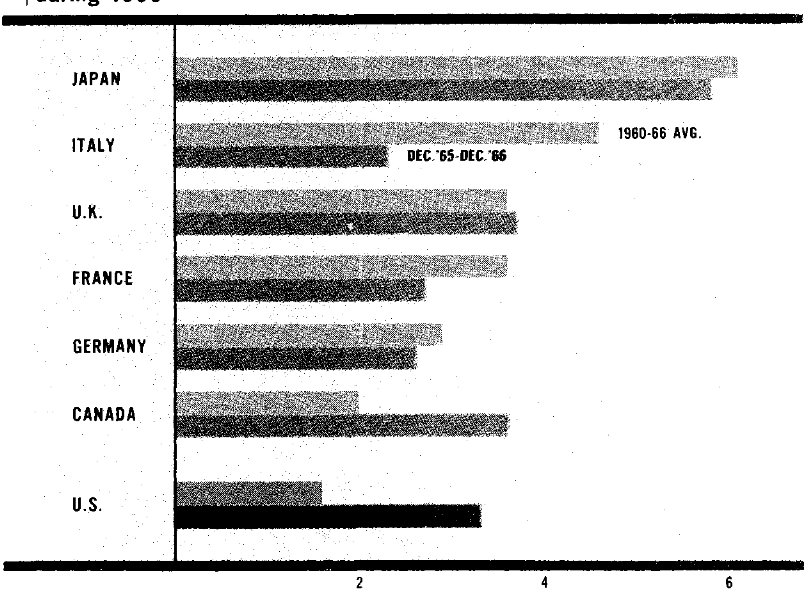
In these circumstances, the large volume of capital market offerings in December was quickly distributed at declining rates, and money market conditions eased substantially. By the year-end, Treasury bill rates had erased two-thirds to four-fifths of their rise from the preceding December; long-term bond yields had offset about two-fifths to three-quarters of theirs. At these lower yields, bank CD's and other deposits and shares at financial institutions became more competitive, and flows to financial institutions increased dramatically.

U.S. BALANCE OF PAYMENTS

War in Vietnam and excessive demand pressures in the domestic economy prevented any significant further adjustment of the U.S. balance of payments toward equilibrium in 1966. A sharp deterioration in the balance on goods and services was offset by an improvement on capital account. But the drain on U.S. monetary reserves continued at a pace that, while slower than in 1965, was more rapid than in the two preceding years.

The net deterioration on current account in 1966 could be attributed in large part to cyclical forces of excess demand that lifted merchandise imports well above trend before they began to level off toward the end of the year. However, a renewed advance in domestic prices and costs, after several years of better price–cost performance in this country than abroad, indicated an interruption of the fundamental competitive adjustment that had been under way earlier.

12 **CONSUMER PRICES rise as much in U.S. as in most other countries during 1966**



The capital account benefited greatly from the effects of unusually tight domestic credit conditions, reinforced by the interest equalization tax (IET) and by voluntary programs to restrain net outflows of U.S. capital; it also benefited from some large official transactions. Toward the year-end, when some easing of the credit stringency became appropriate for domestic needs, it became clear that the capital account was in danger of worsening again as the current account improved. Hence, the voluntary restraint programs were tightened and extended through 1967, and in January 1967 the administration proposed a 2-year extension of the IET and greater flexibility in its application.

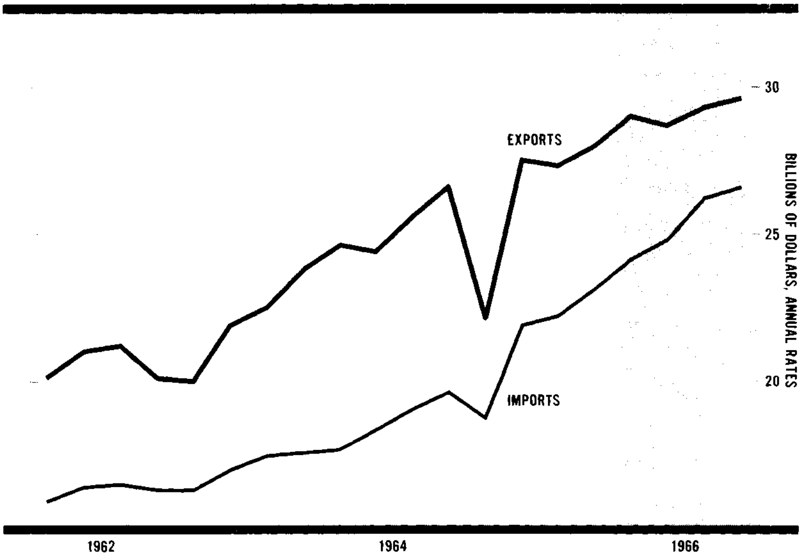
The over-all payments deficit measured on the liquidity basis remained about unchanged in 1966, $1.4 billion compared with $1.3 billion the year before. U.S. official reserve assets declined by $568 million, and total U.S. liquid liabilities to foreigners and international institutions increased by about $850 million. In addition, however, long-term time deposits of foreign official and international institutions, which are not counted as liquid, increased by about $900 million. And holdings by international nonmonetary institutions of long-term securities of U.S. Government agencies, which are not direct debt of the U.S. Government and which are also classified as nonliquid, increased by about $250 million.

An alternative measure of the over-all balance—on the basis of official reserve transactions—showed a surplus of $0.3 billion in 1966, in contrast with a deficit of $1.3 billion in 1965. The difference between the two balances reflected an inflow of more than $2 billion of foreign liquid funds through the foreign branches of U.S. commercial banks. This record inflow resulted both from intense pressure on the reserve and liquidity positions of large U.S. banks, which led them to bid aggressively for foreign funds, and from the sterling crisis of the summer, which encouraged shifts of funds out of sterling into dollars. By the end of the year, the inflow appeared to have ceased.

TRANSACTIONS IN GOODS AND SERVICES

The dominant feature of the current account in 1966, as in 1965, was a very rapid rise in merchandise imports. Imports were 19 per cent larger than the year before and 37 per cent larger than in 1964. They would have risen even more if the Government had not released from its stockpiles about $400 million of materials in 1965 and about $900 million in 1966. In each of the

13 **MERCHANDISE IMPORTS rise rapidly until late 1966; trade surplus narrows**



Seasonally adjusted balance of payments data.

past 2 years, imports increased more than twice as fast as GNP. The 1965–66 import boom was the most rapid and sustained, both absolutely and relative to GNP, since 1950–51. It provided early and persuasive evidence of the emergence and persistence of excessive domestic demand pressures.

The surge in merchandise imports was broadly based. Imports of capital equipment rose very sharply—by 41 per cent in 1965 and by 64 per cent in 1966—reflecting intense domestic demand and pressures on capacity in that sector. The rise in imports of nonfood consumer goods was also rapid, even excluding the tripling of automotive imports from Canada under the agreement of 1965 between Canada and this country. And imports of industrial materials and supplies, which account for almost half of total imports, increased by 11 per cent despite the substantial releases of materials from Government stockpiles noted earlier; this rise reflected strong domestic demands for additions to inventories as well as for current use.

Exports of merchandise also increased in 1966. The 11 per cent gain over 1965 was high by historical standards, thanks to a further advance in agricultural exports and strong demands for other products by Canada, Japan, and nonindustrial countries. But with imports rising so much faster than exports, the trade balance shrank to $3.7 billion—its lowest level since 1959—compared with $4.8 billion in 1965 and a peak of $6.7 billion in 1964.

There was also a marked worsening during the year in military transactions in goods and services. Military expenditures abroad increased by about $800 million from 1965 to 1966, and by the end of the year they were running at an annual rate of $3.8 billion, compared with a low of $2.7 billion in late 1964 and early 1965. Nearly all of the increase could be attributed to operations in Vietnam, but outlays in Europe still constituted about 40 per cent of the global total. Meanwhile sales of military goods and services increased by only about $100 million to about $950 million.

Income receipts from foreign investments increased very little more than income payments on the investments of foreigners in the United States. The balance on other service transactions—travel, transportation, fees and royalties, and miscellaneous—also remained about unchanged. Travel receipts increased almost as much as travel expenditures.

The balance on all goods and services shrank to about $5.3

billion, compared with \$7.0 billion in 1965 and \$8.5 billion in 1964. At the end of the year it was running at an annual rate of less than \$5 billion.

FLOWS OF U.S. CAPITAL

Outflows of U.S. private capital—net of investment abroad of funds borrowed abroad for that purpose by U.S. corporations (see below)—declined further in 1966 to about \$3.3 billion. This was the smallest outflow since 1959. During the year the unusually tight credit conditions in the United States became the main force limiting outflows. However, the voluntary restraint programs remained effective, particularly in connection with the financing of direct investments, and the IET continued to deter U.S. purchases of foreign securities and extensions of long-term bank loans.

U.S. banks reduced their claims on foreigners by about \$160 million during 1966, although the voluntary program would have permitted an increase of \$700 million. (The last year prior to 1966 in which U.S. banks reduced their outstanding claims on foreigners was 1953.) Japanese borrowers made substantial net repayments to banks of long- and short-term credits, and European borrowers repaid term loans. Credits to other areas increased only moderately, as U.S. banks adopted an even more restrictive attitude than the voluntary program would have required.

The foreign affiliates of U.S. nonfinancial corporations continued to increase their spending for plant and equipment in 1966, though not so rapidly as in earlier years. But in response to the Commerce Department's voluntary program to limit direct investment outflows of U.S. capital, domestic and foreign affiliates of U.S. corporations borrowed heavily abroad to finance foreign investments, and outflows from the United States net of the use of proceeds of such borrowing declined to about \$3.0 billion from a record \$3.3 billion the year before.

Purchases by U.S. residents of foreign securities newly issued in this country, mainly by Canadian governments and businesses, were smaller in 1966 than in 1965, despite the postponement into early 1966, at government request, of about $150 million of Canadian issues originally scheduled for late 1965. Redemptions of foreign securities held by U.S. residents rose well above the usual level as the Canadian Government redeemed $140 million in advance of maturity—and also purchased bonds of the International Bank for Reconstruction and Development (IBRD) from U.S. holders—in order to fulfill an intergovernmental understanding reached in connection with Canada's exemption from the IET. Finally, U.S. holdings of foreign securities that had not originally been issued in the United States continued to decline, as they had in every calendar quarter since mid-1963, when the IET took effect. Altogether, net U.S. purchases of foreign securities, at about $400 million, were the smallest since 1957.

As the year ended, outflows of U.S. private capital were on the increase. However, the fourth-quarter rise in direct investment outflows may have been only temporary; there was evidence that U.S. corporations, for the first time since 1961, were not planning a large further increase in foreign outlays and that they would continue to seek maximum financing abroad as requested by the Government. It seemed likely, nevertheless, that total outflows could not long remain so far below the long-run trend as they were in 1966 once domestic credit conditions became less tight, although continuation and strengthening of the voluntary restraint programs and the IET insured against a dangerous hemorrhage of the sort experienced in late 1964.

The extension of grants and credits by the U.S. Government to other countries increased by about $400 million in 1966, mainly as a result of larger disbursements by the Export-Import Bank to finance U.S. sales of civilian jet aircraft and military equipment. The United Kingdom made a scheduled year-end repayment on the U.S. loan of 1946—after obtaining waivers in each of the two preceding years—and nonscheduled repayments of $430 million were received, mainly from Germany, Italy, and France, as against only $220 million in 1965; as a result the flow of Government grants and credits net of repayments remained about unchanged, at $3.4 billion.

FLOWS OF FOREIGN CAPITAL

Tight money in the United States had even greater effects in 1966 on flows of foreign capital than on flows of U.S. capital. It led to a massive inflow of foreign private liquid funds, which reduced the dollar holdings of foreign central banks and thus tended to reduce U.S. reserve losses and to support the dollar in foreign exchange markets. Tight money also facilitated shifts of U.S. funds by foreign official and international institutions out of short-term deposits and Treasury securities into somewhat less liquid long-term deposits and nonguaranteed U.S. Government agency securities. These shifts had the effect of preventing the large increase in the liquidity deficit that might otherwise have occurred.

The main inflow of liquid funds came from the Euro-dollar market through the foreign branches of large U.S. banks, as noted earlier. Liabilities of U.S. head offices to their foreign branches increased by more than $2 billion during the year; at the year-end they were triple their level at the end of 1965. Half of the inflow in 1966 occurred in the third quarter when U.S. banks were under the most intense pressure to seek alternative sources of funds to meet domestic credit demands.

Major U.S. investors were not free to take advantage of the high Euro-dollar rates because of the strictures of the voluntary programs against such outflows and the policies of the foreign branches not to accept deposits from U.S. residents. And private foreigners, on balance, apparently did not withdraw significant amounts of funds from this country for placement in Euro-dollar accounts; holdings of liquid assets in the United States by private foreign residents other than banks increased at about the same pace as in earlier years, and holdings of foreign commercial banks other than branches of U.S. banks did not change appreciably.

Therefore, those foreigners who made Euro-dollar deposits with U.S. branches were mainly using dollars that they had acquired (or would otherwise have sold) in foreign exchange markets for other currencies, or that they had obtained by reducing their outstanding dollar loans to other foreigners, who in turn then had to buy more dollars in the foreign exchange markets. The resulting additions to the demand for, and reductions in the supply of, dollars in foreign exchange markets reduced the dollar accruals and holdings of foreign central banks to levels below those they would otherwise have reached.

The Bank of England in particular lost dollars heavily to the market during the summer, when confidence in sterling was at a low ebb. Even though confidence in sterling began to be restored following the restrictive fiscal and monetary actions taken by the British Government in July, high yields on Euro-dollars tended to slow the return flow of funds into sterling.

Later in the year flows of private funds out of assets denominated in continental European currencies and into dollars helped to reduce or reverse the earlier reserve gains of France and other countries. By the year-end, however, the inflow to the United States from the Euro-dollar market appeared to have ceased, and there were signs that U.S. banks were beginning to make repayments to that market as domestic credit conditions eased.

The acquisition by foreign official and international institutions of a substantial volume of over-1-year time deposits and U.S. Government agency securities was only partly related to interest rate considerations. International institutions, notably the IBRD, have for several years invested the proceeds of their new security offerings in the United States in nonliquid U.S. assets, and they have allowed their liquid assets to decline gradually, so as to minimize the adverse impact of their transactions on the U.S. payments deficit as measured on the liquidity basis.

In 1966, however, they invested substantially more in nonliquid assets than they borrowed—about $450 million compared with about $100 million.

A number of foreign central banks placed in the United States a total of nearly $750 million in long-term deposits during the year. The outstanding volume of such deposits had not exceeded $200 million at any earlier time. These placements, and the corresponding reduction in more liquid holdings, served to reduce the liquidity deficit; they did not affect the balance calculated on the basis of official reserve transactions. Liquidation of U.S. securities other than Treasury issues by the British Government worked to increase both measures of the deficit, but such liquidations were much smaller in 1966 than they had been in 1965.

Residents of foreign countries other than the United Kingdom made net purchases of about $130 million of U.S. corporate securities (other than those sold to finance direct investments abroad) in 1966, in contrast to net sales of $130 million in 1965.

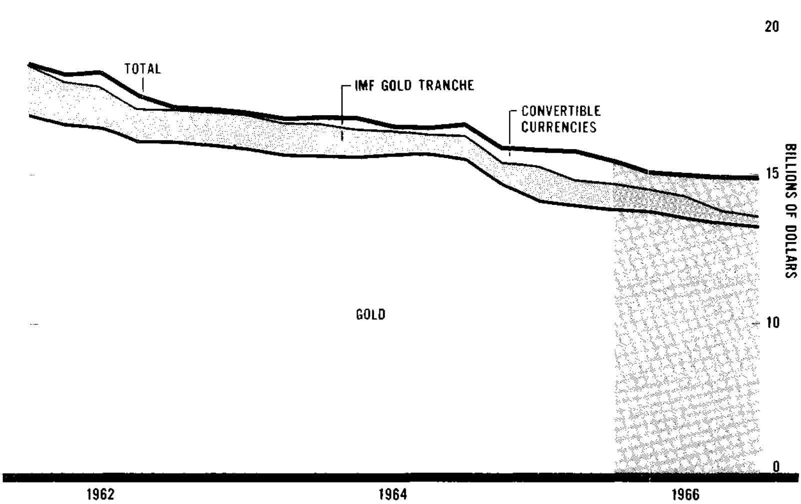
OFFICIAL RESERVE TRANSACTIONS

The United States had a small payments surplus—$270 million—in 1966 as measured on the basis of official reserve transactions. Yet U.S. reserve assets declined, as noted earlier, by $568 million net. The gold stock was reduced by $571 million; sales of $601 million of gold to France during the first 9 months of the year, of smaller amounts to other countries, and of $140 million to domestic users for industrial and artistic purposes outweighed net purchases, including $200 million from Canada, and gold deposits of $177 million made during the year by the International Monetary Fund. In addition, the IMF gold tranche position of the United States was reduced by $537 million net, as the United States drew foreign currencies from the Fund on several occasions (see pages 269-90). On the other hand, the U.S. Treasury and the Federal Reserve added $540 million equivalent to their holdings of foreign convertible currencies during the year.

While U.S. reserve asset holdings declined, U.S. liabilities to foreign official agencies—which constitute an important element in their reserve holdings—declined even more sharply—by $840 million. The decline in liquid liabilities to official holders was considerably greater than this, but there was an increase in certain nonliquid liabilities to foreign central banks and governments, as noted above. The outstanding amount of Treasury securities—some liquid, some nonliquid—denominated in foreign currencies fell from $1,208 million at the end of 1965 to $860 million at the end of 1966.

The favorable balance on the official reserve transactions basis was clearly temporary, depending heavily as it did upon a massive inflow of foreign private liquid funds. At the year-end it appeared that some of these funds were flowing out again as domestic credit conditions eased.

14 U.S. RESERVE ASSETS continue to decline in 1966



During most of the postwar period, deficits in the U.S. balance of payments have been financed in part by increases in U.S. liabilities to foreign central banks and governments and only partly through declines in U.S. reserves. Thus these deficits have added more to the reserves of other countries than they have subtracted from U.S. reserves.

In 1965, however, this situation changed. In that year the U.S. deficit on the reserve transactions basis was financed almost entirely by a reduction in U.S. reserves. Indeed, the reduction in U.S. reserves exceeded the deficit if the latter is adjusted to take account of declines in U.K. official holdings of U.S. securities, which are not usually included in the calculation (Table 8);

TABLE 8

OFFICIAL RESERVE TRANSACTIONS, 1964–66
(In millions of dollars)

Type of transaction	1964	1965	1966	1964–66
Balance on official reserve transactions basis	−1,546	−1,305	+271	−2,580
Settled by:				
Decline in U.S. reserve assets (increase, −), total	171	1,222	568	1,961
Gold	125	[1,2] 1,665	[2] 571	[1,2] 2,361
Convertible currencies	−220	−349	−540	−1,109
IMF gold tranche position	266	[1] −94	537	[1] 709
Increase in U.S. liabilities to foreign official agencies, total [3]	1,375	83	−839	619
Liquid liabilities	1,073	[2] −17	[2] −1,574	[2] −518
Certain nonliquid liabilities [3]	302	100	735	1,137
Memo: Net U.K. sales (−) of U.S. securities other than Treasury issues (including private as well as official sales)	−3	−510	−82	−605

[1] Reflects $259 million payment of gold portion of increased U.S. subscription to the IMF.

[2] Reflects IMF gold deposits with the United States, and corresponding increase in U.S. liabilities to IMF, of $34 million in 1965 and $177 million in 1966.

[3] These liabilities do not include official U.K. holdings of U.S. securities other than Treasury issues; the memorandum item gives some indication of changes in those holdings.

PART II

Records, Operations, and Organization

foreign official claims on the United States including U.K. official holdings of securities actually declined in 1965.

This pattern was continued in 1966. Both U.S. reserves and U.S. reserve liabilities declined. Hence the reserve transactions of the United States with other countries had the effect of reducing total world reserves—rather than increasing them as in the years before 1965.

It will be seen from Table 8 that over the past 3 years combined the United States has not significantly increased its reserve liabilities if rough allowance is made for declines in official U.K. security holdings. Reserve assets of the United States have declined by almost the full amount of the cumulative U.S. deficit on the reserve transactions basis during this period. It is this persisting decline in U.S. reserves that gives increasing urgency to the task of restoring payments equilibrium.

RECORD OF POLICY ACTIONS OF THE BOARD OF GOVERNORS

March 29, 1966

Amendment to Regulation R, Relationships with Dealers in Securities under Section 32 of the Banking Act of 1933.

Effective March 29, 1966, Regulation R was amended to include among the types of obligations excepted in Section 218.2 of the Regulation certificates of interest issued by the Commodity Credit Corporation.

> Votes for this action: Messrs. Martin, Robertson, Shepardson, Daane, Maisel, and Brimmer. Votes against this action: None.

Section 32 of the Banking Act of 1933 provides that no officer, director, or employee of any corporation or unincorporated association, no partner or employee of any partnership, and no individual primarily engaged in the issue, flotation, underwriting, public sale, or distribution, at wholesale or retail, or through syndicate participation, of stocks, bonds, or other similar securities, shall serve at the same time as an officer, director, or employee of any member bank of the Federal Reserve System. However, the statute authorizes the Board of Governors, by general regulations, to except limited classes of relationships from the prohibitions of the statute.

Pursuant to such authority, the Board had heretofore permitted officers, directors, or employees of member banks to serve at the same time as officers, directors, or employees of securities firms dealing only in U.S. Government securities, obligations fully guaranteed as to both principal and interest by the United States, general obligations of territories, dependencies, and insular possessions of the United States, obligations of Federal intermediate credit banks, Federal land banks, Central Bank for Cooperatives, Federal home loan banks, the Federal National Mortgage Association, and the Tennessee Valley Authority; and, subject to specifications contained in paragraph Seventh of Section 5136 of the U.S. Revised Statutes, obligations of the International Bank for Reconstruction and Development, the Inter-American Development Bank, public housing agencies, or any local public agency, and obligations insured by the Federal Housing Administrator.

The current amendment to Regulation R added to this list certificates of interest issued by the Commodity Credit Corporation, it appearing to the Board that the certificates were in the same general category as obligations previously listed.

Governor Maisel, while supporting the action, reiterated his preference that the list of exceptions be expanded to include all obligations that member banks are authorized to deal in or underwrite pursuant to paragraph Seventh of Section 5136, including general obligations of States and political subdivisions.

June 24, 1966

Amendments to Regulation D, Reserves of Member Banks, and Regulation Q, Payment of Interest on Deposits.

(1) Effective with the reserve computation periods beginning July 14, 1966, for reserve city banks and July 21, 1966, for other member banks, the Supplement to Regulation D was amended to increase from 4 per cent to 5 per cent the reserve requirement against time deposits (other than savings deposits) in excess of $5 million at each member bank.

(2) Effective September 1, 1966, Regulations D and Q were amended to bring promissory notes, with the exception of certain designated types of underlying transactions, within the coverage of the definition of "deposit."

> Votes for these actions: Messrs. Martin, Robertson, Mitchell, Maisel, and Brimmer. Votes against these actions: None.

The reserve requirement action was designed to exert a tempering influence on issuance of time certificates of deposit (CD's) by banks. It also served to apply a moderate additional measure of restraint upon the expansion of loanable funds and thus reinforce the operation of other instruments of monetary policy in containing inflationary pressures.

The effect of the action was to increase required reserves by approximately $350 million at reserve city banks and $70 million at other member banks. However, since the increased reserve requirement was not applicable to savings deposits and applied only to time deposits in excess of $5 million held by any member bank, it appeared that only about 950 banks throughout the country—primarily those issuing savings certificates and other CD's in large volume—would be affected.

The purpose of the action on shorter-term promissory notes and similiar instruments was to prevent the future use of those instruments as a means of circumventing the regulations governing reserve requirements and payment of interest on deposits. The types of promissory note transactions specifically excluded from the expanded deposit definition included Federal funds transactions, interbank borrowings, transfers of assets with agreements to repurchase, and bank notes issued for capital purposes with a maturity of more than 2 years and subordinated to claims of depositors. Although the action was not effective until September 1, 1966, it applied to all promissory notes covered by the action that were issued on or after June 27, 1966, and were outstanding on or after the effective date. Such notes and similar instruments had come into use only in the past few years, and the volume outstanding at this time was relatively small.

July 1, 1966

Credit facilities for nonmember depositary-type institutions.

Effective July 1, 1966, and until September 1, 1966, the Board authorized a program under which the Federal Reserve Banks could make credit facilities available to nonmember depositary-type institutions under certain conditions.

Votes for this action: Messrs. Robertson, Shepardson, Daane, Maisel, and Brimmer. Votes against this action: None.

Information available to the Board suggested the possibility that during the period ahead some nonmember depositary-type institutions, including mutual savings banks and savings and loan associations, might be subjected to unusual withdrawals of funds. After consultation with the Federal Reserve Banks, the Board concluded that the Reserve Banks should be prepared to provide emergency credit facilities to such institutions in accordance with certain basic principles.

The Board advised the Federal Reserve Banks that in order to provide for prompt implementation of such a program if needed, it had taken the following action, effective immediately and until September 1, 1966:

(a) Member banks in your district are permitted, pursuant to the eighth paragraph of Section 19 of the Federal Reserve Act and Section 201.5 of Regulation A, to use as security for advances from your Bank, whether under Section 13 or Section 10(b) of the Act, assets acquired from mutual savings banks and other banks that are not members of the Federal Reserve System, but only in accordance with, and subject to, specified limitations; and

(b) Your Bank is authorized, in accordance with the third paragraph of Section 13 of the Federal Reserve Act, in unusual and exigent circumstances to discount for mutual savings banks and other depositary-type institutions paper of the kinds described in that paragraph, subject, however, to the limitations therein contained and in accordance with, and subject to, further limitations now specified by the Board.

Although occasion did not arise to use the emergency credit facilities, as a precautionary measure the Board subsequently twice extended the time during which such facilities were authorized, first to December 1, 1966, and then to March 1, 1967.

July 11, 1966

Termination of Regulation P, Holding Company Affiliates—Voting Permits.

Effective as of July 1, 1966, Regulation P was terminated.

Votes for this action: Messrs. Robertson, Shepardson, Maisel, and Brimmer. Votes against this action: None.

Public Law 89-485, approved July 1, 1966, made numerous amendments, generally of a strengthening nature, to the Bank Holding Company Act of 1956. It also amended Section 2 of the Banking Act of 1933, Section 5144 of the Revised Statutes of the United States, and related statutes so as to eliminate the provisions pertaining to holding company affiliates and the issuance of permits to such affiliates to vote the stock of member banks. Since Regulation P was based on the provisions of law now repealed, the Regulation was terminated effective as of the date of enactment of Public Law 89-485.

July 11, 1966

Amendment to Regulation R, Relationships with Dealers in Securities under Section 32 of the Banking Act of 1933.

Effective July 11, 1966, Regulation R was amended to include among the types of obligations excepted in Section 218.2 of the Regulation securities of the Asian Development Bank.

Votes for this action: Messrs. Robertson, Shepardson, Maisel, and Brimmer. Votes against this action: None.

This amendment reflected the fact that Public Law 89-369, dated March 16, 1966, authorizing participation of the United States in the Asian Development Bank, permitted member banks of the Federal Reserve System to underwrite securities issued by that organization. The effect of the amendment was to allow interlocking relationships between member banks and securities firms dealing in or underwriting the securities in question. The prohibition in Section 32 of the Banking Act of 1933 and the Board's authority to grant exceptions are described in the entry regarding a previous amendment to Regulation R on March 29, 1966.

July 15, 1966

Disapproval of proposed discount rate increase.

The Board disapproved action taken by the Boards of Directors of the Federal Reserve Banks of New York, Cleveland, Chicago, and St. Louis on July 14 establishing a rate of 5 per cent (an increase from 4½ per cent) on discounts for and advances to member banks under Sections 13 and 13a of the Federal Reserve Act, along with appropriately corresponding subsidiary rates on advances under other sections of the Act.

> Votes for this action: Messrs. Robertson, Shepardson, Daane, Maisel, and Brimmer. Votes against this action: None.

(In accordance with provisions of the Federal Reserve Act, the Federal Reserve Banks establish rates on discounts and advances to member banks at least every 14 days and submit such rates to the Board for review and determination. No changes had been made in such rates since those referred to on pages 63-70 of the Board's ANNUAL REPORT for 1965.)

In considering the discount rates established by the several Federal Reserve Banks, the Board was not unmindful of considerations that might have formed a basis for approval. As described in the Record of Policy Actions of the Federal Open Market Committee, published elsewhere in this ANNUAL REPORT, the Committee had been pursuing for several months in the winter and spring a policy of reducing net reserve availability gradually in an effort to resist inflationary pressures. This monetary policy process, together with strong credit demands, had resulted in an upward movement of market interest rates that left the 4½ per cent discount rate substantially out of alignment. This circumstance had led to rather widespread expectations of a discount rate increase and had contributed to market uncertainties.

The directors of the Reserve Banks concerned reasoned that an adjustment of the discount rate would serve as a stabilizing influence. They also believed that a discount rate increase could be helpful in symbolizing continued concern about the persistent deficit in the U.S. balance of international payments and that the use of the discount rate instrument, along with other instruments of Federal Reserve policy, was called for to maximize the effectiveness of monetary policy in the absence of greater fiscal restraint, in the form of a tax increase, to limit excessive credit expansion.

For a variety of reasons, however, it was the conclusion of the Board that on balance a discount rate increase was not warranted at this particular time. Those reasons were not necessarily subscribed to *in toto* or accorded equal weight by each of the members of the Board.

There had been a recent international development on which some members placed considerable stress. On the preceding day, announcement had been made of an increase from 6 per cent to 7 per cent in the discount rate (Bank rate) of the Bank of England. This raised the question whether the effect of the British action, designed to strengthen the position of the pound sterling, should be weakened by offsetting action here.

With respect to the domestic situation, some doubt was expressed within the Board as to whether a discount rate increase of one-half of 1 percentage point would be sufficient to quiet prevailing uncertainties, and therefore to provide a stabilizing influence, or whether such an increase might not simply promote speculation concerning the possibility of additional discount rate action. In view of the many strains and crosscurrents prevailing in financial and credit markets, it also appeared possible that the announcement effect of even a modest change in the discount rate could be exaggerated and such action misconstrued, with ramifications extending beyond the intended scope of the action. Further, although the discount rate was lower than usual relative to market rates, it was not evident that this circumstance was hampering the pursuit of a policy of monetary restraint or that it was causing unmanageable problems in the administration of the Reserve Bank discount windows.

Another factor contributing to the Board's decision was the widespread desire to avoid further escalation of interest rates, including those being offered for funds by banks and nonbank financial institutions. Action was being announced today (July 15) by the Board (and also by the Federal Deposit Insurance Corporation) to lower the maximum rates payable by banks on time deposits with multiple maturities, and the Board had only recently raised the reserve requirement against time deposits in excess of $5 million at each member bank. In addition, the Board was even now submitting to the Congress, with a recommendation for prompt action, a legislative proposal to broaden the regulatory power over rate practices of banks and savings and loan associations.

As to the point that an increase in the discount rate could be regarded as primarily a technical adjustment in view of current money market rates, it was suggested that if the discount rate were moved regularly in order to conform to market rates and market expectations, that would tend to reinforce the role of expectations and make them still more dominant. Thus, control of monetary policy would tend to shift from the monetary authority to the market.

Members of the Board noted that, although the preceding reasons weighed against increasing the discount rate at this particular juncture, the rate might usefully be varied from time to time.

The effect of the Board's action was that the rates on discounts and advances contained in the existing rate schedules of the respective Federal Reserve Banks automatically continued in effect.

* * * * *

The Boards of Directors of several Federal Reserve Banks subsequently submitted to the Board of Governors additional proposals, as follows, for discount rate increases. The rates were disapproved in each instance for reasons generally similar to those stated above.

Reserve Bank	Proposed rate (per cent)	Date of Board action
Boston	5	July 19
Philadelphia	5	July 22
Minneapolis	5½	August 24
Cleveland	5	August 25
Chicago	5½	August 26
Boston	5	August 30
Philadelphia	5	September 2

July 15, 1966

Amendment to Regulation Q, Payment of Interest on Deposits.

Effective July 20, 1966, Regulation Q was amended to define multiple-maturity time deposits, and the Supplement to the Regulation was amended to prescribe maximum rates of interest on such deposits as follows: 5 per cent on such deposits of 90 days or more and 4 per cent on those of less than 90 days.

> Votes for this action: Messrs. Robertson, Shepardson, Daane, Maisel, and Brimmer. Votes against this action: None.

The term "multiple-maturity time deposit" was defined as any time deposit (1) payable at the depositor's option on more than one date, whether on a specified date or at the expiration of a specified time after the date of deposit (for example, a deposit payable at the option of the depositor either 3 months or 6 months after the date of deposit), (2) payable after written notice of withdrawal, or (3) with respect to which the underlying instrument or contract or any informal understanding or agreement provides for automatic renewal at maturity.

Previously, member banks had been able to pay as high as 5½ per cent on such deposits. The Board's action, which made no change in the maximum permissible rate for time deposits having a single maturity (5½ per cent) or savings accounts (4 per cent), was designed to help forestall excessive interest rate competition among financial institutions at a time when monetary policy was aimed at curbing the rate of expansion of bank credit.

On the same day this action was taken, the Board sent to the congressional Committees on Banking and Currency draft legislation that would broaden existing authority to regulate interest rates payable by insured banks on time and savings deposits and extend parallel authority to the Federal Home Loan Bank Board with respect to dividend rates payable by savings and loan associations. The Board's letters pointed out that, although separate ceilings were being imposed on multiple-maturity time deposits in an effort to differentiate between money market CD's and consumer-type deposits, the multiple-maturity concept was not ideally suited for the purpose. However, it appeared to be the best alternative available under existing law. The Board noted that the only effective means for accomplishing the purposes sought to be achieved in the current situation might be to differentiate on the basis of amount of deposit, even though the Board had previously expressed reservations about such an approach except as a temporary expedient.

In its letters the Board also expressed doubt as to the efficacy of attempting to prevent a rate war by limiting rates payable only by banks and pointed out that the draft legislation therefore included authority for imposition of rate ceilings by the Federal Home Loan Bank Board. The Board observed that under the proposed legislation the imposition of rate ceilings would not be mandatory; instead, such ceilings could be imposed or placed on a standby basis by the appropriate agency, after consultation with the others, in the light of conditions existing at any given time.

August 17, 1966

Amendment to Regulation D, Reserves of Member Banks.

Effective with the reserve computation periods beginning September 8, 1966, for reserve city banks and September 15, 1966, for other member banks, the Supplement to Regulation D was amended to increase from 5 per cent to 6 per cent the reserve requirement against time deposits (other than savings deposits) in excess of $5 million at each member bank.

> Votes for this action: Messrs. Robertson, Shepardson, Mitchell, and Brimmer. Votes against this action: None.

On June 24, 1966, effective on specified dates of the following month for reserve city and other member banks, respectively, the Board had increased from 4 per cent to 5 per cent the reserve requirement on time deposits (other than savings deposits) in excess of $5 million at each member bank.

On August 11, 1966, the Board considered a proposal that the requirement be increased from 5 per cent to 6 per cent (the maximum that could be imposed under existing law). The proposal was presented on the basis that such action would further discourage reliance on CD's as a base for credit expansion in the face of continuing strong loan demands. It was pointed out that banks might attempt to increase the issuance of negotiable CD's in anticipation of large September maturities and tax-period credit demands, and in the circumstances might be inclined to raise offering rates generally to the ceiling on minimum maturities, and perhaps on denominations under as well as over $100,000. In such an environment any additional increase in the cost of replacing CD's should reinforce the inducement to banks to restrict customer loan accommodation and to husband the liquidity of their asset portfolios. An increase in the reserve requirement to the legal maximum would also afford further indication that the Board meant to moderate both inflationary credit expansion and overly aggressive rate competition for savings.

Of the members of the Board present on August 11, three (Governors Robertson, Shepardson, and Mitchell) favored such action. However, the other two members present (Governors Daane and Brimmer) opposed it. Accordingly, since the provisions of Section 19 of the Federal Reserve Act require the affirmative votes of not less than four members of the Board of Governors for a change in reserve requirements, the proposal failed of approval.

Governor Daane agreed that the System, in the absence of sufficient fiscal restraint, should move further in the direction of credit tightening, but in view of the existing sensitive state of the money market he believed that the announcement of an increase in reserve requirements could have severe repercussions. He also felt that such action would intensify the problem faced by banks in September in replacing CD's without achieving the differential impact on bank credit expansion that was intended, and he noted that the action could trigger an increase in the commercial bank prime rate. Furthermore, a cushioning of the impact of the reserve requirement increase, coming at a time when the System would normally be supplying reserves, would necessarily mean much larger open market operations than otherwise, with related technical difficulties. It seemed to him that further gradual credit tightening through open market operations would be a preferable course of action.

Governor Brimmer concurred to some extent in those views, with emphasis on his concern that the proposed action, if announced, might trigger an increase in the prime rate. Considering the delicacy of the present financial situation, including the state of money market conditions, he felt that alternative credit-tightening procedures should be explored carefully before a decision was made, especially the possibility of tightening through open market operations.

On August 17, 1966, when the proposed reserve requirement action was again considered by the Board, an increase in the commercial bank prime rate had been announced. Another development taken into account, from the standpoint of timing, was the fact that an auction of $3 billion of Treasury tax-anticipation bills was imminent, and it seemed appropriate on grounds of equity that any increase in reserve requirements be announced before rather than after bids had been made for the bills. Governor Daane, who was prevented from returning from out of town because of transportation difficulties related to the airline strike, made known to the Board by telephone that in light of the Treasury financing he would not request deferral of the action if a majority of the Board favored it, although he continued to have the serious reservations that he had expressed previously.

The members of the Board present at the August 17 meeting recognized the risk involved in announcement of a reserve requirement increase, given the sensitive state of the money market. However, they concluded that the risk was warranted by the need for further credit tightening and the greater prospect of obtaining a differential impact through the reserve requirement mechanism than through the use of other instruments. The members noted that some cushioning through open market operations might be required, along with assistance to individual member banks through the System's discount facilities, and it was suggested that clarification of the purposes for which the discount window could properly be used in the forthcoming period would be advisable.

The Board's announcement of the reserve requirement change pointed out that the increase was designed to exert a tempering influence on bank issuance of CD's and to apply some additional restraint upon the expansion of bank credit to businesses and other borrowers. While it was estimated that the action would increase required reserves by about $450 million—approximately $370 million at reserve city banks and $75 million at other member banks—the increase was expected to affect mainly the larger banks issuing savings certificates and other CD's in substantial volume.

The Board noted that monetary actions already taken had resulted in some moderation of the rate of bank credit growth, but that in view of increasing price pressures stemming from recent developments in the economy, this action was being taken to reinforce the anti-inflationary effects of over-all monetary restraint. The Board expressed recognition that in the period ahead some banks might be faced with unusual pressures, but it stated that in such circumstances Federal Reserve discount facilities would be available to assist member banks while they were making an orderly adjustment in their positions. Such adjustments, however, would be expected to emphasize increased restraint in lending policies and maintenance of an appropriate degree of liquidity on the part of borrowing banks.

September 1, 1966

Use of discount facilities in the current economic environment.

A letter was sent to all member banks of the Federal Reserve System expressing System views on bank credit expansion in the current economic environment and on the use of Federal Reserve discount facilities in such circumstances.

Votes for this action: Messrs. Robertson, Shepardson, Mitchell, Maisel, and Brimmer. Votes against this action: None.

While the growth of total bank credit and total bank lending had moderated somewhat as compared with the preceding year, total bank loans plus investments had grown at an annual rate of more than 8 per cent during the first 8 months of 1966 and total bank loans at a rate of more than 12 per cent. Meanwhile, bank lending to business had increased at an annual rate of about 20 per cent. Credit-financed business spending had tended toward unsustainable levels and had added appreciably to current inflationary pressures. Furthermore, the exceedingly rapid expansion in business loans was being financed in part by liquidation of other banking assets and by curtailment of other lending in ways that could contribute to disorderly conditions in credit markets.

Against that background a decision was made by the Board, in consultation with the Presidents of the Federal Reserve Banks, that a letter should be sent to each member bank over the signature of the President of the Reserve Bank in the member bank's district expressing System views on bank credit expansion in the current economic environment and on the use of Reserve Bank discount facilities.

The text of the letter follows:

It is the view of the Federal Reserve System that orderly bank credit expansion is appropriate in today's economy. However, that expansion should be moderate enough to help insure that spending—and particularly that financed by bank credit—does not exceed the bounds that can be accommodated by the nation's growing physical resources. An excessive expansion of bank credits would aggravate inflationary pressures that are already visible.

While the growth of total bank credit and total bank lending has moderated somewhat as compared with last year, total bank loans plus investments have grown at an annual rate of over 8 per cent during the first 8 months of this year, and total bank loans at a rate of over 12 per cent. Meanwhile bank lending to business has increased at an annual rate of about 20 per cent.

It is recognized that business demands for bank credit have been particularly intense. While such credit requests often appear justifiable when looked at individually, the aggregate total of credit-financed business spending has tended towards unsustainable levels and has added appreciably to current inflationary pressures. Furthermore, such exceedingly rapid business loan expansion is being financed in part by liquidation of other banking assets and by curtailment of other lending in ways that could contribute to disorderly conditions in other credit markets.

The System believes that the national economic interest would be better served by a slower rate of expansion of bank loans to business within the context of moderate over-all money and credit growth. Further substantial adjustments through bank liquidation of municipal securities or other investments would add to pressures on financial markets. Hence, the System believes that a greater share of member bank adjustments should take the form of moderation in the rate of expansion of loans, and particularly business loans.

Accordingly, this objective will be kept in mind by the Federal Reserve Banks in their extensions of credit to member banks through the discount window. Member banks will 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 these efforts. It is recognized that banks adjusting their positions through loan curtailment may at times need a longer period of discount accommodation than would be required for the disposition of securities.

This program is in conformity with the provision in Section 201.0, par. (e) of the Board's Regulation A governing lending to member banks:

"In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. . . ."

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, will continue to be available as in the past.

A slower rate of business loan expansion is in the interest of the entire banking system and of the economy as a whole. All banks should be aware of this consideration, whether or not they need to borrow from the Federal Reserve. Management of bank resources in accordance with the principles outlined above can make a constructive contribution to sustained economic prosperity, and the Federal Reserve System is confident that the banks will give their whole-hearted support to this effort.

* * * * *

Termination of the special discount arrangements set forth in the September 1 letter was announced on December 27, 1966. Credit conditions had changed in the interim, the expansion of business loans had been reduced to a more moderate rate, and banks were no longer unloading securities in unreceptive markets. Consequently, the purpose of the letter had been served.

September 21, 1966

Amendments to Regulation Q, Payment of Interest on Deposits.

Effective September 26, 1966, the Supplement to Regulation Q was amended (1) to reduce from 5½ per cent to 5 per cent the maximum rate of interest permitted to be paid by member banks on any time deposits under $100,000, and (2) to permit the effects of compounding to be disregarded in calculating the rate of interest on time or savings deposits, but with provision that the basis of compounding be stated explicitly.

Votes for this action: Messrs. Martin, Robertson, Shepardson, Mitchell, Daane, Maisel, and Brimmer.
Votes against this action: None.

The action reducing to 5 per cent the maximum rate of interest permitted to be paid on time deposits of less than $100,000 was taken under the authority contained in Public Law 89-597, approved by the President earlier on this same date, providing increased flexibility for establishing maximum rates payable on time and savings deposits at commercial banks and other depositary institutions. (Actions under authority of the new legislation were also announced by the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board, such actions being applicable to rates payable by institutions under the respective jurisdictions of those agencies.)

The purpose of the reduction of the maximum rate payable on time deposits of less than $100,000 was to limit further escalation of interest rates paid in competition for consumer savings. The action, which also was expected to help in keeping the growth of commercial bank credit to a moderate pace, was the latest of a series of measures taken by the Federal Reserve System to temper the aggressive competition for funds by commercial banks and other financial institutions and at the same time to help assure an orderly and moderate rate of growth in bank credit in order to restrain inflationary pressures. The earlier actions had included a reduction of maximum rates on time deposits with multiple maturities, two increases in the reserves required to be maintained by member banks against a portion of their time deposits, and issuance of a letter to member banks concerning the need to follow lending policies that would result in reducing the rate of growth of business loans.

The current reduction in maximum rate did not, in itself, require any change in the rate of interest being paid on CD's and other time deposits outstanding on the effective date (September 26); if a member bank had agreed to pay a specified rate of interest on such a deposit, it could continue to pay the contract rate to maturity. If the obligation was then renewed, however, the rate of interest could not exceed the new 5 per cent maximum.

The action on compounding of interest was designed to permit member banks slightly greater flexibility in the terms of their deposit contracts and in their operations by authorizing the compounding of interest at the applicable maximum permissible rate on any basis that the member bank might choose to adopt. However, if a member bank elected to compound interest, either at the maximum permissible rate or at a lower rate, it must state the basis of compounding (such as semiannually, quarterly, monthly, weekly, daily, or continuously) in every advertisement, announcement, solicitation, and agreement relating to the rate of interest paid.

September 27, 1966

Increase in maximum interest rate on Regulation V loans.

Effective September 27, 1966, the Board raised from 6 per cent to 7½ per cent the maximum permissible rate of interest on loans made pursuant to Regulation V, Loan Guarantees for Defense Production, with retention of the ceiling of 6 per cent for purposes of calculating guarantee fees, and with no change in the maximum commitment fee of one-half of 1 per cent or in the schedule of guarantee fees.

> Votes for this action: Messrs. Martin, Robertson, Shepardson, Mitchell, Maisel, and Brimmer. Votes against this action: None.

Under the provisions of the Defense Production Act of 1950 and implementing Executive Orders, certain designated procurement agencies of the Government are authorized to guarantee loans made by commercial banks and other private institutions to finance and expedite production for national defense and to finance contractors and subcontractors in connection with, or in contemplation of, the termination of their defense contracts. The Federal Reserve Banks act as fiscal agents of the guaranteeing agencies in receiving applications and in the making of contracts of guarantee. The Board's Regulation V, issued pursuant to the aforementioned statutory authority, provides that rates of interest, guarantee fees, commitment fees, and other charges that may be made with respect to guaranteed loans and guarantees executed through the agency of any Federal Reserve Bank pursuant to the Regulation will from time to time be prescribed, either specifically or by maximum limits or otherwise, by the Board of Governors after consultation with the guaranteeing agencies.

The action on the maximum permissible interest rate, which was taken after such consultation, was designed to permit a net return to financing institutions more in line with current lending and money market rates and thus help to assure financing from commercial sources for contractors and subcontractors engaged in defense work. The net return to financing institutions under the former ceiling rate, in effect since 1957, had become increasingly noncompetitive with alternative loan and investment opportunities, and the amounts disbursed under authorized Regulation V loans had dropped from $152 million in the fiscal year 1964 to $119 million and $78 million in the fiscal years 1965 and 1966, respectively, notwithstanding the substantial increase in military procurement.

Regulation V was reissued, effective September 27, 1966, in a form that included a Supplement setting forth the maximum permissible rate of interest, the schedule of guarantee fees, and commitment fees. In addition, minor technical changes were made in the body of the Regulation.

December 6, 1966

Amendments to Regulation D, Reserves of Member Banks, and Regulation Q, Payment of Interest on Deposits.

(1) Effective January 1, 1967, Regulations D and Q were amended to sharpen the technical distinctions between "time deposits" and "savings deposits."

(2) Effective January 5, 1967, the Supplement to Regulation D was amended to reduce from 6 per cent to 4 per cent the reserves required to be maintained against Christmas and vacation club accounts. (The lower rate of required reserves had already been in effect at member banks whose total time deposits, other than savings deposits, did not exceed $5 million.)

Votes for these actions: Messrs. Martin, Shepardson, Mitchell, Daane, Maisel, and Brimmer. Votes against these actions: None.

Prior hereto, deposits of individuals or certain nonprofit organizations as to which the depositor was required by the deposit contract to give notice in writing not less than 30 days before making a withdrawal might be either "savings deposits" or "time deposits" (time certificates of deposit or time deposits, open account). Under the amended regulations, such a deposit could only be a "time deposit," the distinguishing feature of "savings deposits" being the reservation by the bank of the right to require 30 days' notice of withdrawal. In practice, banks routinely reserve such a right, although it is rarely exercised.

The amendments also were designed to make clear that a deposit payable on a specified date or at the expiration of a specified period of time after the date of the deposit (sometimes referred to as a "fixed maturity" deposit) does not constitute a "savings deposit."

As to Christmas and vacation club accounts, technically classified as time deposits, the Board concluded that with such accounts serving the same function as savings deposits there was no reason why reserves required to be maintained against them should be higher than for savings deposits.

December 9, 1966

Voluntary foreign credit restraint.

The Board adopted guidelines for 1967 for the use of banks and nonbank financial institutions in limiting foreign credits voluntarily as part of the President's balance of payments program.

Votes for this action: Messrs. Shepardson, Mitchell, Daane, Maisel, and Brimmer. Votes against this action: None.

In a message to Congress in February 1965, the President had presented a program aimed at achieving improvement in the U.S.

balance of payments position, the principal focus of which was on measures to reduce the outflow of U.S. capital. One part of the program called upon the Federal Reserve System to work with financial institutions in limiting their foreign lending and investing on a voluntary basis. In March 1965 the Board adopted sets of guidelines applicable to banks and nonbank financial institutions, respectively. Several amendments to the guidelines were adopted during 1965, and in December revised guidelines were issued for use in 1966. On April 1, 1966, the guidelines applicable to nonbank financial institutions were amended to remove acquisition by such institutions of foreign equity securities held by U.S. investors from the purview of the guidelines for long-term lending and investing abroad.

After a series of discussions in which all of the members of the Board had participated, the Board at this time adopted revised guidelines for the use of banks and nonbank financial institutions in 1967.

The new bank guidelines were in substantially the same form as those that had been in use since 1965. The volume of outstanding credits to foreigners on December 31, 1964, was retained as the base, along with the ceiling of 109 per cent of that base that was in effect during 1966. However, banks were requested to limit the use of their leeway as of September 30, 1966 (the leeway for the banking system as a whole approached $1.2 billion), to a rate not exceeding 20 per cent thereof per quarter, beginning with the fourth quarter of 1966. Banks were also requested to limit the increase in nonpriority credits (defined as credits other than those that financed U.S. exports or met credit needs of developing countries) over the amount outstanding on September 30, 1966, to 10 per cent (about $120 million) of the total possible expansion. This change was designed to give added stimulus to priority credits by suggesting a quantitative limit for nonexport credits to developed countries.

The program for nonbank financial institutions was greatly simplified. The three guidelines used in the 1966 program were replaced by a single guideline that permitted an increase of 5 per cent during the 15 months ending December 31, 1967, in assets covered by that guideline. Covered assets were redefined to exclude certain types of assets previously subject to target ceilings—for example, bonds of the International Bank for Reconstruction and Development and of the Inter-American Development Bank.

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

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[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.

OPERATIONS OF THE SYSTEM OPEN MARKET ACCOUNT

The following two reports describe the actions taken during 1966 to carry out the policy directives of the Federal Open Market Committee.

The report on operations in domestic securities was prepared by Alan R. Holmes, Manager of the System Open Market Account, who supervises these operations. It is written from the vantage point of the Trading Desk at the Federal Reserve Bank of New York, where operations in these securities are effected to carry out the policy directives of the Federal Open Market Committee. The report outlines the factors that the Manager takes into account in the day-to-day provision of bank reserves.

The report on foreign currency operations was prepared by Charles A. Coombs, Special Manager of the System Open Market Account, who supervises the Federal Reserve's operations in such currencies. The Federal Reserve has been buying and selling foreign currencies since early 1962 as part of the efforts to defend the dollar and strengthen the world payments system. All of these operations for the System Account are carried out, under the authorization of the Federal Open Market Committee, by the Federal Reserve Bank of New York, which also handles foreign currency transactions for the U.S. Treasury.

The report on operations in foreign currencies begins on page 269.

REVIEW OF OPEN MARKET OPERATIONS IN DOMESTIC SECURITIES

In broad terms, the objectives of open market operations passed through five phases during the year 1966. Operations were directed first at moderating the adjustment of financial markets to the increase in the discount rate in December 1965. Then they were used to bring steadily increasing pressure on bank reserve positions in order to restrict the growth of the reserve base, bank credit, and the money supply in the face of mounting inflationary pressures in an overheated economy. Later on, as the effects of earlier steps took hold, the objective was to maintain firm but orderly conditions in the money market, while moderating the unusual liquidity pressures that were prevailing in a market atmosphere of considerable uncertainty. Operations toward the end of the year permitted some relaxation of the pressure on banks reserve positions, and finally, after a while, sought a modest but overt easing in money market conditions and a resumption of growth in the money and credit aggregates amid signs of moderating tendencies in some sectors of the economy.

The heavy burden placed on monetary policy to counter inflationary pressures during the year—in the absence of greater fiscal restraint on spending and incomes—led to considerable stresses and strains on financial institutions and markets, and these strains in turn often complicated the conduct of System operations. In late August interest rates mounted to the highest levels in 40 years, and fears of a market crisis began to be expressed by some participants. While these fears were exaggerated, it was necessary to take them into account in the conduct of open market operations. The fears subsided after further restrictive fiscal actions were proposed in September. By the end of the year, many interest rates had returned to levels near those existing at the start of the year, a better atmosphere prevailed in financial markets, and a resumption of bank credit expansion appeared to be under way.

In carrying out open market operations in the economic and financial environment that prevailed in 1966, several innovations were made, and considerable flexibility was required. An innovation in early May involved the addition of a "proviso clause" to the content of the Federal Open Market Committee's current policy directive, instructing the Manager of the System Open Market Account to make some modifications in operations in the light of cumulating evidence of developments in required reserves or bank credit. In early July, when very unsettled conditions prevailed in the Treasury bill market and an airlines strike added suddenly to the supply of reserves by increasing float, the System introduced a new operating technique of "matched sale–purchase transactions" to absorb reserves on a temporary basis with as little impact on the general market atmosphere as possible. These transactions involved the sale by the System of Treasury bills for immediate delivery and the simultaneous purchase of the same issues of bills at competitive prices for delivery at a future date. This new technique was employed on a number of other occasions during the year, and it proved to be an effective means for the temporary absorption of reserves, somewhat akin to the function performed by repurchase agreements in dealing with temporary reserve needs. Finally, the Committee broadened the avenues for reserve injections during the year by removing the 2-year limitation on the maturity of Treasury securities that might be purchased for the Open Market Account under repurchase agreements, and by authorizing—pursuant to new legislation—repurchase agreements against direct obligations of Government agencies and obligations fully guaranteed by such agencies.

On an over-all basis, including repurchase agreements and matched transactions, the System bought and sold nearly $45.5 billion of securities during the year, with the net increase in System holdings over the year amounting to $3.5 billion. (See table on page 207.) These net purchases served to offset the drain on reserves resulting from the continuing outflow of gold and the rise in currency in circulation over the year. The purchases also provided for an increase of $1.1 billion in the reserve base over the year.

In describing the System's open market operations in 1966 in more detail, it is useful to divide the year into the following five periods:

1. January 1–February 8: Transition to a Firmer Policy Posture
2. February 9–June 7: Gradual but Steady Increase in Pressure on Bank Reserve Positions
3. June 8–September 13: Peaking of Financial Market Pressures
4. September 14–November 22: Relaxation of Market Tensions
5. November 23–December 31: Modest but Overt Move Toward Ease

January 1–February 8: Transition to a firmer policy posture. The first 6 weeks of 1966 were a period of transition for Federal Reserve open market operations. Economic activity and credit demands were expanding vigorously, as a rapidly growing military effort for the war in Vietnam was added to the strong demands of the private sector. Capacity limits were being approached, inflationary pressures were increasing, and the outlook was for further strength in economic activity and credit demands over the year ahead.

In response to these forces the Federal Reserve had, in early December 1965, raised the discount rate and the maximum permissible rates on time and savings deposits under Regulation Q. During the weeks immediately following, open market operations were directed at moderating the sharp upward adjustments in interest rates that ensued and at preserving a generally "even keel" situation while the Treasury conducted several sizable financing operations. In this way, operations helped to accommodate the widely fluctuating seasonal pressures around the end of the year, which—as it happened—were accentuated by a transit strike in New York City.

These adjustments worked themselves out during the period under review, and by early February open market operations had restored average net borrowed reserves in the banking system to approximately the level that prevailed before the increase in the discount rate. Meanwhile, the Federal Open Market Committee set the stage for a shift in its general policy stance by moving at its January 11 meeting from a position of "accommodating moderate growth in the reserve base, bank credit, and the money supply," as had been the case throughout 1965, to "moderating the growth" in these aggregate measures.

Implementing the Committee's objectives in the environment of considerable market churning and of wide fluctuations in various factors affecting reserve availability and distribution —such as usually occur in the opening weeks of a new year— involved a fairly large volume of open market operations over the 6-week period. Gross outright purchases of Treasury bills for the System Open Market Account over the period totaled $1.4 billion, while gross sales and redemptions amounted to $1.2 billion. In addition, $1.7 billion of Treasury issues were purchased under repurchase agreements with nonbank securities dealers, and $1.6 billion of such contracts matured or were withdrawn by the dealers. Operations in bankers' acceptances, also relatively large during the period, were a useful supplement in meeting the Committee's reserve objectives. In all, gross transactions by the System on an outright basis and under repurchase agreements averaged more than $250 million a day during the period; there were net purchases in the opening days of January, net sales in the 2 weeks ended January 19, and net purchases again in the final 3 weeks of the interval.

SYSTEM OPERATIONS IN GOVERNMENT SECURITIES DURING 1966
(In millions of dollars)

Type of operation	Jan. 1–Feb. 8	Feb. 9–June 7	June 8–Sept. 13	Sept. 14–Nov. 22	Nov. 23–Dec. 31	Total
Outright purchases:						
Treasury bills:						
From market	784	3,381	[1] 4,769	[1] 2,764	963	[1] 12,661
From foreign accounts	629	466	767	326	327	2,515
Coupon issues	....	[2] 254	185	....	35	[2] 474
Special certificate of indebtedness	....	....	....	....	169	169
Outright sales:						
Treasury bills:						
To market	677	2,210	[1] 3,570	[1] 2,185	....	[1] 8,642
To foreign accounts	287	524	500	344	....	1,655
Coupon issues	....	....	....	....	....	....
Redemptions:						
Treasury bills	228	524	257	664	503	2,176
Special certificate of indebtedness	....	....	....	....	169	169
Repurchase agreements:						
Government securities:						
Purchases	1,741	1,499	716	1,021	4,779	9,756
Sales	1,618	1,911	716	1,021	4,153	9,419
Government agency issues:						
Purchases	....	....	....	....	197	197
Sales	....	....	....	....	163	163
Net change in holdings	+344	+431	+1,394	−103	+1,482	+3,548
Memorandum item:						
Matched sale-and-purchase transactions:						
Sales	....	....	2,836	1,220	....	4,056
Purchases	....	....	2,836	1,220	....	4,056

[1] See "Memorandum" item at bottom of table for amounts of matched sale-and-purchase transactions included in this total.
[2] Includes $28 million from foreign accounts.
NOTE.—All figures are as of date of delivery.

The pattern of financial market developments that accompanied these operations varied considerably over the period. On the one hand, there was a continuing upward adjustment in many short-term interest rates. Leapfrogging of rates on negotiable time certificates of deposit (CD's) led the parade, as banks competed aggressively for funds under the new, more liberal rate ceilings. By the end of the period a 5¼ per cent rate on deposits maturing in more than a year was available at major New York City banks, compared with a high of 4⅞ per cent in late 1965. Offering rates on 3-month CD's were up as much as 20 basis points to 5 per cent. This upward ratcheting of rates on CD's, among other things, contributed to a state of nervousness in the Treasury bill market through much of the period, and the market rate on 3-month bills moved up by 15 basis points to 4.64 per cent bid on February 8. Rates on bankers' acceptances and commercial and financial paper rose by 1/8 of a percentage point.

In the money market, on the other hand, tautness in the first 2 weeks of the period, when the major money market banks had very large basic reserve deficits, was followed by somewhat more relaxed conditions in subsequent weeks as reserves shifted back to the money centers. Although nationwide net borrowed reserves gradually deepened to the levels prevailing prior to the change in the discount rate, Federal funds were generally available in sizable volume at rates of 4½ or 4⅝ per cent—the same range as in December. Member banks' borrowings from the Federal Reserve fluctuated from week to week, but the daily average of $440 million over the period as a whole was about the same as the average in the last 2 months of 1965.

Finally, although demands for bank credit and capital market financing proved considerably stronger than usual for that time of year, these demands were met without major difficulty at the higher rate levels that developed in the wake of the increase in the discount rate. Outstanding business loans at commercial banks declined by only about half as much as normal, and on a seasonally adjusted basis total bank credit rose at an annual rate of more than 12 per cent in January. In the capital markets, a total of $5.5 billion of new cash was raised through sales of corporate, municipal, Treasury coupon, and Government agency issues in the first 6 weeks of the year. Despite these demands, prices of most long-term securities rose for a time in January. Although subsequent price declines in the final weeks of the period more than erased the earlier gains, the atmosphere for Treasury financing remained sufficiently promising through January for the Treasury to seek and achieve a helpful lengthening of the debt in its February refunding. As the period drew to a close, however, there was renewed concern over the tenability of existing interest rates in the face of signs that still stronger credit demands lay ahead.

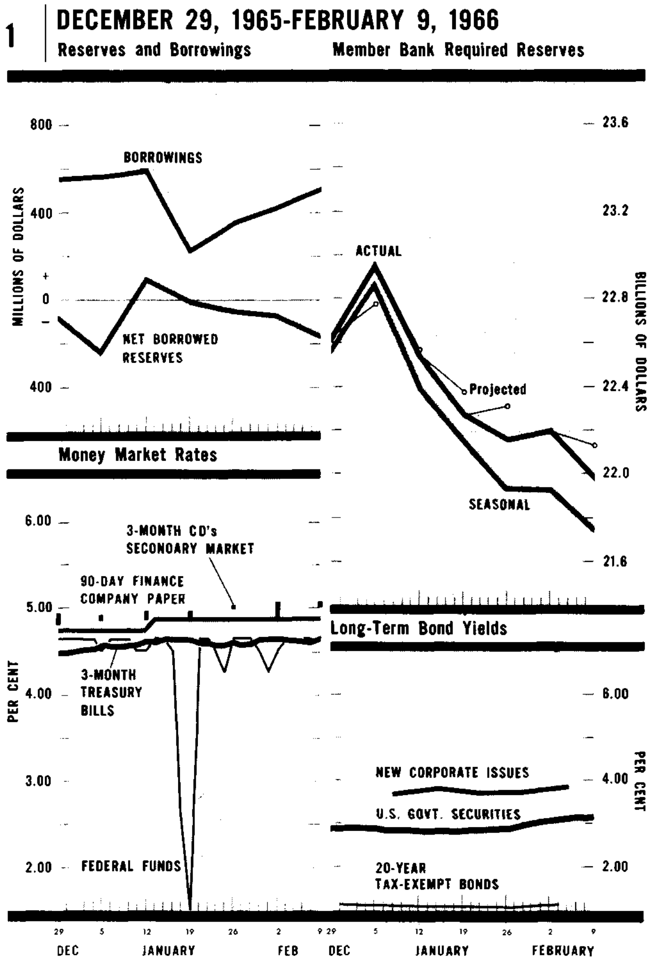
System operations. Several developments complicated the conduct of open market operations as the period unfolded. The first was a transit strike in New York City, which began on January 1 and for a time prevented many employees of banks and securities firms in the city from getting to their offices. This made it difficult for the banks to obtain accurate estimates of their reserve positions and tended to make them cautious in managing their reserves, a situation which in turn made the System's evaluation of underlying conditions in the money market more difficult. The strike also impeded the consummation of securities transactions, including those carried out by the System to inject and absorb reserves, as only limited work forces were available for the physical processing and delivery of the securities involved. To ease some of the delivery problems, the New York Reserve Bank requested on Monday, January 3, that dealers in Government securities avoid making outright transactions for "cash" (that is, same day) delivery for the duration of the strike.

The first several days of the strike coincided with a period of reserve need by the banking system and an emerging tightness in the money market. Heavy year-end demands for bank credit persisted somewhat longer than expected into the new year. As a result, banks in the major money centers, where much of the demand often converges, continued to experience very deep basic reserve deficits, which averaged more than 15 per cent of their aggregate required reserves.

In injecting reserves to head off undue tightness in the market, the System made extensive use of repurchase agreements and also purchased large amounts of Treasury bills being sold by foreign accounts. In all, these operations added $721 million of reserves over the January 3–10 period and enabled the System to avoid outright transactions in the market at the height of the strike difficulties. The repurchase agreements also served to mitigate the nervousness pervading the Treasury bill market and to moderate the upward pressure on short-term interest rates that stemmed from the sharply higher dealer loan rates posted by the New York City banks.

Conditions in the Treasury bill market increasingly complicated open market operations as January wore on. In this period, the System had to shift from reserve-supplying to reserve-absorbing operations to offset movements in factors that were releasing reserves—particularly the decline in required reserves of member banks as some of the year-end bulge in loans and deposits gradually was liquidated. Around this time, however, dealers were reluctant buyers and aggressive sellers of bills, as they reacted to the rise in rates on CD's, to high financing costs, to the addition of $100 million to the volume of Treasury bills sold in each weekly auction and the sale (after overallotments) of more than $1.6 billion of Treasury certificates in a cash financing on January 10, and finally, to the general difficulties in trading securities before the New York City transit strike was settled on January 13. In this environment the System proceeded cautiously in absorbing reserves. Repurchase agreements with the nonbank dealers were allowed to mature or be withdrawn without replacement, and a small amount of bills was sold outright in response to unsolicited dealer bids for scarce issues and directly to foreign accounts. In addition, some of the System's holdings of maturing bills were redeemed in the auction on January 10.

Because of this only gradual absorption of reserves, net reserve availability bulged to an average of $98 million of free reserves in the week ended January 12 (see Chart 1). Net borrowed reserves in the preceding week had been deeper than expected—at $243 million. Even with the extra reserve availability, money market conditions did not ease immediately. Major money center banks moved into an even deeper basic reserve deficit position than earlier, and most of the extra reserve availability was lodged in country banks, whose average excess reserves rose to a very high level of $617 million in the January 12 statement week.



Finance company paper, offering rate. Treasury bills, daily bid rate. Federal funds, effective rate. New corporate issues, Aaa basis.

In the following statement week, excess reserves accumulated earlier by country banks did flow into the money centers, and somewhat easier market conditions emerged. Not until the end of that week, however, did the atmosphere in the bill market improve sufficiently to permit large-scale sales of bills by the System to absorb some of the redundant reserves. By then Treasury bill rates had moved up to levels that dealers thought might begin to attract greater investor demand. The average issuing rate on 3-month bills auctioned on January 17 was at a record (to that date) of 4.673 per cent, 22 basis points higher than the rate in the final auction of December 1965.

Further sales of bills by the System toward the end of the week ended January 26—after it was learned that nationwide net reserve availability was higher than had been thought earlier—were accomplished without difficulty. For several days dealers had been rebuilding inventories in anticipation of possible demand for bills arising out of the Treasury's forthcoming refunding operation. In any event, investment demand for bills proved rather disappointing to the dealers over the next several days. By this time, however, the System was in the process of meeting month-end reserve needs, and it purchased a sizable volume of bills from the dealers over the January 28–February 1 period. These purchases exerted some steadying influence on the bill market while the books were open for the refunding operation. The System also injected reserves around this period through the purchase under repurchase agreements of rights to the refunding issues. These agreements facilitated financing of the rights until the February 15 payment date in a period when there was renewed concern among market participants over the high cost of alternative sources of funds.

Capital markets. Developments in the longer-term securities markets during the period have already been summarized briefly. In general, the markets were in a technically strong position in early January, following the sharp decline in prices in December and the preceding months of 1965. By the week ending January 12, dealers' total positions in Treasury coupon issues had fallen to a daily average of $160 million, and they had a net short position in issues maturing in more than 1 year. Moreover, dealers and investors reacted favorably to limitation by the Treasury of its early January cash financing to the short-term area. Indeed, the offering of the 4¾ per cent 10-month certificate priced to yield 4.85 per cent, which was announced on January 5 for sale on January 10, attracted subscriptions totaling more than $10 billion. Allotments totaled a little more than $1.6 billion. As switching activity for tax purposes expanded and investor and professional demand emerged, prices of outstanding Treasury notes and bonds rose sharply, with gains ranging from 1/8 to more than a full point over the first 12 days of January.

Market participants remained generally cautious even during this rally, however, and as the period progressed, some of their apprehensions gradually came to the forefront again. A major concern—which was to affect the securities markets in varying degrees throughout the year—related to Vietnam; in this period there was a disappointment over waning prospects for a peace settlement during the pause in U.S. bombing attacks on North Vietnam and a feeling that resumption of the air strikes was close at hand. There was also a growing realization of the strength of the economic outlook, especially with the continued fighting in Vietnam, and of the likely strength of credit demands ahead.

The size of these demands was underscored by a steady stream of large additions to the calendar of prospective corporate and municipal bond offerings. In addition, some market participants were disappointed that the President had not recommended stronger measures of fiscal restraint in his messages to the Congress. Skepticism over the possibility of attaining an administrative budget deficit of only $1.8 billion for the fiscal year 1967, and a growing awareness that very large sales of Government assets were projected in the budget, contributed to the apprehension in the market.

Despite these latent worries, prices held generally steady for a time and activity gradually decreased in anticipation of the Treasury's February financing operation. A number of participants thought that the market would be receptive to and might derive direction from an offering in the 5-year area, the longest maturity that could be sold given the 4 1/4 per cent coupon ceiling on longer-term issues. The financing that was announced on

January 26 offered holders of February, April, May, and August maturities the right to exchange their holdings for a new 5 per cent note to mature in 4 years and 9 months. Holders of the February and April maturities were also offered the right to exchange into a 4⅞ per cent 18-month note, priced to yield 4.96 per cent. A total of $13.7 billion of publicly held securities, plus holdings by the Federal Reserve and other official accounts, were eligible for exchange. Initial reaction to the combination refunding and prerefunding was favorable, and when-issued prices of the two new notes rose to premiums of 7/64 and 3/32 of a point above their offering prices.

The general market atmosphere deteriorated soon thereafter, however, as bombing of North Vietnam was resumed, as credit demands continued to grow, and as concern increased that, in the absence of more restrictive fiscal policies, monetary policy would move toward further restraint once the refunding was completed. Syndicates handling several corporate and municipal bond issues that were moving slowly were terminated, with yields on these issues adjusted upward by 4 to 6 basis points. Prices of outstanding Treasury coupon issues fell sharply; those on the refunding issues also came under downward pressure, although this was cushioned somewhat by Treasury trust account purchases of the new issues. In this atmosphere, dealers were reluctant to assume large underwriting positions in the refunding.

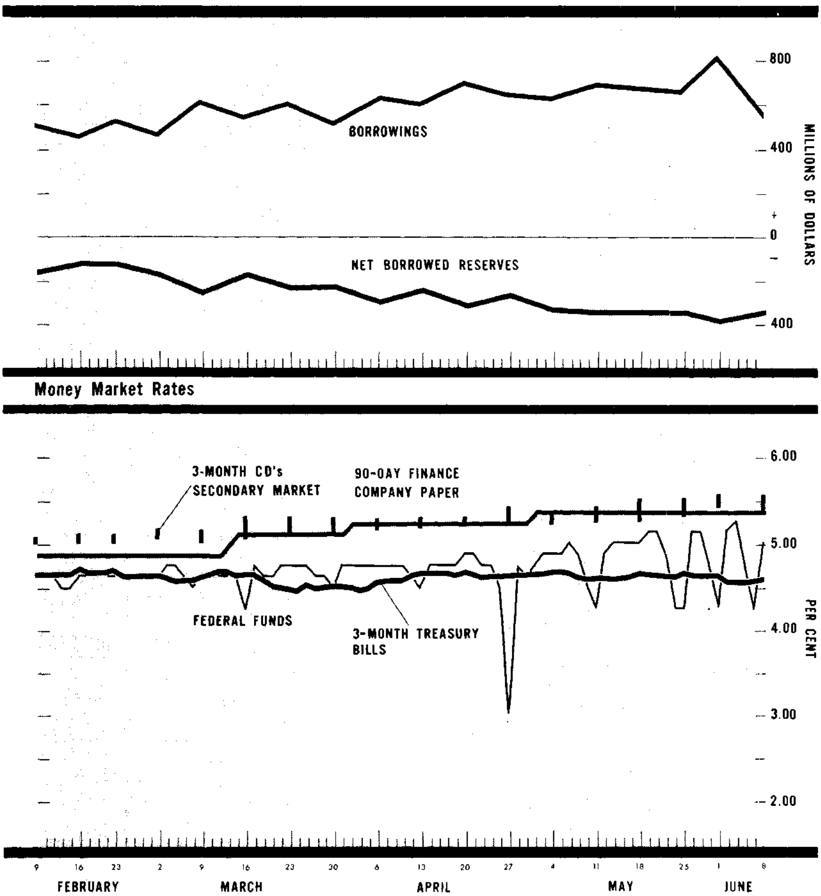
Investors at large, on the other hand, apparently placed greater weight on the high, intermediate-term yield than on current market developments, for the total public exchange into the new issues was unexpectedly large—$6.5 billion for the 5 per cent issue and $860 million for the 4⅞ per cent notes. This very successful completion of the refunding added about 1 month to the average maturity of the Federal debt and reduced the sizes of the prospective May and August financings to routine proportions.

Over the remainder of the period bond prices continued to fall in an unfavorable market atmosphere. Rumors of a peace feeler from North Vietnam had a temporary, buoyant effect, but this soon faded. By February 8 prices of some long-term Treasury issues had fallen by more than 2 points from their mid-January highs, and most issues were ⅛ to 2¼ points below the prices prevailing at the year's start. At these lower prices long-term Treasury issues yielded as much as 4.70 per cent, 11 basis points higher than at the end of December. In the corporate market, where the calendar of future offerings was growing, a utility issue rated Aa was offered without special call protection at a yield of 5.04 per cent on February 9, compared with a 4.89 per cent yield offered on a similarly rated issue in early January. Reoffering yields on municipal securities were also up somewhat from earlier in the year, with the Bond Buyer's index of yields on 20 seasoned tax-exempt issues at 3.58 per cent on February 10, compared with 3.54 per cent on the last Thursday of December.

February 9–June 7: Gradual but steady increase in pressure on bank reserve positions. By the second week of February, the period of even keel requirements in connection with the Treasury's refunding operation was nearing an end. The economy was expanding vigorously amid rising prices and continuing strong demands for credit. Against this background, a series of steps were taken, beginning with actions at the meeting of the Federal Open Market Committee on February 8, to bring gradually increasing pressure on bank reserve positions. Implementation of these actions led to a progressive deepening in nationwide net borrowed reserves from an average of about $70 million in the 6 weeks ended February 9 to around $200 million by late March, $300 million by early May, and $350 million in the final three statement weeks of the period under review here (see Chart 2). There was a corresponding steady rise in borrowings by member banks from the Reserve Banks, from an average of $440 million in the opening 6 weeks of the year to an average of $670 million in the final 3 weeks of the period under review.

The interaction of this increased pressure on bank reserve positions and of still swelling demands for credit led to consider-

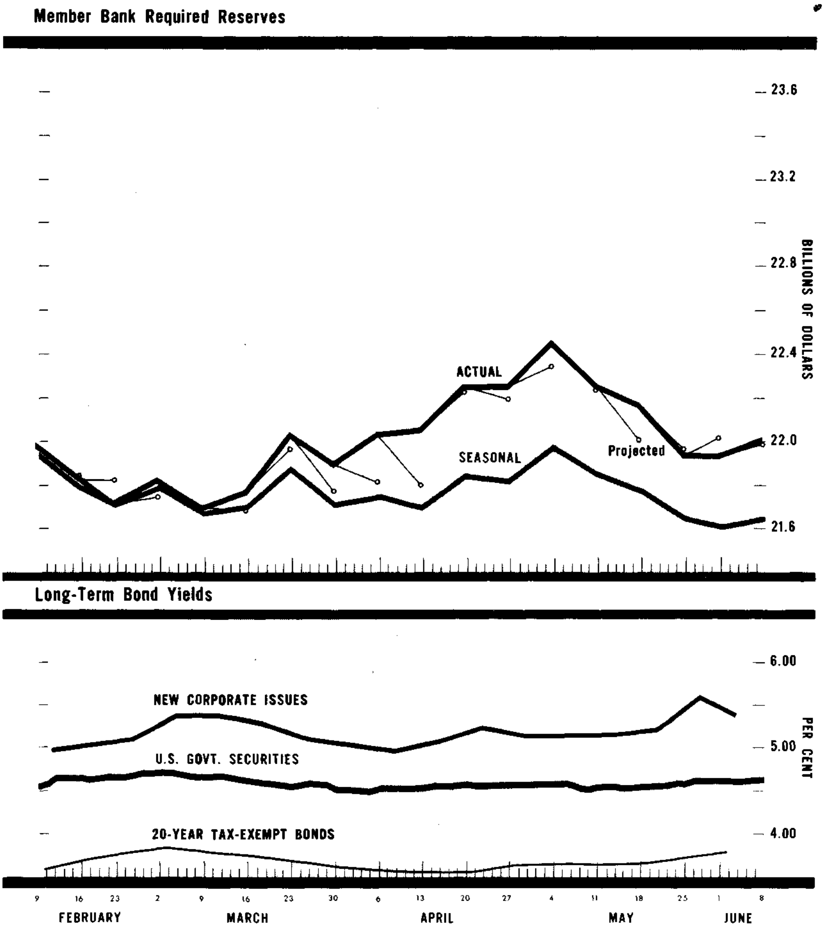
2 **FEBRUARY 9 - JUNE 8, 1966**
Reserves and Borrowings



For note see p. 211.

able further upward movement of most interest rates over the period. These rate increases in turn, and the related flows of funds that were set in motion, served somewhat to temper the speed and degree of the System's moves toward greater monetary restraint.

Rates on Federal funds rose in steps of 1/8 of a percentage



point, and by the end of the period these funds were often being traded at 5¼ per cent, compared with only limited trading at rates as high as 4¾ per cent in the early weeks of the year. Rates available on CD's at major banks in New York City moved up from 5¼ per cent on 12-month money at the start of the period to the 5½ per cent ceiling on deposits as short as 3 months by early June. Increases in rates on bankers' acceptances and commercial and sales finance company paper ranged from ½ to ⅝ of a percentage point over the period, and rates on short-term Government agency securities moved up by approximately 45 basis points. Even then, a 9-month issue of the Federal intermediate credit banks yielding 5.60 per cent was accorded a poor reception in late May. Meanwhile, commercial banks raised their lending rate to prime business customers from 5 to 5½ per cent on March 10, and a general increase in borrowing costs also occurred in most sectors of the capital markets as the period progressed.

Only Treasury bill rates were insulated from this general upward pressure. In fact most bill rates actually showed net declines over the period. This reflected, in large part, the heavy seasonal demand for bills from State and local governments, combined with a reduction in the supply of bills outstanding as tax-anticipation bills matured in March and another sizable volume of maturities was in prospect for June. In addition, however, many investors continued to prefer the added liquidity provided by bills in a period of generally rising interest rates, and under these circumstances market supplies of bills were continually being depleted despite the widening rate spread between bills and other instruments. One period in which there was an acute scarcity of bills was around March 24, when the rate on 3-month bills dipped to a low for the year to date of 4.46 per cent bid. On June 7, 3-month bills were bid at yields of 4.60 per cent compared with 4.64 per cent on February 8. This performance of the Treasury bill market was a dramatic demonstration of how independent the various sectors of the securities markets can be, even over an extended period of time, when special circumstances dominate.

Despite the increased pressure on bank reserve positions and the sharp upward movement of most interest rates, credit continued to expand at a rapid rate. Businesses had particularly heavy demands for credit during the spring and early summer as they sought to finance accelerated payments of taxes to the Treasury. The speedup of tax payments had been one of the fiscal measures proposed by the President in January.

The strength of the credit–deposit expansion at the banks was reflected in movements in member banks' required reserves. In each of 11 consecutive statement weeks from early March through early May, the actual level of aggregate required reserves turned out to be higher than the estimates prepared at the start of each week for use by the Manager of the System Open Market Account, and the level continued to run well above a normal seasonal pattern in subsequent weeks (see Chart 2). In the capital markets, despite the cancellation of some offerings, underwriters were continually facing a heavy calendar of corporate, municipal, and especially Federal agency securities. Furthermore, a steady stream of announcements forewarned of large future flotations.

In underscoring its concern over the rapid expansion of credit, the Federal Open Market Committee voted at its April 12 meeting to change the statement of its policy stance in the first paragraph of its directive from a position of "moderating" to one of "restricting" the growth in the reserve base, bank credit, and the money supply. Then, at the May 10 meeting, the Committee changed the content of the operating instructions contained in the second paragraph of its directive. As before, the Committee called for operations "with a view to attaining some further gradual reduction in net reserve availability." But to this it added a "proviso clause" calling for "a greater reduction if growth in required reserves does not moderate substantially."

Such a proviso clause, which had been under discussion by the Committee and its staff for several months, was designed to permit the Manager to modify day-to-day operations if cumulating evidence of an undesirably rapid expansion of credit developed during the interval between Committee meetings. The initial choice of required reserves as the conditioning variable in the proviso was made largely on practical considerations involving the timely availability of data relating to current bank credit and money supply expansion. Later in the year the conditioning variable was shifted to total member bank deposits subject to reserve requirements, the so-called "bank credit proxy."

The proviso clause was used in one form or another in the directives throughout the rest of the year. It provided a means of responding to unexpectedly or undesirably large movements in the banking aggregates, while still allowing open market operations to facilitate a generally smooth day-to-day functioning of the banking system and the over-all payments mechanism in the face of sharply fluctuating flows of reserves and deposits in the short run.

System operations. In conducting its day-to-day operations during the period February 9 through June 7, the System purchased slightly more than $3.8 billion of Treasury bills on an outright basis and sold or redeemed about $3.2 billion of bills. It made somewhat less use of repurchase agreements against Treasury issues than it had earlier in the year. Gross purchases under such agreements totaled about $1.5 billion, and terminations of these and earlier contracts amounted to $1.9 billion. On the other hand, the System did reenter the market for Treasury coupon securities during this period after an absence from this market since early September 1965.

The System's first purchases of coupon issues, on February 17, were confined to very short maturities. Later on, the maturity range of the System's purchases was lengthened gradually, although the Federal Reserve remained only a marginal factor in over-all market activity in coupon issues. System purchases of coupon securities for the whole period amounted to $254 million, of which all but $31 million had maturities of 3 years or less. These purchases proved especially helpful as a means of injecting reserves in March and again in early June when acute scarcities prevailing in the Treasury bill market were hampering System operations. Repurchase agreements against bankers' acceptances also were a helpful supplement to operations when Treasury bills were scarce.

While the total volume of System operations was somewhat less on a daily-average basis than it had been in the opening weeks of the year, swings between buying and selling securities were considerably more frequent than they had been earlier. This variability resulted from the System's efforts to maintain continuing pressure on member bank reserve positions in the face of inter- and intra-weekly cycles in the level and distribution of nationwide net reserve availability and/or in bank reserve management strategy.

The statement week ended February 9, the last week covered in the preceding period, and the following 4 weeks (through March 9) witnessed an extended series of short-run reversals of System operations. The distribution of nationwide reserve availability tended to favor the major banks in New York City during the period, as these banks evidently sought to improve their basic reserve positions in anticipation of the seasonal pressures expected around the corporate dividend and tax payment dates in mid-March. On the other hand, banks in other money centers and country banks generally were under some reserve pressure. These banks managed their reserve positions cautiously and were fairly aggressive bidders in the Federal funds market on the opening days—Thursday and Friday—of each of the 5 statement weeks from February 3 through March 9.

With nationwide net reserve availability at generally low levels on Thursdays and Fridays, conditions in the money market became rather taut and virtually all trading in Federal funds on such days was in the 4⅝ or 4¾ per cent area. To meet some of the indicated reserve needs and forestall undue tightness in the money market, the Federal Reserve injected roughly $200 million to $450 million of reserves at the beginning of each of the weeks in question, mostly through outright purchases of Treasury bills. In the wake of these operations, banks generally were able to cover most of their deficiencies, and their borrowings at

Federal Reserve Banks on each Thursday and Friday of the period were only a little above the weekly average.

Money market pressures tended to subside for a time following the weekends in each of the statement weeks. As it turned out, nationwide net reserve availability persistently exceeded earlier estimates, and many banks came through the weekends with accumulated reserve surpluses. In this environment, banks that still had deficiences were able to cover their needs in the Federal funds market on Monday and Tuesday of each week at rates generally 1/8 to 1/4 of a percentage point below those prevailing before the weekend, and aggregate member bank borrowings from the Reserve Banks dropped appreciably on these days. Undue easing was headed off, however, as the System reversed direction in each of the 5 statement weeks and absorbed about $150 million to $550 million of reserves through outright sales of Treasury bills. Generally by Wednesday of each week a renewed firmness appeared in the money market, with Federal funds again trading at the higher rates prevailing before the weekend and borrowings from the Reserve Banks expanding.

System open market operations were of more limited scope and did not shift direction so often in the following several weeks, which included the March dividend and tax payment dates and the unwinding after these dates. The rise in the bank prime rate on March 10 temporarily caused some nervousness in financial markets, and as usual for this time of year there was considerable market churning. In the week ended March 16, credit demands converged on the New York City banks, and their total loans and investments rose by $1.4 billion. At the same time these banks lost a net of around $160 million of CD's, and they also lost other funds as repurchase agreements with corporations matured. These developments led to some deterioration in basic reserve positions at New York City banks. In general, however, the pressures were less than anticipated and advance preparations proved to be more than adequate. In fact, money market conditions were fairly comfortable in the week immediately surrounding the tax date, and this fact helped to calm the nervousness in other markets. Thus the System waited until late in the week to meet the modest reserve need that was indicated.

The New York City banks soon moved back into a basic reserve surplus after mid-March as a result of an unusually rapid repayment of loans made earlier and also of their success in attracting new CD money at somewhat higher rates. Other banks, however, continued to be under pressure, and nationwide net reserve availability now tended to fall progressively short of levels initially expected by the Account Manager. The System moved to head off some of the emerging tautness in the money market late in the week ended March 23, but it proceeded cautiously in making these reserve injections because of the current scarcities of Treasury issues in the market.

Money market pressures mounted further around mid-April when banks, particularly those in New York City, experienced a much larger than anticipated expansion of credit over the midmonth tax date. In the week ended April 20 the basic reserve deficit of the major New York City banks rose to an average of nearly $1 billion. System operations during this period were directed toward absorbing the reserves supplied by the midmonth rise in float; other reserves were absorbed when the Treasury initially used part of its tax receipts to replenish its depleted balances at the Reserve Banks. Money center banks as a group apparently did not realize for a time how large their reserve deficiencies would be. When the deficiencies became apparent, after the April 16–17 weekend, these banks bid strongly for Federal funds, and a large amount of trading took place for the first time at 4⅞ per cent. Even so, large reserve needs remained to be filled, and borrowings from the Reserve Banks bulged to $1,026 million on Tuesday, April 19, and to $1,587 million on Wednesday, April 20. By not acting to mitigate these pressures, the System gave financial markets a clear indication of its basic policy stance.

Similarly tight money market situations recurred at the end of alternate weeks over the next month or so, a period when System open market operations again frequently reversed direction, this time to counter repetitive 2-week cycles in nationwide reserve availability and bank reserve management strategy. The cycles took the form of a generally cautious approach to reserve management on the part of banks on the opening days of each of the statement weeks ended April 27, May 11, and May 25, the first week in each 2-week cycle. Banks sought to avoid carrying reserve deficiencies over the weekend by bidding aggressively for Federal funds at progressively higher rates on Thursdays and Fridays and borrowing heavily from the Reserve Banks.

As it turned out, reserves became more plentiful after the weekends, partly because of the overborrowing earlier; the result was that money market conditions eased and member bank borrowings dropped progressively on Monday, Tuesday, and Wednesday of each of these weeks. This ease carried over into the opening days of the new statement weeks, the second week of the cycles. This was particularly true in the weeks ending May 4 and May 18, when banks as a group tended to borrow only modest amounts from the Federal Reserve discount windows on Thursdays and Fridays. Then as the reserve needs became more apparent late in the week, there was a scrambling for funds in the Federal funds market and a bulge in borrowings at the Reserve Banks on Tuesdays and Wednesdays. This return of tautness in the money market marked the full swing of the 2-week cycle, and as the tautness carried over into a new reserve settlement period a new cycle was begun.

Open market operations during this period generally sought to counter these swings in conditions in the money market, insofar as possible, to prevent undue easing that would undermine a steadily restrictive policy toward bank credit expansion or to head off extreme tautness that might generate instability in financial markets. This involved providing some reserves to meet apparent needs in the tight money market environment at the beginning of the 2-week cycles and then absorbing at least part of the excess that emerged after the weekends. As a rule, the absorptions were not sufficient to head off completely the money market ease that was developing, although they did serve as an indication of the System's intent to keep the banks under pressure. In the second half of the cycle, when money market pressures become quite intense, the System generally provided only limited amounts of reserves and thereby allowed most of the weight of the pressures to be felt.

The cumulative effects of the tightening of System policy were being felt more and more as the February–early June period drew to a close. Most System operations during this period were directed at offsetting drains from other factors, but the money market was generally quite firm, with some Federal funds transactions at 5¼ per cent for the first time and with borrowings from the Reserve Banks heavy. In this environment, banks in the money centers stepped up their bidding for CD's and adjusted their asset portfolios to improve their basic reserve positions in apparent anticipation of very heavy pressures around the June dividend and tax payment dates.

The acceleration of corporate tax payments as well as of payments of withheld Federal income taxes and social security taxes—anti-inflationary measures enacted by the Congress earlier in the year—was expected to make pressures over the coming weeks more intense than usual. In addition, with most market rates of interest having moved sharply higher, there was increasing concern at thrift institutions over potential large-scale withdrawals of funds in search of higher yields during the interest-crediting period at the end of June. Savings banks and savings and loan associations had experienced heavy losses of deposits and shares at the end of the first quarter of the year, and many had already virtually ceased to make any new mortgage commitments in order to preserve at least some liquidity cushion.

Treasury bill market. As noted earlier, little of the steady increase in money market pressures over the February–June period carried into the Treasury bill market. To be sure, with dealer financing costs high—and moving higher—through the period, dealers continually were constrained from taking any overly optimistic view of future developments in the bill market. And at times, the high costs of financing and the concern over increases in supplies of bills combined to produce a very cautious atmosphere in the market. This happened for example, in the first several weeks of the interval when the Treasury's weekly bill auctions were continuing to be enlarged by $100 million and when participants began to focus on the possibility of a large return of bills to the market around the March dividend and tax payment dates. The Treasury raised a total of $1.3 billion of new money through additions to the weekly auctions during the first 3 months of the year; however, the extra supply of bills from this source was more than offset when $3 billion of tax-anticipation bills matured in late March. Another period of hesitancy occurred in late April and early May when dealers were disappointed over the lack of demand for bills arising out of the Treasury's May refunding operation.

Even in the periods of greatest caution, however, rates on 3-month bills rose no more than 5 basis points above the level prevailing at the start of the interval. The more dominant tendency by far was for rates to drift lower—a testimony to the very strong demand for bills that prevailed on balance over the period from a wide range of investors. As usual during this time of year, public funds managed by State and local governments were the largest and most persistent buyers. They continually sought a temporary investment outlet for growing tax receipts as well as for some of the proceeds of the heavy volume of tax-exempt issues floated in the capital market.

From the end of January through the end of May, State and local governments increased their bill holdings by more than $1.1 billion. Proceeds of corporate bond flotations also often found their way temporarily into the bill market. In addition, some investors, both large and small, used the bill market as a haven for funds while awaiting more favorable conditions in the stock or bond markets. And finally, there was the Federal Reserve's activity in the bill market, which, while somewhat less than in comparable periods of other recent years, took up about $600 million of bills, net, from the supply of bills over the period as a whole.

Capital markets. The capital markets were marked by very sharp swings in sentiment over the February–early June period —from deepening gloom through the end of February to considerable optimism in March and early April and then back to a heavy atmosphere by late May and early June. Demands for credit in these markets were quite heavy throughout the period. In dollar amounts, the greatest demands came from corporate and State and local government borrowers, which together sold $10.1 billion of new securities from early February through early June, or about 7½ per cent more than during the comparable period of the preceding year.

The source of greatest pressure during most of the period—and particularly in May and June—however, was the sharp increase in borrowings by Government agencies. These agencies, both through increases in the size of regular issues and through heavy sales of new participation certificates by the Export-Import Bank and the Federal National Mortgage Association, offered issues totaling $8.1 billion from early February through early June and raised a net of $3.8 billion of new money, volumes in both cases that were about twice as large as in the comparable period of the preceding year. In terms of market impact, this agency financing far more than offset the effects of an actual reduction in the outstanding amount of direct Treasury obligations over the period.

A number of factors underlay the swings in sentiment that confronted this heavy financing schedule. These included alternately pessimistic and optimistic interpretations of the latest business developments, of the need for and prospects of a tax increase to restrain inflationary pressures, of the probable extent of further moves toward monetary restraint by the Federal Reserve, and finally, of the prospects for a peaceful settlement of the war in Vietnam. A mere listing of these factors, however, does not tell the whole story; it was not uncommon for similar developments to have a bearish impact in the bond market at one time and a bullish impact at another time.

In February, for example, participants in the bond market tended to view reports of further sharp rises in business activity and increasing inflationary pressures as being bearish for bond prices. In this environment new issues coming to market were accorded generally unenthusiastic receptions; prices of outstanding bonds moved sharply lower; and yields on Government, corporate, and municipal securities reached the highest levels in more than 40 years. At their peak near the beginning of March, long-term Treasury issues yielded as much as 4.86 per cent compared with a high of 4.70 per cent 3 weeks earlier. At about the same time, a new Aa-rated corporate bond was released from syndicate pricing restrictions and was traded in the free market at a yield of 5.30 per cent, 30 basis points higher than the yield on similar issues traded in early February.

Later, after a technical reaction had sparked the March rally in prices—which was then fueled by investor and dealer buying amid talk of a possible tax increase—reports of rising economic activity tended to have quite a different influence on most sectors of the bond markets. In particular, reports of increasing pressures on capacity, of higher prices, and of business plans to expand capital expenditures were generally interpreted as enhancing prospects for a tax hike and thus were followed by increases in bond prices. Some temporary caution emerged after the announcement of the increase in the commercial bank prime rate on March 10—which for a time led to some fears that the Federal Reserve discount rate might soon be raised—and also on occasion after publication of reports indicating successively deeper levels of net borrowed reserves.

Other factors, however, quickly helped to restore the general feeling of optimism about the outlook for bond prices. Among these factors was the cancellation of a large tax-exempt bond issue that had been scheduled for sale on March 17. As funds previously put aside for this issue were released, demand improved in all sectors of the markets. Remarks by President Johnson on March 29 that he would not hesitate to ask for a tax increase if consumer and wholesale prices should continue to rise too fast led to still further large gains in bond prices. So too did Secretary of the Treasury Fowler's plea in early April for restraint on bank lending "without skyrocketing of interest rates." Developments in Vietnam generally had little effect on bond markets during this period.

The buoyancy in the market extended generally through the first week of April. By that time prices of most Treasury notes and bonds had more than regained their February losses and yields on some short-term issues—which were in scarce supply—were at their lows for the year. Offerings of new corporate and municipal issues were well received during this period, and underwriters were left with little in the way of unsold issues. In this environment an Aa-rated corporate issue was brought to market on April 5 at a yield of 5.00 per cent. The Bond Buyer's index of 20 seasoned tax-exempt bonds reached a low of 3.53 per cent a week or so later, on April 14, compared with 3.83 per cent at its peak on March 3.

The improvement in general atmosphere also appeared in the market for Government agency securities, and prices of outstanding agency issues rose for a time. On the other hand, the heavy volume of new agency issues coming to market, which included the sale of $410 million of FNMA participation certificates around mid-March, generated somewhat mixed reactions. Receptions of these issues generally turned out quite good, but only because offering yields remained near their earlier highs.

The rally in the capital markets came to an end around mid-April. Prices drifted lower for a time and then fell off more sharply in late May and early June. Further discussion of the need for a tax increase intermittently buoyed the markets on individual days—as did occasional rumors of peace efforts in Vietnam. On the whole, however, participants came to the view that prospects for fiscal action had dimmed while hopes for peace usually were quickly dashed by new belligerent statements from North Vietnam or its allies. In this atmosphere, increased attention was paid to the gradual further increase in monetary restraint.

Meanwhile, scheduled offerings of corporate and municipal bonds began to build up, and there was particular concern over the capacity of the market to digest the very large volume of Government agency issues that still had to be sold before the end of the fiscal year. Dealers' inventories of agency issues had built up even further from an already high level. Indeed, by the end of April, inventories of such securities were up to about $950 million, compared with average holdings of about $300 million in the first 3 months of the year.

It was in this environment that the Treasury had to conduct its May refunding operation. Public holdings of the maturing issues, fortunately, had been reduced by earlier prerefundings to the relatively modest amount of $2.5 billion. To keep the operation as routine as possible, the Treasury offered holders a straightforward exchange into a new 4⅞ per cent 18-month note priced at a discount to yield 4.98 per cent. This was in line with market expectations, and the announcement had no apparent effect on prices of outstanding issues.

Interest in the new issue proved extremely apathetic, however, and despite some when-issued purchases by Treasury trust accounts, the price of the notes dropped almost immediately to a level just below the initial offering price. Dealers took an extremely small underwriting position in the new issue, and only a little more than half of the maturing issues held by the public were exchanged. The 43 per cent "attrition" was the highest in any modern refunding. With market attention diverted around this time by sharp declines in stock prices and reports of cutbacks in automobile production, the actual results of the refunding had little impact on bond prices, and the Treasury announced that its cash position was sufficiently strong to absorb the attrition without any modification of its current financing plans for the months immediately ahead.

A plethora of Federal agency securities came to market over the following weeks. Despite successively higher yields, all were accorded slow initial receptions as investors held back, waiting to buy at lower prices in the secondary market. Anticipation of heavy future offerings, including a probable large-sized offering of participation certificates under authorization of the recently enacted Participation Sales Act of 1966, added to the heavy atmosphere overhanging the market.

By the end of the period under review prices of most Treasury notes and bonds had dropped to levels near their lows for the year, and yields on long-term issues were as high as 4.78 per cent. Aa-rated corporate issues with 5 years of protection against special call were trading at yields around 5.5 per cent, about the same as at the April peak and up 50 basis points from the rates prevailing in early February. The Bond Buyer's index of yields on 20 seasoned tax-exempt issues was up to 3.78 per cent by early June, within 5 points of the March peak. And in the market for agency issues, where the upward pressures on rates were most intense, the participation certificates that came to market on June 9 carried yields as high as 5.70 per cent on 1-year maturities, about 60 basis points higher than rates on similar maturities in mid-February.

June 8–September 13: Peaking of financial market pressures. Stresses and strains on the nation's financial system mounted to a peak of intensity during the June 8–September 13 interval. To be sure, there were intermittent lulls when participants in the money and bond markets tentatively began to hope that the crest of pressures had passed. One such lull occurred in the opening weeks of the period. New corporate, municipal, and agency issues began to attract good investment demand, and for a time prices of securities generally rose. Very heavy credit demands over the June dividend and tax payment period had pushed money center banks into deep basic reserve deficits, but no undue stress was in evidence. Near the end of June the thrift institutions seemed to be weathering the midyear interest-crediting period with smaller than expected withdrawals of deposits and shares. Another lull occurred in the second half of July, when market participants cautiously took heart from the fact that the Federal Reserve had not raised the discount rate, as it had been widely expected to do.

Except for these respites, however, the period was marked by progressively deepening gloom in all financial markets. Indeed, by late August—before official policy actions succeeded in restoring a degree of calm in early September—there were even some fears being expressed that a financial crisis might be near at hand. Although such fears were not borne out, the feeling of apprehension led a number of borrowers to accelerate their capital market offerings, and this in turn added to an already congested market situation. At the depths of the gloom in the second half of August, conditions in the market for tax-exempt securities were on the verge of disorder, and yields throughout short- and long-term markets were at the highest levels in more than 40 years.

In addition to the heavy current demands for credit, the major immediate cause of the highly unsettled conditions in late August was a growing apprehension over the ability of the markets to accommodate the pressures that seemed to be building up for September. In particular, it was expected that large fall loan demands would at that time be converging on a banking system that faced the possibility of a large-scale runoff of maturing negotiable CD's. To this was added a growing concern over the capacity of the market to digest a sizable offering of Treasury tax-anticipation bills in late August and an expected sale of FNMA participation certificates and other Federal agency offerings in September. The prospective FNMA and agency financings were of particular concern because of the already heavy schedule of new corporate and municipal offerings.

Meanwhile, hopes for a tax increase to combat inflationary pressures had waned, and the conviction spread that the major burden of economic restraint would continue to rest on monetary policy. Federal Reserve actions on June 27 and August 17 to raise reserve requirements against certain time deposits of member banks were interpreted as consistent with such a view. In this environment, market participants came to feel not only that the squeeze on the banks imposed by current Regulation Q ceilings would not be removed by increases in the ceilings, but also that general monetary policy might tighten further.

These various apprehensions became particularly heavy on Friday afternoon, August 26, and securities prices, which had eroded throughout the capital markets in preceding weeks, began to drop at an accelerated pace. Some temporary steadiness emerged in the market for Treasury securities the next Monday after sizable purchases of Treasury bills by the Federal Reserve early in the day. But a second break in prices occurred late that afternoon in the wake of an upward adjustment of about 25 basis points in the yield of a recent corporate bond offering that had been moving slowly. Finally, late on Tuesday, August 30, a better atmosphere seemed to be in the making, and it was kept alive by a series of statements and actions over the next 2 weeks.

The initial spark to the rally was a sudden revival of hopes for a tax increase, following a statement by the Under Secretary of the Treasury to the effect that monetary policy should not be called on for further restraint and that, if such restraint were needed, it would have to come in the form of a rise in taxes or a cut in Government spending. To this was added a report late on the following day that the FNMA might reconsider its offering of participation certificates now widely expected in September.

On the next day, September 1, the Federal Reserve System issued a letter seeking to assure member banks that funds would be available at the discount window to meet unusual liquidity pressures over the period ahead and calling on banks to accomplish additional necessary adjustments in their portfolios over ensuing weeks by holding down the growth of business loans rather than by further substantial liquidation of tax-exempt and other securities. Then on Thursday, September 8, President Johnson announced a program of fiscal and debt management actions to restrain inflationary forces and help moderate financial market pressures. The program included cutbacks in "lower priority" Federal expenditures, a temporary suspension of certain tax benefits applicable to business investment, and a sharp curtailment in Federal agency borrowing in the capital markets. Taken together, the actions succeeded in restoring a feeling of confidence in the markets.

Open market policy. Federal Reserve open market policy was conditioned in an important way by the gyrations in market sentiment in August and September as well as by several other developments during the period under review here. Open market operations through much of the period were directed primarily at maintaining net reserve availability and related money market conditions in about the range reached in late May and early June, with continued reliance on the "proviso clause" to provide for modifying operations in the light of developments in required reserves and bank credit. In addition, however, operations had also to be concerned with a series of special considerations.

In late June, for example, the Federal Open Market Committee was concerned with the possible need for moderating unusual liquidity pressures at financial institutions that might develop around the midyear interest-crediting period. In the event, as noted earlier, mutual savings banks and savings and loan associations got through the period better than many observers had expected, and no special System action was needed. Beginning in late July there was a need for maintaining generally "even keel" conditions around the time of the Treasury's August refunding operation. And then later in August, against the background of the extreme uncertainty in the markets, the Committee directed that operations be conducted specifically with a view to supplying the minimum amount of reserves consistent with maintenance of orderly money market conditions and moderation of unusual liquidity pressures.

As these policies were carried out, nationwide net borrowed reserves in the banking system fluctuated around an average of $370 million for the period as a whole. In general, net reserve availability was allowed to run somewhat higher than average in the first half of the 2-week reserve settlement periods for country banks, to accommodate the large amounts of excess reserves that these banks typically held at that time. This was followed by a somewhat deeper than average level of net borrowed reserves in the second half of the 2-week settlement period when the previously accumulated excess reserves generally were released into the money market. In this way bank reserve positions were kept under a fairly constant degree of pressure, as reflected in the rather narrow week-to-week fluctuations in member bank borrowings from the Reserve Banks around an average of $755 million for the period as a whole (see Chart 3).

Meanwhile, bank credit did bulge temporarily in the latter half of June, as the banking system accommodated business demands arising out of the need to make enlarged corporate tax payments around midmonth and also the accelerated payments of withheld income taxes and of social security taxes that went into effect on June 20. Total loans and investments at weekly reporting banks rose by $3.7 billion in the 2 weeks ended June 22, compared with a net rise of only $1.9 billion in the roughly comparable weeks of the preceding year. Later on, however, growth in bank credit slackened somewhat and weekly averages of required reserves fell rather persistently short of the levels projected as each week began. Indeed, in August the so-called "bank credit proxy"—daily-average member bank deposits subject to reserve requirements—actually declined on a seasonally adjusted basis, following the sharp increases earlier in the year.

With banks' reserve positions maintained under steady pressure over the June–September period, short-term interest rates continued to climb. Federal funds traded at successively new high

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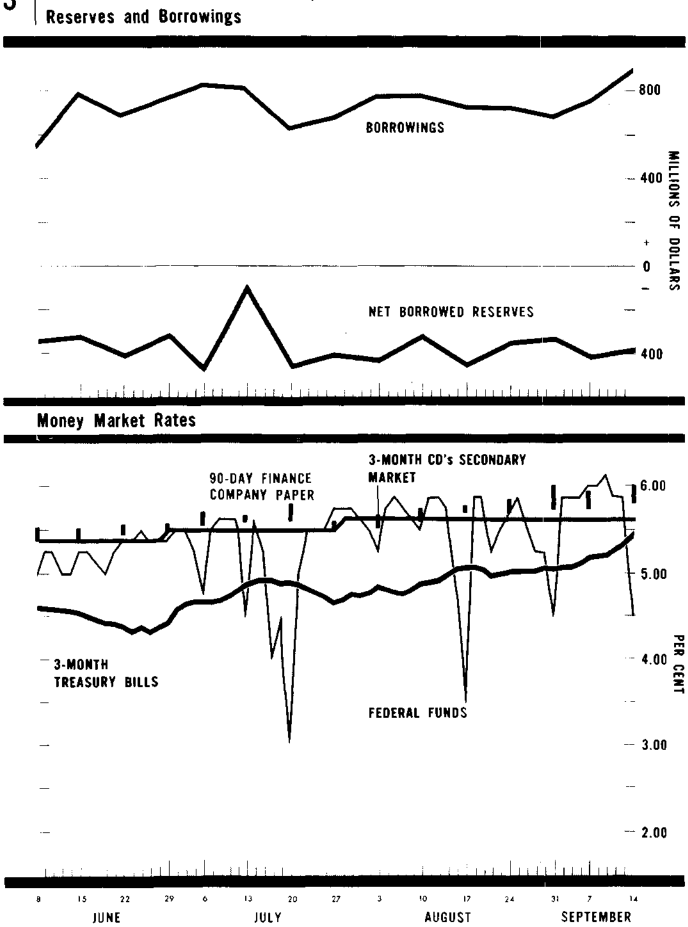
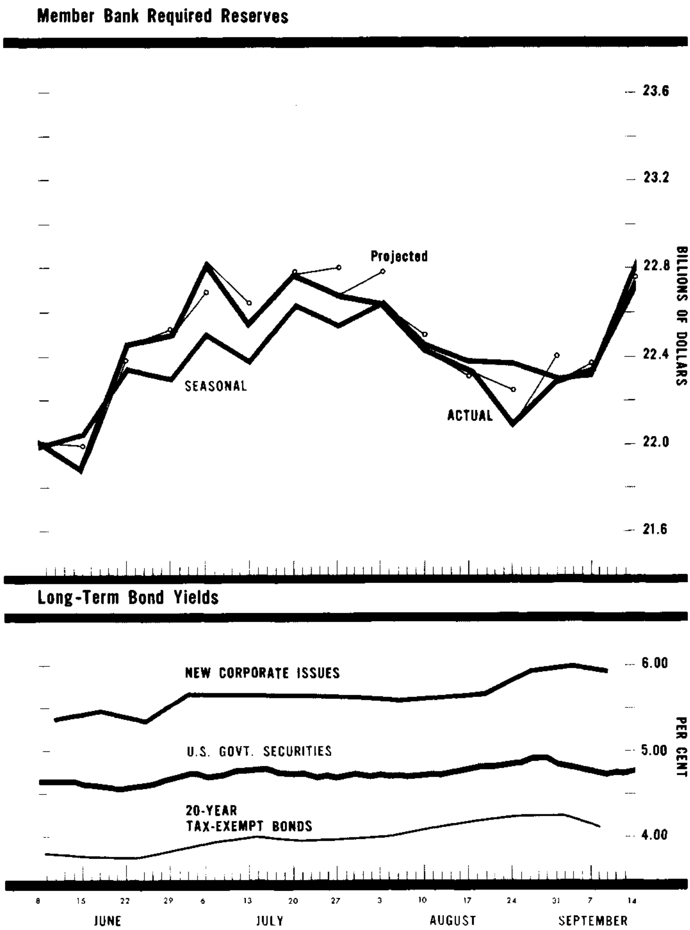


For notes see p. 211.

rates of 5⅝ per cent by June 24, 5¾ per cent by July 8, 5⅞ per cent by August 4, 6 per cent 2 weeks later, and even 6¼ per cent in the final statement week of the period. Major banks raised the prime loan rate to 5¾ per cent at the end of June and then to 6 per cent in mid-August, and New York City banks posted dealer lending rates generally in a range of 6¼–6½ per cent.



Some banks occasionally posted even higher rates or were not willing to make loans at all. Rates on bankers' acceptances and commercial and finance company paper all rose by ¼ to ½ of a percentage point over the period. Even Treasury bill rates, which had been lower than other short-term rates by an unusually wide margin in the first half of the year, moved up sharply from their late June lows, with increases of more than a full percentage point recorded on some maturities over the next 2½ months.

There was one exception, of course, to this upward march in short-term rates, namely the rates offered on negotiable CD's. After having led the parade through the early months of the year, rates offered on CD's by some banks in New York City reached the 5½ per cent Regulation Q ceiling on deposits of any maturity by late June, amid the pressures following the corporate tax dates. The banks were able to about hold their own in replacing sizable amounts of maturing CD's—albeit generally with new deposits of only very short term—up through mid-August.

In subsequent weeks, however, with market rates on competing instruments well above the 5½ per cent ceiling rate on CD's, banks experienced a steady erosion in their outstanding volume of CD's—the apprehension of which, as noted earlier, was one of the main factors underlying the late-August gloom throughout the financial markets. As one means of offsetting the potential and actual loss of domestic funds, several of the major money market banks with overseas branches became active seekers of funds in the Euro-dollar market during the period under review here. In the 2 months through the end of August a group of these banks increased their outstanding Euro-dollar liabilities by nearly $1.2 billion, and such liabilities rose by another $1.2 billion through mid-December.

System operations. In conducting open market operations over the June–September period, the Account Manager sought to carry out over-all System policy objectives without adding unnecessarily to the basic apprehensions dominating market psychology. Operations were complicated by the fact that the markets for Government securities tended to be quite thin. Dealers were reluctant to hold sizable positions in the face of the uncertain environment, the rapid upward movement of interest rates, and the high cost and limited availability of dealer financing. Over the first 2 months of the period, until the Treasury auctioned $3 billion of tax-anticipation bills in mid-August, the total amount of Treasury bills held by dealers in their trading positions averaged only $1.1 billion, compared with an average of $3 billion in the comparable months of 1965. On occasion, such as around the end of June and again in early August, their holdings of bills in trading accounts dropped to around $250 million. In the environment of this period large outright purchases or sales by the System would have risked contributing to exaggerated movements in bill rates.

Difficulties in injecting reserves in the face of market scarcities of bills had been present in varying degrees throughout the spring, as noted in the preceding period. They became pressing again in the second half of June as the System moved to meet part of the sizable reserve needs accompanying the large expansion of credit over the tax date, and to provide for the needs around the July 4 holiday. The money market had become taut in the statement week ended June 22 as the convergence of credit demands had produced a basic reserve deficit of more than $1.5 billion at major money center banks. On the last day of that week Federal funds traded predominantly at 5⅜ per cent, and there was some trading for the first time at 5½ per cent. The System moved to head off further tightening by purchasing $308 million of Treasury bills from dealers and foreign accounts, for both cash and regular delivery. These purchases, plus heavy demand for bills from public funds as well as from commercial banks, which were buying bills to include in midyear statements, reduced dealers' holdings of bills in trading positions to less than $270 million on June 23.

With the July 4 reserve needs still to be met, the Federal Open Market Committee at its June 28 meeting broadened the avenues for reserve injection by removing the 2-year limitation on the maturity of Treasury issues that the System could purchase under repurchase agreements. In recommending approval of this added flexibility, the Manager noted that it might be necessary over the period immediately ahead to make repurchase agreements against Treasury issues that the dealers themselves might acquire under repurchase agreements with investors. Such "back-to-back" agreements would in effect make use of the dealers as direct channelers of funds to points of need in the market.

In the event, there proved to be no real problems in injecting reserves, as a large supply of bills became available over succeeding days directly from foreign accounts that had to meet midyear liquidity needs and also in the market as banks unwound their midyear window-dressing operations. As a result, there was no need for using back-to-back repurchase agreements, and only limited use was made of the authorization to purchase Treasury issues of any maturity under repurchase agreements. The broader authorization remained in effect throughout the rest of the year, however, and proved helpful in meeting reserve needs on other occasions.

Reserve injections were also accomplished in late June by System purchases of a sizable amount of bankers' acceptances under repurchase agreements and of Treasury coupon issues, with the maturity range of the coupon issues purchased extending, for the first time during the year, to more than 10 years. After the end-of-June operation the System remained out of the coupon market during the period of unsettled conditions during the summer and fall and did not make any additional purchases of coupon issues until late December.

The operating difficulties of absorbing a large amount of reserves in an uneasy market environment came into particular prominence in the wake of a strike against five major domestic airlines beginning on Friday, July 8. The strike hampered the clearing of checks through the banking system. As the Federal Reserve continued to grant credit on the uncollected checks according to normal schedules, however, there was a sharp rise in Federal Reserve float and a corresponding bulge in nationwide net reserve availability. By Tuesday, July 12, float had risen to a level about $1 billion higher than normal for that time of year, and it remained $800 million or more above normal throughout the strike, which was not settled until August 19.

Although some of these extra reserves were absorbed as the Treasury agreed to increase its balance at the Reserve Banks, a sizable amount remained to be absorbed by open market operations. Treasury bill rates were rising sharply at the time, however, and the market was not expected to be receptive to large outright sales of bills. Moreover, any such sales might have had to be followed quickly by large outright purchases, if the strike were suddenly settled. Thus, in the thin market then existing, the use of outright transactions to deal with the rise in float could have resulted in very large fluctuations in interest rates.

In this situation the Account Manager—after consultation with the Open Market Committee in a special telephone meeting on July 11—initiated a new operating technique of selling selected issues of Treasury bills to dealers for cash and simultaneously making a commitment to purchase the same issues of bills at competitively determined prices for delivery to the System a few days later. Such matched sale–purchase transactions could be carried on in large size because they did not involve an indeterminate market risk for the dealers. Furthermore, they automatically kept the reserve absorption on a short-term basis, while leaving open the possibility of extending the period of reserve absorption with new transactions if the airline strike continued.

The first of these operations was undertaken too late in the statement week ended July 13 to have more than a small effect on the average level of net reserve availability for that week as a whole, during which net borrowed reserves turned out to be only $94 million. In the next several weeks, however, such operations were a major factor in pushing net borrowed reserves back over the $400 million level. In all, more than $1.9 billion of bills were sold in six matched sale–purchase operations through the end of July, with outstanding commitments to purchase under such transactions reaching a high of $822 million in the July 15–18 period.

Subsequently, matched sale–purchase transactions were used on other occasions when reserves had to be absorbed temporarily.

Many of these cases involved mopping up short-lived reserve redundancies that emerged late in a statement week. Only a limited amount of reserves had to be absorbed through other means during the strained market situation in August. This was easily accomplished by a redemption of bills in the regular weekly auction on August 8 and the sale around the same time of a few short-dated bills—which were in demand—to the market and directly to foreign accounts.

The System injected reserves at the beginning of August to offset reserve drains from other factors, and again toward the end of the month to supply the reserves needed around the Labor Day holiday. In each case the injections were made in the way that seemed most likely to contribute to the continued orderly functioning of the market. Early in the month, when dealers were concerned about the high cost of financing positions that had been swollen by acquisitions of rights to the Treasury's August refunding, the System confined its operations to the purchase of rights and other Treasury issues under repurchase agreements. In the latter part of the month, on the other hand, after dealers' positions in longer-term bills had begun to weigh rather heavily on the market in the wake of the Treasury's auction of tax-anticipation bills, the System made large outright purchases of bills. One such operation was conducted at the opening of the market on Monday, August 29, following the sudden acceleration in the pace of price declines in all market sectors late the preceding Friday afternoon. In all, the System purchased $419 million of Treasury bills from dealers in this operation, for both cash and regular delivery. As noted above, these purchases had a temporary, steadying influence on the markets.

For the June 8–September 13 period as a whole, the System's outright transactions in Treasury bills included gross purchases of $5.5 billion and gross sales and redemptions of $4.3 billion, with $2.8 billion of each representing bills sold and simultaneously purchased under matched transactions. Purchases of coupon issues, all of which were consummated before the end of June, totaled $185 million. Except for the use of repurchase agreements against rights during the Treasury's August refunding, the System made only limited use of this instrument over the period. Thus, total purchases of Treasury issues under such agreements amounted to only $716 million, of which nearly two-thirds were arranged in early August. All of these repurchase agreements were arranged at the 4½ per cent discount rate, which at times was 2 percentage points or more below the cost of alternative sources of dealer financing.

Treasury finance. The uncertainty and progressively heavier atmosphere in securities markets presented problems over the period for Treasury debt management operations as well as for Federal Reserve open market operations. In a number of Treasury bill auctions during the period, investor bidding was so weak that the total offering was covered by only a small margin—and then only at sharply higher rates than prevailed on outstanding bills. This was particularly true of the first two weekly auctions in July, which followed the increase in reserve requirements against certain time deposits and the rise in the bank prime rate at the end of June. The auctions also came at a time when there was widespread expectation in the markets that the Federal Reserve discount rate would soon be raised. In each of these auctions the average issuing rates on the new 3- and 6-month bills were 15 or more basis points higher than the bid rates on comparable bills at the close of the day preceding the auction. Moreover, tenders were accepted in these auctions at rates as much as 10 basis points above the average issuing rates, although such margins generally run no more than 2 or 3 basis points in more normal times.

Similarly weak bidding prevailed in the weekly bill auction held in mid-August and in the auction of 1-year bills held about a week later. Although the atmosphere in the bond markets changed for the better shortly thereafter, it remained quite heavy in the bill market, and bidding in the auctions was still generally restrained throughout the rest of the period. In part, this reflected dealers' concerns over continued high financing costs—with loan rates at some New York City banks occasionally reaching 6⅝ per cent. There was also considerable apprehension over the increased supply of bills stemming from the auction of $3 billion of tax-anticipation bills on August 28 as well as over the impending return of bills to the market around the September dividend and tax dates.

Toward the end of the period, there was also concern over prospects of large-scale Treasury financing in the bill area throughout the rest of the fall. The curtailment of agency financing, included as part of the President's program announced on September 8, was generally expected to mean that the Treasury would have to sell more bills to raise the needed cash. In this environment, bidding was weak in the final weekly auction of the period, and rates on most bill issues closed on Tuesday, September 13, at new highs. Rates on 3- and 6-month bills that day were 5.43 and 5.85 per cent bid, respectively, compared with 4.60 and 4.76 per cent at the start of the period in June.

Financing in the Federal agency market also ran into difficulties over the period. Despite the progressively higher yields that were offered, each of the new agency issues that came to market during July and August encountered investor resistance. By the end of August a 2-year issue of 5⅞ per cent debentures, which had been offered at a yield of 5.91 per cent earlier in the month, was trading in the secondary market at a yield as high as 6.15 per cent. By way of comparison, a 1-year issue of debentures had been sold in mid-June, during the temporary improvement in the markets, at a yield of 5.75 per cent.

This continued upward pressure on yields in the agency market reflected, among other things, the very large amount of new money being raised through sales of agency issues. To be sure, the volume of such financing fell off in July and August from the extraordinary pace in May and June. Still, more than $1 billion of new funds were raised in this market during July and August, more than double the amount raised in the comparable period of the preceding year. Moreover, as noted above, there was growing apprehension that a still larger volume of offerings would be forthcoming in September, including the sale of a large volume of FNMA participation certificates, in accordance with the provision for $4.2 billion of such sales in the 1967 Federal budget. It was in an effort to quiet these apprehensions that the President's program included a curtailment of agency financing in the public sector during the last 4 months of 1966.

Against this background of the general deterioration in market atmosphere over the period as a whole, the Treasury had to refund its August 15 maturities. Fortunately, from the Treasury's standpoint, one of the periods of temporary improvement in the market began after mid-July and continued through the period that the subscription books were open on August 1–3. The improvement stemmed in large part from the fact that uncertainties in the market associated with the widespread expectation of an increase in the Federal Reserve discount rate had temporarily been resolved because the 4½ per cent rate was left intact.

In the absence of a change in the discount rate, some participants came to feel that prices had declined too much and that yields might be near their peaks. By late July the market seemed receptive to a Treasury issue maturing in 4 or 5 years, and in fact the announcement of an offering on a rights basis of both a 5¼ per cent 1-year certificate and a 5¼ per cent note due in May 1971 was accorded a favorable response. Holders of the issues maturing in August were allowed to exchange for either of the new maturities, and holders of issues due to mature in November were offered the opportunity to exchange into the new note.

The 5¼ per cent coupons, which represented the highest rate paid on Treasury coupon issues since 1921, proved attractive, and the exchanges were sufficient to extend the average maturity of the marketable Federal debt by 1 month. Nearly 80 per cent of the $3.1 billion of publicly held August maturities and about a third of the $4.9 billion of the November maturities held by the public were exchanged. By the time the subscription books had closed, however, the atmosphere in the markets had begun to change. The steel industry announced a price increase on August 3, the day the books closed, and around the same time large additions were being made to the already heavy calendar of future corporate bond offerings. As prices in all securities markets weakened over subsequent days, some of the new Treasury issues that were overhanging the market were bought for Treasury trust accounts. Even so, by the payment date for the refunding, on August 15, the new certificates and notes were trading at discounts of $\frac{8}{32}$ and $\frac{14}{32}$ of a point below par.

Yield movements. Prices of both new and outstanding Treasury issues moved steadily lower over most of the balance of August. In some cases they fell by as much as 2 points. At the lows on Monday, August 29, the new 5-year notes were bid at $97\frac{31}{32}$ to yield 5.75 per cent. Yields throughout the Treasury coupon market were at the highest levels since the 1920's. Some issues in the 2- to 5-year range were yielding as much as 6.25 per cent; some 5- to 10-year issues 5.96 per cent; and some long-term bonds 5.26 per cent. At the start of the period, in early June, the highest available yields in these three maturity ranges had been 5.08, 4.99, and 4.78 per cent, respectively.

The subsequent very sharp improvement that took place in the markets in early September—the causes for which were reviewed above—brought yields on Treasury coupon issues down by as much as 54 basis points from their peaks. By the close on September 13 the highest yield in the 2- to 5-year range was down to 5.80 per cent, while maximum yields in the 5- to 10-year range and on longer-term issues were down to 5.48 and 5.04 per cent, respectively. Yields on outstanding longer-term agency issues also declined, especially as it became clear that there would be no offering of FNMA participation certificates, though in the short-term market two new issues that were offered around the middle of September bore record rates of 6.05 and 6.20 per cent.

Movements in yields on corporate and municipal bonds generally paralleled those on Treasury issues. More than $3.3 billion of corporate bond issues were floated between mid-June and the end of August, with about half coming in the month of August alone, when many borrowers accelerated their market offerings. The offerings encountered increasing investor resistance as the period progressed, and even with record yields buyers generally were not interested unless the borrower extended special protection against early call to 10 years and also agreed to accept delayed payment. At the late August peak, an Aa-rated issue with 10 years of special call protection was offered at a yield of 6.34 per cent, compared with an offering yield of 5.75 per cent in early June on a slightly lower-rated issue with only 5 years of special call protection. Yields on corporate issues fell by as much as 40 basis points over the first 2 weeks of September, and shortly after the period under review here, an Aa-rated issue was sold quickly at a 5.90 per cent yield.

In the tax-exempt market, which became by far the most unsettled of all the markets during August, there was only a routine volume of new issue activity. Several large commercial banks, however, were making very sizable sales of tax-exempt issues in order to ease some of the pressures on their reserve positions. On a nationwide basis, commercial banks' holdings of securities other than Governments (a balance sheet category that in fact includes mostly tax-exempt issues) fell by $200 million in August. With commercial banks acting as net sellers rather than in their normal role of net buyers, and with other investors and dealers generally discouraged, it was difficult to find bidders for offerings of tax-exempt issues even at sharply reduced prices and higher yields. By the end of August the Bond Buyer's index of yields on 20 seasoned tax-exempt bonds had risen to 4.24 per cent, a full ½ of a percentage point above the level prevailing around mid-June. The over-all market atmosphere improved over subsequent weeks, and by mid-September the index had declined to 4.11 per cent.

September 14–November 22: Relaxation of market tensions. The better atmosphere that developed in financial markets in early September—in the wake of the various official measures taken to stem inflationary pressures and ease stresses in securities markets—continued and was consolidated, with occasional setbacks, over the September 14–November 22 interval. The markets were alternately buoyed and depressed by a number of factors on individual days and within particular short intervals. On the whole, however, the feeling prevailed that the strains of late August would not soon recur, and although the banking system continued under pressure, confidence reappeared that the financial markets could cope with the demands immediately ahead.

Among the various factors affecting the markets during the period were shifting views on (1) the adequacy of the new fiscal measures and the likelihood of still further fiscal action to redress continuing imbalances in the economy, (2) prospects for peace in Vietnam, (3) the outlook for the domestic economy in the face of weakness in some sectors, and (4) the prospects for monetary policy. With respect to the last, the conviction developed among participants that monetary policy would not permit a renewed buildup of money market pressures that would propel interest rates back toward their late summer peaks. To this was added—as the period drew to a close—an emerging feeling that some slight easing of monetary policy already was in process.

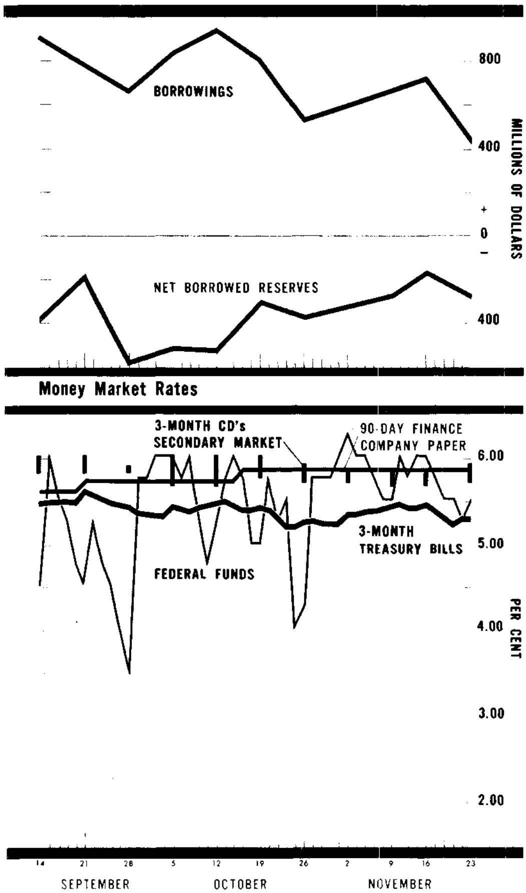
In this environment, bond prices rose fairly steadily in all markets through October, at which point yields were down to levels not seen since early June. However, a buildup in the corporate and municipal bond calendar after a post-August breather led to renewed caution in the capital markets during the first half of November, and prices declined again for a time. Net price changes over the period as a whole were mixed. In the Treasury bill market, a deepening apprehensiveness persisted through the third week of September amid worries over prospective large increases in the supply of bills outstanding around the corporate tax payment date and as the Treasury sought to meet its enlarged cash needs over the remainder of the year in the wake of the curtailment of Federal agency financing. As it turned out, the additions were absorbed rather easily and bill rates moved down rather sharply over the balance of the period (see Chart 4).

The banking system emerged from the September tax payment period in a considerably better position than many had expected. Despite continued losses of outstanding CD's, banks were able to cover their reserve deficits in a money market atmosphere that was more relaxed than a few weeks earlier. This easier money market environment may have reflected in part firmer lending policies at the banks and in part some abatement in demands for credit in the wake of overborrowing earlier in the year and the slower pace of economic expansion. Whatever the reasons, total outstanding bank credit declined by $2.7 billion on a seasonally adjusted basis between the end of August and the end of October.

As in earlier months of the year, open market operations in the September–November period were directed at both proximate and "provisory" objectives. The proximate objective over much of the period was the maintenance of "firm but orderly" conditions in the money market—though this was modified to the maintenance of "generally steady" conditions in the market during the last 3 weeks of the interval around the time of the Treasury's November refunding operation. Throughout the period, however, the directive included a proviso clause calling for modification of operations in the light of developments in bank credit and, for a time, also in the light of unusual liquidity pressures.

In contrast to the proviso clauses in effect during the late spring and throughout the summer—which provided only for resistance to undesirably or unexpectedly rapid increases in required reserves (or bank credit)—a "two-way" clause was adopted by the Committee at its September 13 meeting. The new clause called for seeking either greater or less firmness in the

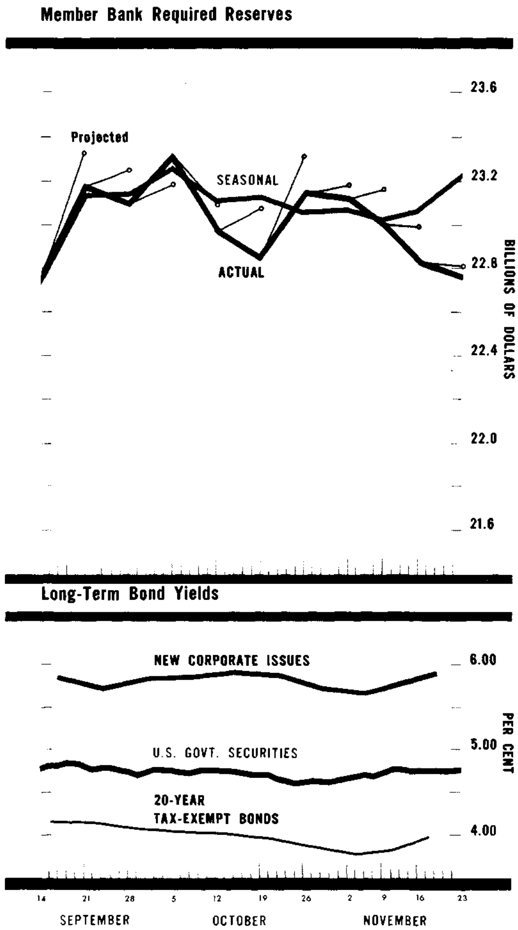
4 | SEPTEMBER 14 - NOVEMBER 23, 1966
Reserves and Borrowings



For notes see p. 211.

money market, depending upon developments in bank credit. Because there were persistent shortfalls of bank credit below projected levels as the period progressed, System operations gradually leaned toward a little less firmness.

Over the period as a whole, the System's outright purchases of Treasury bills totaled \$3.1 billion, while sales and redemp-



tions of bills amounted to $3.2 billion. With the market for coupon issues still in a state of flux—albeit with prices generally rising in contrast to the sharp declines during the summer—no outright purchases were made of such issues over the period. The System continued to use repurchase agreements rather sparingly, although in all it did purchase a little more than

$1 billion of securities under such agreements during the period. Most of these agreements were arranged in early November when high rates on dealer loans at the New York City banks were causing some nervousness in the securities markets at a time when issues from the Treasury's November refunding remained to be distributed. Over the period the System absorbed reserves for several weeks around the middle of each of the months of September, October, and November, and only briefly provided reserves around the ends of September and October when Federal Reserve float was at a low ebb.

In the wake of these operations the general atmosphere in the money market became more relaxed than it had been in the summer, although quantitative indicators of money market conditions tended at times to move in somewhat divergent directions. Nationwide net borrowed reserves, for example, fluctuated in a wide range in the first several weeks of the interval before being eased back to a persistently lower level around mid-October. By that time, staff projections were pointing to a third consecutive month of weakness in daily-average member bank deposits subject to reserve requirements—the proxy for bank credit. With the weakness in bank credit persisting, net borrowed reserves were allowed to fall to an average of about $220 million in the final 2 weeks of the period reviewed here, compared with weekly averages of more than $400 million during the summer and early fall.

Member banks' borrowings from the Reserve Banks also tended to decline as the period progressed, although there were wide week-to-week fluctuations, in part because a few banks apparently shifted their strategies for managing their reserve positions. Banks borrowed particularly large amounts from the Reserve Banks in the week ended October 12 even though Federal funds appeared to be relatively abundant. This development for a time impaired the System's abilty to judge the state of the money market and the true state of reserve availability. In the final 2 weeks of the period borrowings averaged $575 million, compared with an average of about $755 million over the June–September period.

In the Federal funds market, on the other hand, the most relaxed atmosphere seemed to prevail during the first month and a half of the interval—that is, through late October—when a considerable volume of trading occurred on a number of days at rates below 6 per cent. Later, in the opening weeks of November, reserves shifted sharply away from banks in the major money centers. Bidding for funds was fairly aggressive, and trading was for the most part at rates of 6 per cent or more, even with the increased level of nationwide net reserve availability. In the final week of the period, the Federal funds rate eased again as reserves flowed back toward the money center banks.

Other short-term interest rates showed mixed changes over the period. Rates on commercial and finance company paper rose in two steps by a total of ¼ of a percentage point. Rates on dealer loans at the New York City banks held generally in a 6 to 6½ per cent range through the end of October, then moved up to as high as 6¾ and even 6⅞ per cent over much of the next 3 weeks, a time when dealers' financing needs were enlarged by their recent acquisitions of Treasury bills and other securities. Rates on Treasury bills and CD's of major money market banks trading in the secondary market, on the other hand, declined generally by ⅛ to ⅜ of a percentage point, net, over the period.

System operations. At the beginning of the period there was still some apprehension in the money and securities markets stemming from the churning and pressures around the mid-September corporate tax date. Major banks across the country faced CD maturities on the tax date itself totaling about $1.2 billion, and they had large amounts maturing throughout the rest of the month as well.

In the event, open market operations insured that the banking system had the funds needed to avoid undue strain during the period. The banks were able to replace about three-fourths of their maturing certificates over the period with new CD's, albeit mostly of 1-month maturity. This performance—along with a sharp, further buildup of Euro-dollar deposits by a few banks—and a temporary rise in nationwide net reserve availability helped the banking system to operate during the period of seasonal pressure with considerably less strain than many observers had expected. Even at major banks in New York City, which lost about $560 million of CD's and experienced an increase in credit of $540 million over the September 21 statement week, pressure on reserve positions was only about average for a tax period. Moreover, with the very quick payoff of many of these loans the next week, New York City banks found themselves in quite comfortable reserve positions by the end of September.

Open market operations during the last 2 weeks of September generally proceeded cautiously to absorb a part of the bulge in reserves generated by the midmonth rise in float and other factors. Early in the period rates on Treasury bills were rising sharply, because market participants thought the decision to avoid sales of participation certificates and to limit Government agency financing in the market would require an increase in direct Treasury financing. In this nervous market atmosphere the System for a time made considerable use of matched sale–purchase transactions, which absorbed reserves with minimal effects on market rates of interest. Outright sales by the System during this period were limited to responding to unsolicited dealer bids and to orders from foreign accounts. Partly because of this cautious approach, net borrowed reserves declined to an average of $179 million in the week ended September 21, helping to accommodate the churning in the markets and an unusually large increase in excess reserves held by country banks.

The spillover of accumulated excess reserves into the following week preserved a generally comfortable money market environment, which in turn contributed to a gradual strengthening in the bill market. Rates on Federal funds remained at 5 per cent or less until the very end of the week. As the week progressed, the System made fairly large-scale sales of Treasury bills, both outright and under matched transactions, and net borrowed reserves were deepened to an average of $583 million, the deepest level of the year.

Estimates of bank credit were persistently revised downward over succeeding weeks. In response to this development the System began around mid-October to absorb less than the full amount of reserves released by movements in other factors and thus allowed net reserve availability to expand somewhat. As a generally relaxed atmosphere emerged and persisted in the money market, some market participants began to feel that the System's policy had shifted slightly in an effort to avoid a renewed escalation of interest rates. The actions in late September by the Board of Governors of the Federal Reserve System and by the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board in exercising newly enacted powers to set interest rate ceilings on consumer-type savings deposits were interpreted as generally consistent with this view.

In early November, reserves began to shift away from banks in the money centers. This reflected in large part the Treasury's drawing down of its tax and loan accounts at these and other banks as its cash balances began moving toward a seasonal low. Funds coming into the banking system, on the other hand, were widely dispersed among banks outside money centers, which tended to hold onto somewhat larger than normal amounts of excess reserves, partly because of the uncertainties around that time of year caused by the closing of the markets for the Veterans' Day and Election Day holidays. With New York City banks bidding strongly for the limited amount of money available in the Federal funds market, the funds rate moved quickly to 6 per cent and above on the first of November, and a generally taut situation became evident in the money market. As the New York City banks raised their lending rates to securities dealers above 6½ per cent, a feeling of nervousness began to pervade the Treasury bill market—and longer-term markets as well—at the time the Treasury was conducting its November refunding.

Under these circumstances the System moved promptly to supply additional reserves. It arranged $122 million of repurchase agreements on Tuesday, November 1, and bought about $270 million of bills on an outright basis from the market and foreign accounts the next morning. With pressures still in evidence, the System reentered the market that same day and purchased an additional $202 million of Treasury issues under repurchase agreements. Further prompt injections of reserves over subsequent days continued to help avoid undue tautness in an environment of expanding net reserve availability. Not until the week ended November 22, however, when reserves shifted back toward banks in the money centers, did the money market regain the tone prevailing in the second half of October.

Securities markets. Conditions in the securities markets, as noted earlier, generally showed further improvement over the September–November period, even though there was a temporary reemergence of caution in the first 2 weeks of November. The sharp curtailment of financing by Government agencies, one of the actions included in the administration's September package, removed one of the most pressing sources of supply overhanging the market. As it turned out, agency financing in the public sector over the period actually involved a net reduction of $560 million in outstanding issues. All the new money raised by the agencies during the period came through sales of issues to the Treasury trust accounts, a new debt management procedure initiated by the Treasury earlier in the year.

This curtailment of agency financing in the market, of course, necessitated increased Treasury borrowing on its own behalf over the balance of the year. The Treasury indicated on September 20 that its over-all cash needs over the final months of the year would total about $8 billion and that most of these funds would be raised through sales of bills. In anticipation of this heavy financing, the bill market continued to exhibit considerable nervousness in the opening week of the period, as noted earlier. By Monday, September 19, guesses about rates on the

3-month bills to be auctioned that afternoon reached as high as 5.65 per cent. In any event, the rates turned out to be somewhat lower than initial expectations, but were still at records of 5.586 and 6.039 per cent for the 3- and 6-month bills, respectively. This marked the high in bill rates for the year, and over subsequent weeks these rates declined by as much as 53 basis points. At the close of the period, rates on 3-month bills were at 5.28 per cent bid, compared with 5.59 per cent around mid-September.

A very good demand for bills prevailed over the period, and dealers made net sales at a rate averaging about $200 million a day. As in the spring, public funds were a predominant source of demand, although there was also considerable interest on the part of individuals, who were attracted by the high yields. In the face of this demand, the supply of new bills coming to the market was readily absorbed, and dealers were often aggressive bidders in the various auctions as they sought to rebuild their inventories.

Part of the Treasury's financing in the bill market involved a change in the cycle of monthly offerings of bills. Instead of selling $1 billion of 1-year bills at the end of each month, the Treasury began in late September to sell $900 million of 1-year bills and $500 million of 9-month bills. The latter represented a reopening of an issue that had been sold initially 3 months earlier. Previous experience suggested that the initial offering of the 1-year bill series had been a little large, but that the issue had become quite scarce after a few months. The new cycle was designed to remedy these difficulties and also to raise a total of $1.6 billion of new cash over the last 4 months of the year. The remainder of the bill financing during the period involved the sale of $3.5 billion of tax-anticipation bills on October 11 and the sale of a strip of $1.2 billion of month-end bills on November 17, just after the early November hesitation in the bill market had run its course. These auctions were well received.

Financing activity in the longer-term markets took something of a breather in the second half of September and during October. Offerings of new corporate bonds during this period were considerably lighter than in the immediately preceding months, and most issues were sold out by underwriters in fairly quick order. New tax-exempt offerings also sold well over this interval. For a while it appeared that some potential borrowers were holding back on their offerings, waiting to see how far the trend toward lower yields would go.

Then, after several aggressively priced issues failed to move well in early November, the calendar of corporate and tax-exempt offerings scheduled for November and December began to build up to considerable size. This, along with discussion of the possibility of renewed sales of FNMA participation certificates before the end of the year, exerted a renewed measure of caution in the capital markets, where the atmosphere was also affected in part by the temporary, renewed tautness that emerged in the money market at this time. The possibility of additional sales of participation certificates had been left open when the administration announced its fiscal and debt management package early in September, but market participants had for a time generally assumed that no such offering would be forthcoming.

The growing calendar of future offerings continued to weigh on the corporate and tax-exempt markets over the rest of the period. By the end of the period an Aa-rated corporate issue was trading at a yield of 5.80 per cent after having been offered in late October at a yield of 5.70 per cent. The Bond Buyer's index of 20 seasoned tax-exempt bonds, after reaching a low of 3.74 per cent in early November, moved up to 4.00 per cent by the end of the period.

The renewed hesitancy in the longer-term markets occurred at the time that the Treasury was refunding $4.1 billion of issues coming due at mid-November. Before this had happened, the prolonged price rise during October had led many observers to feel that the market would be receptive to an offering beyond the short-term maturity area. Indeed, when the Treasury announced on October 27 a cash offering of $2.5 billion of new 5⅝ per cent 15-month notes and $1.6 billion of new 5⅜ per cent 5-year notes, prices of outstanding issues actually improved, and a firm tone was in evidence. Subsequently, the new issues came under some selling pressure, and by November 14 when-issued prices had dropped by as much as 5/32 of a point below par. Prices of some outstanding Treasury issues fell by more than 2¼ points over this period—erasing about two-thirds of the gains since mid-September.

After mid-November, however, the return of more comfortable conditions in the money market and renewed demand for Treasury bills and coupon issues sparked a better atmosphere. Prices in the short- and intermediate-term sectors were the first to improve, while gains in the longer-term area were delayed until the end of the month. At the end of the period yields on long-term Treasury issues were generally around 4.95 per cent, compared with about 5.00 per cent in mid-September.

November 23–December 31: Modest but overt move toward ease. Federal Reserve open market operations during the final 6 weeks of 1966 were directed at attaining somewhat easier conditions in the money market and providing the base for a resumption of bank credit growth. The easing that had already been permitted in the immediately preceding weeks under the proviso clause had contributed to a more relaxed atmosphere throughout financial markets, but bank credit had remained weak and interest rates had risen again for a time in the first half of November.

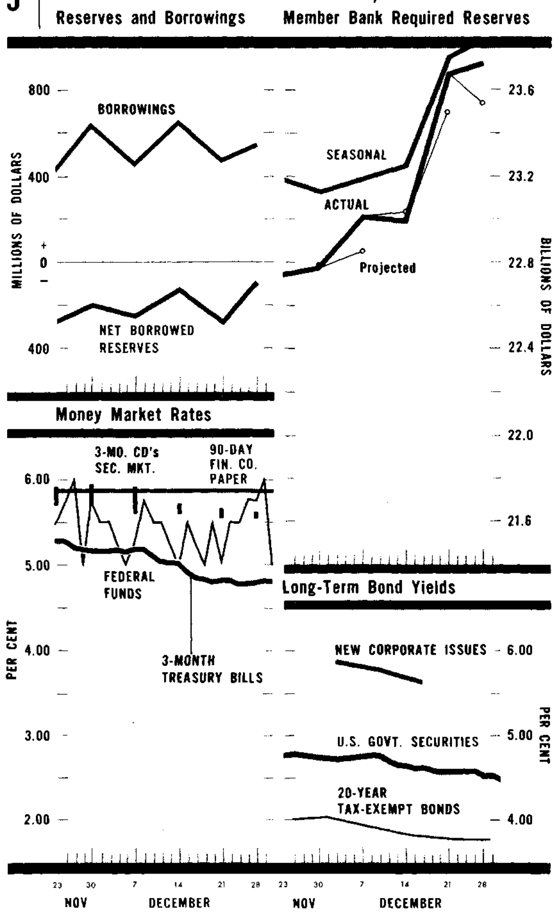
Against this background, the Federal Open Market Committee voted at its November 22 meeting to take a modest but overt step toward ease, with a revised proviso clause calling for modification of this stance only if bank credit appeared to be resuming a rapid rate of expansion. A move toward somewhat greater ease was voted at the Committee's December 13 meeting. Financial markets reacted strongly to the System's shift toward less restraint, and bank credit showed signs of picking up again as the period progressed.

In carrying out the Committee's policy, the Manager of the System Open Market Account moved promptly, and at times aggressively, to inject reserves ahead of developing needs, and as it turned out, the System made no outright sales of securities to absorb reserves. In the wake of these operations, most Federal funds trading was in a 5 to 5½ per cent range during the period, compared with a range generally from 5½ to 6 per cent in the preceding period. Treasury bill rates declined by as much as 65 basis points over the period, and New York City banks lowered their rates on dealer loans first to a 6¼–6½ per cent range and then to a 5¾–6¼ per cent range for a time around mid-December. Rates on bankers' acceptances were reduced by ¼ of a percentage point over the period. Member banks' net borrowed reserves and their borrowings from the Reserve Banks moved irregularly downward, averaging about $190 million and $510 million, respectively, in the final 2 weeks of December (see Chart 5).

Market participants, many of whom had for a time been looking for concrete signs of a change in System policy, were quick to react to the new money market environment. This was especially true following aggressive actions by the System to inject reserves in late November when it appeared that net reserve availability after the Thanksgiving Day holiday was falling far short of expected levels. Dealers bid aggressively for Treasury bills in each of the following bill auctions, both to build up positions in expectation of lower rates and to meet a heavy demand for bills from public funds and corporations, and later on from banks. Demand for Treasury coupon issues also expanded, from both dealers and investors. In the corporate and municipal markets a heavy buildup of the calendar had caused considerable concern earlier, but the new issues moved readily at declining yields.

By mid-December the 3-month Treasury bill rate had fallen below 5 per cent, and the 6-month bill rate was nearly a full percentage point below September's high of 6.04 per cent. Rates

5 | **NOVEMBER 23-DECEMBER 30, 1966**



For notes see p. 211.

on short-term Federal agency issues had also retreated sharply, and 3-month CD's were trading in the secondary market at rates as low as 5.60 per cent, compared with rates of around 5¾ per cent in November. In this environment new CD's offered at the 5½ per cent Regulation Q ceiling began to become competitive again. Thus, after 4 months of decline and a net loss of $3.2 billion in CD's, the volume of outstanding CD's at weekly reporting banks increased in each of the last two statement weeks of December.

The greater availability of funds encouraged banks to begin rebuilding their liquidity. For example, large banks that report weekly expanded their holdings of Treasury bills by $1.1 billion during December, which was considerably more than in comparable weeks of earlier years. They also sharply increased their lending to Government securities dealers. Both of these developments played a key role in the renewed expansion of bank credit in December.

Moreover, with funds from domestic sources more readily available and less expensive, some banks that previously had been aggressive bidders for Euro-dollars also began around mid-December to cut back somewhat on their participation in that market. This, together with cooperative central bank action to maintain availability in the Euro-dollar market, enabled that market to get through December without undue pressures.

System operations. The System's open market operations during the period involved extensive use of repurchase agreements, an instrument well suited to dealing with the seasonal pressures and uncertainties in financial markets that are characteristic of December. In all, $5 billion of Treasury and Government agency securities were purchased under such agreements during the period, more than half of the total for the year as a whole, while $4.3 billion of such agreements were terminated. The amount of agreements outstanding at any one time reached as high as $800 million on December 27, and the average amount outstanding over the period as a whole was just over $450 million. The Account Manager initiated purchases of Federal agency issues under repurchase agreements on December 5, under authority voted by the Federal Open Market Committee at its November 1 meeting, pursuant to new legislation enacted by the Congress earlier in the fall.

Other System operations during the period included the outright purchase of nearly $1.3 billion of Treasury bills from the market and from foreign accounts and the purchase of $35 million of Treasury coupon issues. The purchases of coupon issues were the first since late June, and they reaffirmed the System's intent to supply some portion of the normal growth in the reserve base in this manner, while remaining a marginal participant in the market. In addition, on Friday, December 9, the System purchased directly from the Treasury a special 4¼ per cent 3-day certificate of indebtedness in the amount of $169 million to assist the Treasury through a period of seasonally low cash balances. This marked the first use of this special facility since 1958.

There were no outright sales of securities by the System during the period, as the pursuit of easier money market conditions generally called for leaving in the banking system the few excesses of reserve availability that did emerge. However, the System did bid in several of the weekly bill auctions to redeem part of its holdings of bills scheduled to mature the following Thursday. Bills totaling $503 million were redeemed over the period.

The heavy use of repurchase agreements during the period reflected several considerations. In particular, there was the desire to preserve as much day-to-day flexibility as possible in dealing with the wide and uncertain swings in reserve needs that generally are typical of the last weeks of the year. This is a period usually marked by surging credit demands around the quarterly tax payment date, as well as by large fluctuations in float and currency in circulation. By using repurchase agreements rather than outright purchases, the System could afford to inject large amounts of reserves temporarily on days when the money market threatened to tighten without committing itself to a possibly more permanent addition to the reserve base since the agreements were scheduled to mature automatically a few days later.

As it turned out, with the renewed expansion of bank credit in December persistently pushing required reserves beyond initial estimates, the maturing agreements tended to be constantly replaced and supplemented. The eventual maturity of most of the agreements around the end of December left room at that time for large outright purchases of Treasury bills by the System from foreign accounts, which were selling bills in quantity to make year-end payments. Purchases of bills were also made at that time from the market where demands were drying up after completion of banks' purchases before the year-end statement publishing date.

The use of repurchase agreements also served to inject reserves at what threatened to be the point of greatest pressure in the money market. Dealers' financing needs expanded progressively over the period, as dealers steadily built up their net trading positions to around $4.5 billion toward the end of December from about $3 billion at the end of November. Moreover, the availability of such agreements reduced the financing burden on the major New York City banks, which were already experiencing some deterioration in basic reserve positions, and contributed to the easing of money market rates. The proportion of dealers' trading positions financed in December through System repurchase agreements, on the average, was not much larger, however, than in other recent Decembers.

A few specific examples illustrate the general character of System operations during the period. At the very beginning of the period the System was concerned with meeting indicated reserve needs around the Thanksgiving Day holiday and over the November month-end. For this purpose the Account Manager had made net purchases of securities, both outright and under repurchase agreements, totaling $652 million on Wednesday, November 23, and Friday, November 25.

After the ensuing weekend, however, it was learned that net reserve availability for the week was turning out considerably short of earlier expectations. At the same time, trading in Federal funds opened at 6 per cent on Monday—above the levels generally prevailing on other recent days—and dealers needed substantial amounts of funds. Under these circumstances, the System moved quickly to head off further tightening in the money market. It purchased $126 million of bills in the market and from foreign accounts and bought an additional $185 million of bills from the market for foreign accounts, which had funds to invest that day. As soon as these outright purchases had been consummated, the System moved aggressively back into the market and purchased an additional $424 million of Government securities and bankers' acceptances under new 10-day repurchase agreements. In arranging these repurchase agreements against Government securities, the Account Manager gave the dealers time to acquire additional collateral over whatever amounts might have been immediately available.

The money market turned more comfortable after this massive reserve injection, and some Federal funds traded as low as 5 per cent on Monday, November 28, and as low as 4¾ per cent on the following day. The reappearance of a firm tone on Wednesday, November 30, was countered with the injection of an additional $289 million of reserves, net, under new repurchase agreements. All in all, over this 8-day period the System injected about $1.1 billion of reserves. These injections more than offset the reserve drains stemming from movements in other factors, and member banks' net borrowed reserves declined in the week to an average of $175 million.

Operations over subsequent weeks, while generally more modest in size, followed a similar pattern. Net reserve availability fell rather persistently short of initial estimates, partly because of greater than expected bulges in required reserves as expansion of bank credit resumed. The shortfalls in net reserve availability were particularly large in the weeks ended December 21 and 28. The bulk of the credit expansion during this period occurred at major banks in money centers throughout the country. These banks accumulated basic reserve deficits averaging nearly $2.2 billion in the statement week ended December 21 before benefiting from a gain in reserves in the following week. By quickly renewing maturing repurchase agreements, however, and then injecting additional reserves through further purchases late in the statement weeks, the System maintained an ample level of reserve availability throughout the banking system, and the pressures were accommodated quite smoothly.

Some pressures did emerge on the next to last business day of the year, Thursday, December 29. Banks sought to meet, in advance, their reserve needs for the following holiday weekend so as to avoid having to borrow on the year-end statement date. Dealer financing needs were also quite heavy, in part because more than $500 million of repurchase agreements with the System matured that day. Trading in Federal funds opened at 6 per cent that morning and threatened to move to higher rates as the availability of money appeared limited.

In these circumstances the System purchased $233 million of bills in a go-around of the market and an additional $260 million of bills directly from foreign accounts. To this amount was added a total of $532 million of Treasury and Government agency securities and bankers' acceptances purchased under new repurchase agreements, bringing the net reserve injection for the day to about $500 million. The Federal funds market did not tighten further after these operations, although member banks borrowings from the Reserve Bank bulged to $2.1 billion that day. The next day—Friday, December 30, which was the statement publishing date—the Federal funds market eased again and member banks' borrowings dropped back to $173 million.

Securities markets. The sizable injections of reserves around the end of November were generally interpreted by participants in the securities markets as a clear signal that System policy had shifted. This view became stronger as the easier conditions in the money market continued in subsequent weeks. To the buoyancy in the markets stemming from this factor was added further discussion of a slowing in the pace of the over-all economic advance, of the possibility that the administration's forthcoming annual messages to the Congress would include a request for additional fiscal action to redress imbalances in the economy, and finally, renewed hopes for peace negotiations in Vietnam. In this environment the feeling prevailed that prices of securities would rise. As demand from professional and investment sources expanded, prices in fact did rise quite sharply.

In the short-term markets, demand for Treasury bills was especially strong. Dealers built up their net trading positions in bills to nearly \$3.5 billion by the end of December and still sold sizable amounts of bills to public funds and commercial banks. Bill rates moved down by 20 to 65 basis points over the period, with 3-month bills bid at 4.81 per cent on December 30. This was 78 basis points below the high reached in mid-September and only 29 basis points above the rate prevailing at the beginning of the year. The spread between rates on 3- and 6-month bills, which had widened to as much as 50 basis points in early September, was only 11 basis points at the year-end—reflecting the increased confidence in the outlook for interest rates generally among market participants.

Demand for Treasury coupon issues also expanded over the period, and there was a considerable amount of tax switching transactions as the year drew to a close. In the corporate and municipal markets, underwriters approached the forthcoming heavy supply of new issues with increasing confidence, and when the offerings attracted good investor response, all sectors of the markets were encouraged further. Against this background, further discussion of the possibility of renewed sales of FNMA participation certificates had little effect on market sentiment, and indeed by midmonth participants seemed to be optimistically awaiting formal announcement of the terms of sale. The announcement, which came on December 19, indicated that the offering early in the new year would consist of \$600 million to be sold to the public and \$500 million to be sold to Government trust accounts. The size of the offering to the public was somewhat less than had been expected, and prices of outstanding bond issues rose sharply further in all market sectors.

The markets took further encouragement from the Federal Reserve's formal announcement on December 27 that due to the change in credit conditions, including the more moderate

rate of expansion of business loans, the special discount arrangements announced in the System's September 1 letter were terminated. This was taken as additional evidence of the System's move toward an easier policy stance. By the month-end, prices of Treasury coupon issues were up by as much as 4⅛ points from their levels on November 22. Yields in the 1- to 5-year and long-term sectors of the Treasury market were down to 4.98 and 4.63 per cent, respectively. These were 127 and 63 basis points below the peaks reached around the end of August and indeed were not very far from the levels prevailing at the year's start.

The decline in tax-exempt yields over the period brought the Bond Buyer's index of yields on 20 seasoned tax-exempt issues down to 3.77 per cent by the end of December. While this level was nearly 50 basis points below the August peak, it was still about 25 basis points higher than at the year's start. In the corporate market, on the other hand, the better atmosphere in the final weeks of the year had less of an impact on yields. Over the year as a whole, borrowers had sold a total of $17 billion of new issues in this market, or 9 per cent more than in 1965, and yields at the year-end were still well above their beginning-of-year levels. Indeed, yields were only about 30 basis points below their August peaks. Thus, by mid-December an index of yields on new corporate issues, adjusted to an Aaa basis—calculated by the staff of the Board of Governors—was 5.63 per cent, compared with 5.98 per cent in early September and 4.82 per cent at the start of the year.

REVIEW OF OPEN MARKET OPERATIONS IN FOREIGN CURRENCIES

There were very heavy flows of funds across the foreign exchanges and in the Euro-dollar market during 1966. These stemmed from the continuing deficit in the U.S. balance of payments, from sharp shifts in the balance of payments positions of several other industrial countries, and from the emergence of another major crisis for the pound sterling. The potentially adverse effects of some of these developments on the U.S. dollar and the U.S. gold stock were cushioned to a considerable extent by large inflows of private capital to the United States induced by tightening monetary conditions in this country. At the same time, the use of official international credit facilities again helped to protect a number of major currencies, including the dollar, from too much buffeting.

One of the significant developments of the year was the further strengthening of the international monetary system to withstand the pressures generated by speculative shifts and payments swings. This strengthening included an enlargement of the Federal Reserve System's reciprocal currency arrangements with foreign central banks and the Bank for International Settlements (BIS) from $2.8 billion to $4.5 billion and an increase of more than 25 per cent in the resources of the International Monetary Fund (IMF). Moreover, the scope of official operations was extended at the year-end as several monetary authorities and the BIS entered into operations designed to ease year-end pressures in the Euro-dollar market.

With the United States still in payments deficit, partly as a result of the Vietnam war, the dollar again experienced a backwash from a major sterling crisis. During the late spring and early summer very large amounts of sterling were converted into dollars, some of which flowed to continental European central banks. Moreover, the payments surpluses of France and Italy remained large—although they moderated during the course of the year—while Germany's balance of payments swung sharply from deficit to surplus.

These developments would have resulted in a much greater pressure on the dollar in the exchange markets had it not been for the increasing stringency of monetary policy in the United States. U.S. commercial banks, through their branches in Europe, bid actively for Euro-dollar deposits at rates high enough to induce private foreigners to hold larger amounts of dollars in this form rather than convert them into local currencies. Inflows through the branches were particularly large during the third quarter, when the sterling crisis was at its peak, and thus greatly reduced the flow of dollars to continental central banks and the amount of U.S. official financing that might otherwise have been required. Nevertheless, the over-all flow of dollars through central banks was very large during the year, and in response to these flows the foreign exchange operations of the Federal Reserve and the Treasury continued to expand.

During the first part of 1966 the Federal Reserve was able to repay all of its outstanding drawings under swap agreements. In addition, significant progress was made in reducing other foreign exchange commitments of the United States. The deficit in Germany's payments position that had emerged in the latter half of 1965 persisted into 1966, and the U.S. Treasury was able to acquire enough marks to liquidate $252 million of its outstanding German mark-denominated securities. The Treasury also reduced its indebtedness in Swiss francs and Austrian schillings.

In the first quarter the tone of the sterling market continued to reflect the improvement that had begun in September 1965, and the Bank of England was able to repay its swap drawings from the Federal Reserve. However, the position of sterling began to deteriorate in late spring, as Britain's payments deficit persisted and the country suffered a prolonged maritime strike.

In early summer, sterling again came under extremely heavy pressure in exchange markets, and the British Government enacted a drastic stabilization program. To finance its support of the pound, the Bank of England relied heavily on short-term international credit facilities, including those with the Federal Reserve and U.S. Treasury, the Basle group of central banks, and the BIS.

As part of the outflow of funds from Britain and from the continuing U.S. deficit found its way into the hands of central banks on the continent, the United States was called upon to make use of its own credit lines. Swap drawings totaling $570 million were made in the third quarter by the Federal Reserve in Swiss francs, Dutch guilders, Belgian francs, and Italian lire. In August the Treasury made a new drawing of $250 million equivalent of lire on the IMF and sold the lire to the Federal Reserve, which used them to repay short-term borrowings. In addition, in September the Italian and French Governments prepaid some of their postwar debt to the United States, as the German Government was to do at the year-end.

TABLE 1

FEDERAL RESERVE RECIPROCAL CURRENCY ARRANGEMENTS

Other party to arrangement	Amount of facility (in millions of dollars equivalent)	
	Dec. 31, 1965	Dec. 31, 1966
Austrian National Bank	50	100
National Bank of Belgium	100	150
Bank of Canada	250	500
Bank of England	750	1,350
Bank of France	100	100
German Federal Bank	250	400
Bank of Italy	450	600
Bank of Japan	250	450
Netherlands Bank	100	150
Bank of Sweden	50	100
Swiss National Bank	150	200
Bank for International Settlements	[1] 300	[1] 400
Total	2,800	4,500

[1] Half available in Swiss francs and half in other European currencies.

The pressures that developed in exchange markets during the spring and summer created widespread apprehension and prompted the Federal Reserve to initiate discussions aimed at increasing its reciprocal currency facilities with a number of major central banks. As market fears intensified, these talks were broadened to include virtually all parties to the swap network. In mid-September the Federal Reserve announced a general enlargement of the swap lines from $2.8 billion to $4.5 billion (Table 1). These increases brought the credit lines to levels well above the size of any routine drawings that might reasonably be expected and thus created a broad margin of safety against any unforeseeable threats to international currency stability. At the same time the Bank of England announced an increase in its credit facilities with a number of other central banks as well as with the Federal Reserve.

Following the announcement of this reinforcement of the international financial mechanism, and as some of the extreme pessimism in financial markets began to lift, the exchanges started to calm. Although U.S. banks continued to attract Euro-dollar funds, the markets were much less strained, and sterling staged a strong recovery in the exchange market.

As the year-end approached, however, there was the danger that the customary large flows of funds back into continental European centers for year-end payments and balance-sheet window dressing would put a severe strain on the Euro-currency and exchange markets, and on sterling in particular. In order to head off such a development, the Federal Reserve, the BIS, and several major continental central banks joined forces in operations in Euro-dollars. The BIS injected into the Euro-dollar stream some $275 million of funds drawn from the Federal Reserve under the swap facility and from its own resources, while the Swiss National Bank, as in past years, rechanneled into the Euro-dollar market its dollar gains stemming from year-end flows. The Federal Reserve and the U.S. Treasury moved into the market for sterling and executed a total

TABLE 2

FOREIGN CURRENCY TRANSACTIONS OF THE FEDERAL RESERVE, 1966

(In millions of dollars equivalent)

Currency	Transactions under swap lines					Third-currency swaps		Other transactions			
				Acquisitions of funds for repaying swaps				With U.S. Treasury		With others[1]	
	Drawings	Repay-ments	Dis-burse-ments of swap-acquired balances	From U.S. Treas-ury	From others	Pur-chases and re-acqui-sitions	Sales and re-pay-ments	Pur-chases	Sales	Pur-chases	Sales
Operations initiated by the System:											
Belgian franc	30.0	65.0	30.0	......	64.9	......	......	......	......	......	......
Pound sterling	......	......	......	......	......	50.0	50.0	......	31.7	430.0	304.0
German mark	140.0	......	140.0	......	2.5	40.1	......	......	54.8	72.3	61.2
Italian lira	325.0	410.0	325.0	225.0	140.9	[2]50.0	50.0	25.5	......	23.9	......
Dutch guilder	65.0	30.0	65.0	......	30.0	......	......	......	......	......	2.5
Swiss franc	150.0	60.0	150.0	......	61.0	......	40.1	......	48.0	88.9	......
Total	**710.0**	**565.0**	**710.0**	**225.0**	**299.3**	**140.1**	**140.1**	**25.5**	**134.5**	**615.1**	**367.7**
Swap operations initiated by others:											
Pound sterling	625.0	750.0	......	......	......	......	......	......	......	......	......
Other	302.6	102.6	......	......	......	......	......	......	......	......	......
Total	**927.6**	**852.6**									

[1] Includes forward as well as spot transactions; excludes Italian lira forward operations and renewals of forward sales.
[2] Used to repay swap drawing.

of $88 million of 1-month swaps to help insulate sterling from the year-end strain. During the closing weeks of the year the Netherlands Bank also redeposited some funds in the Euro-dollar market, while the German Federal Bank and the Bank of Italy took action to reduce the seasonal pullback of funds by their commercial banks. The effect of these coordinated actions was to damp emerging pressures in the Euro-dollar market and to enable that market to pass through a potentially dangerous period without undue strain.

The remainder of this report presents a more detailed review of Federal Reserve operations in sterling, German marks, Swiss francs, Italian lire, Netherlands guilders, and Belgian francs. It also gives an account of U.S. transactions with the IMF; some of these were related to System activities.

Sterling. During the first few weeks of the year, sterling was riding the crest of a recovery that had begun with the September 10, 1965 announcement of renewed international support for the pound. By early February the Bank of England had completely paid off the $890 million of credits received from the Federal Reserve and U.S. Treasury in 1965, including $475 million outstanding at the end of the year under the reciprocal currency arrangement with the Federal Reserve.

During February, however, the exchange markets became more cautious in view of disappointing January trade results and the impending British general election. By the end of February, the sterling rate had moved below par for the first time since September 1965, and the rate eased further in March as uncertainties about sterling were reinforced by a tightening of the Euro-dollar market.

The Labor Party's decisive victory at the polls on March 30 had been expected by the market, and relatively quiet conditions prevailed throughout April in guarded anticipation of Chancellor Callaghan's budget for the new fiscal year. The market interpreted the budget announced on May 3 as being only moderately restrictive, particularly since the principal provisions were not scheduled to take effect until the fall, and initially there was some selling of pounds. This was countered by support from the Bank of England and the U.S. Treasury, and the market quickly regained its equilibrium; but it remained vulnerable to new setbacks as British imports continued at abnormally high levels.

In this atmosphere, the outbreak of the British seamen's strike in mid-May brought a rapid deterioration of confidence in sterling, and a series of intensive selling waves began on June 3. Temporary relief from these pressures was provided by the announcement in mid-June that the credit lines from U.S., European, and other sources that had been made available in support of the pound during the autumn of 1965 had now been placed on a continuing basis. The respite for sterling provided by this announcement was short-lived, however, as increasing stringency in the Euro-dollar market left British interest rates not fully competitive, with consequent outflows from sterling in late June.

While spot sterling came under pressure, forward sterling quotations narrowed and a sizable arbitrage incentive in favor of the United Kingdom developed in relation to short-term instruments in the New York market. Consequently, the Federal Reserve Bank of New York, with the agreement of the Bank of England, undertook market swap transactions in which, for System and Treasury accounts, it bought a total of $67 million equivalent of sterling spot against delivery 1 month forward. This operation both reduced the arbitrage incentive to shift funds from New York and eased exchange market pressures on spot sterling quotations.

Although the seamen's strike was settled by the end of June, market attitudes had deteriorated and sales of sterling rose to a climax during July. Figures that were released on July 4 indicated that during the preceding 4 months British reserves had declined $372 million, even after recourse to international assistance (including $275 million from the United States). In addition, there was disagreement within the Labor Party over the proposed tightening of the incomes policy, an important element in the long-term resolution of Britain's payments difficulties. As selling of sterling reached very heavy proportions toward mid-July, the Bank of England continued to provide firm support for the pound in both spot and forward markets. On July 14 it raised its discount rate from 6 per cent to 7 per cent and doubled the special deposits required of the London and Scottish banks. However, the market shrugged off the discount rate increase as merely a technical adjustment to rising interest rates abroad. Selling of sterling then intensified when the Prime Minister, in speaking to Parliament, confirmed that Britain faced a new financial crisis and warned of new restrictive measures.

Against this background of massive sales of sterling, the British Government, on July 20, introduced a drastic austerity program, including a wage freeze, restraint on prices and dividends, additional taxes, reduced travel allowances, and further curbs on public expenditures at home and overseas. In order to emphasize to the market the confidence of U.S. authorities in the ultimate success of the British program and to help stem and possibly reverse reserve losses by the Bank of England in the market, the Federal Reserve Bank of New York moved into the sterling market in New York and began buying pounds for both System and U.S. Treasury account as the sterling rate advanced from \$2.7866 before the announcement of the new program to above \$2.7900 by July 22.

During the next few weeks, sterling remained vulnerable, both because the market was skeptical of the political feasibility of the strong new measures and because British foreign trade figures remained disappointing. In addition, a sharp rise in yields on dollar-denominated instruments exerted a strong pull on funds from sterling, while the approach of the IMF-World Bank meeting, which was to be held in September, tended to unsettle market sentiment. Against this background of uncertainty in the exchange market and the seriously strained conditions in many national money markets, the Federal Reserve on September

13 announced the increase in its over-all reciprocal currency facilities with other central banks from $2.8 billion to $4.5 billion. Included was an increase of $600 million to $1,350 million in the arrangement with the Bank of England. The Bank of England simultaneously announced that it had arranged additional facilities with other central banks.

With this renewed evidence of central bank solidarity, the market atmosphere improved and selling pressures on sterling subsided. In following weeks the restrictive measures initiated by the British Government in earlier months began to show results, and as public opinion rallied in support of the Government's defense of sterling, speculative talk about sterling died down and short-covering began. Additional demand for sterling came from the requirements of international oil companies and from favorable reaction to a progressive improvement in Britain's trade performance. In October and November the Bank of England took in a substantial amount of dollars; of this, $120 million was added to reserves, while a start was made on repaying central bank assistance.

During the final weeks of the year, the market atmosphere was somewhat uneven, although on balance the Bank of England was still able to add to reserves from market operations. Some selling of sterling was occasioned by concern about mounting tension surrounding the Rhodesian issue. Even more importantly, the year-end preparations in several financial centers gave rise to very large flows of funds across the exchanges, and in the process money moved out of sterling on a short-term covered basis. The flow of covered funds contributed to an appreciable narrowing in the discount for 1-month sterling; simultaneously, U.S. money rates were declining. As under similar circumstances earlier in the year, the Federal Reserve and the Treasury, in consultation with the Bank of England, again purchased spot sterling against sales for 1-month forward delivery at increasingly wide discounts. These operations—totaling $88 million—complemented coordinated action taken by several other central banks and the BIS to relieve potentially disruptive year-end pressures in the Euro-dollar market.

Sterling thus was insulated from year-end window-dressing pressures, and during December it benefited again from encouraging trade figures and from some repatriation of corporate profits at the end of the year. Consequently, in December British reserves would have increased $11 million even after some further repayment of short-term central bank debt, had it not been for $193 million of year-end debt payments on North American loans. Because of these repayments, reserves dropped by $182 million in December to $3,100 million.

As sterling moved through crisis to convalescence, the Bank of England made extensive use of the network of central bank credit facilities of various types that have been constructed during the past 5 years. In the case of the Federal Reserve swap line, Bank of England drawings rose to a peak of $450 million at the end of July, declined to $400 million by the end of September and to $350 million at year-end, and were paid off completely by early March 1967. In addition to these drawings on the Federal Reserve swap line, the Bank of England made use of sizable special credits provided by the U.S. Treasury, and to a lesser extent—that is, a maximum of $50 million—by the Federal Reserve. After rising to a peak during the midsummer months, such special credits declined to $175 million at the end of September and to $160 million at the year-end and were fully liquidated during January 1967. At the height of the crisis the Bank of England also secured credit assistance from other central banks with repayments being effected later.

German mark. The German balance of payments swung from deficit to substantial surplus during 1966. This swing was related largely to a cyclical slowdown in the German economy, which had been overheated during most of 1965 and early 1966. As German imports stabilized early in 1966 and exports began to rise sharply, the trade surplus expanded. This improvement on the trade account was a major force in 1966 behind an over-all improvement in Germany's external position, as other current-account items continued in deficit and the capital accounts were about in balance.

At various intervals both German and U.S. authorities acted to moderate the impact of the German payments position on the exchange markets and on German official reserves. The German Federal Bank intervened in support of the mark early in the year, but as an over-all payments surplus emerged during the second quarter, the German Federal Bank began to purchase dollars, and it closed the year with a net gain of $419 million in holdings of gold and convertible currencies. Similarly, the U.S. authorities purchased sizable amounts of marks in the first half of the year and liquidated $252 million of mark-denominated U.S. Treasury securities. In December, however, the Federal Reserve sold a sizable amount of marks in the New York market and absorbed $155 million of official German gains—using mainly marks drawn under the Federal Reserve swap line, which had been increased in September by $150 million to $400 million.

During the first 4 months of the year the German balance of payments was still in deficit, primarily because of seasonal outflows of short-term funds from German banks and because of rising German expenditures for services from abroad. Consequently, the mark was generally on offer at rates somewhat below its parity of $0.2500, and support operations by the German Federal Bank resulted in a decline of $281 million in official German reserves by April 30.

The ready availability of German marks enabled the U.S. authorities to buy marks as they had been doing since June 1965 in order to repay mark-denominated U.S. Treasury indebtedness to the German Federal Bank. During the first half of 1966 a total of $232 million of marks was bought for Treasury account, mostly in the New York market. The Treasury used these marks, together with balances on hand, to redeem at maturity a total of $252 million equivalent of mark-denominated securities held by the German Federal Bank. With these repayments, and with those that had been initiated in the second half of 1965, the Treasury within the 12-month period ended July 1 had reduced its mark-denominated indebtedness by $329 million, to $350 million equivalent.

The German Federal Bank pursued a generally restrictive monetary policy during the year, and the resulting firmness in the money market encouraged German firms to borrow abroad. On May 26 the Federal Bank announced an increase in its discount rate to 5 per cent from 4 per cent, and in June the money market tightened further in connection with large tax payments and the usual midyear window-dressing operations. Moreover, in late June and during July the sterling crisis led to flows of funds to Germany.

As a result of these developments, as well as of the recovery of the German trade position, the German balance of payments began moving into surplus during the second quarter, and the demand for marks increased. In June and July the spot rate moved back to parity and above, and the German Federal Bank added $467 million to its reserves of gold and convertible currencies, thus more than recouping losses incurred during the first 4 months of the year.

More balanced conditions prevailed later in the summer, but by October demand for marks began to increase again as the German trade surplus continued to widen and a tight German money market prompted German firms to continue borrowing abroad. As a result, spot quotations for the mark resumed their rise. The German Federal Bank purchased dollars on a large scale in October and again beginning in late November, when demand for marks intensified in connection with mounting year-end liquidity requirements in Germany.

The German Federal Bank had sought to relieve some of these pressures by announcing in early November a 9 per cent reduction in commercial banks' reserve requirements for December. Nevertheless, beginning in late November large short-term capital flows to Germany took place in preparation for the year-end and for a mid-December tax payment. The spot rate for the mark advanced almost to its ceiling, and during December the Federal Bank made very sizable purchases of dollars.

Under the circumstances, the System acted in December to relieve pressures on two fronts. First, in order to meet the demand for marks that had spilled over to the New York market, the System, in consultation with the German monetary authorities, sold marks in that market from its available balances; early in the month it sold spot $29 million equivalent. Then just before Christmas the market began to bid strongly for marks on a 1-month swap basis. The System shifted its intervention accordingly and sold $17.5 million of marks spot against 1-month forward purchase. In addition, the System absorbed $155 million of the large gains in Germany's official dollar holdings; it purchased $15 million with marks accumulated during 1965 and $140 million with marks drawn under its swap facility with the German Federal Bank.

In the last 2 days of December, when trading was for delivery after the year-end, marks began coming on offer in connection with a reversal of some of the earlier short-term flows of funds to Germany. The German Federal Bank then gave up some of its earlier December gains as the rate for the mark declined to $0.2514½, while the System began buying marks on a small scale in New York to help cover swap commitments.

Swiss franc. The rate for the Swiss franc declined steadily during the first quarter of 1966 as a result of seasonal influences and of sizable outflows of capital induced by easy monetary conditions in the Swiss market, rising Euro-dollar rates, and attractive yields on offshore U.S. corporate issues. By early March, the Swiss franc had fallen to $0.2304⅛ and the Swiss National Bank began selling dollars to moderate the rate decline. At the same time, payments to foreign countries by the Swiss Government and by federal agencies further reduced the reserves of the National Bank. To replenish its dollar balances the Swiss National

Bank between February and May bought $133 million from the Federal Reserve and the U.S. Treasury, mostly against Swiss francs but also through sales of $18 million of gold.

The Federal Reserve and the Treasury in turn used the Swiss francs they acquired to repay Swiss-franc-indebtedness and to add to balances. The Federal Reserve fully repaid its $40 million equivalent German mark–Swiss franc swap with the BIS, while the Treasury liquidated a similar swap for $15 million equivalent. The System temporarily added $46 million equivalent to its balances—simultaneously selling the Swiss francs forward to the Treasury for delivery on May 16 and July 20, on which dates the Treasury repaid at maturity two Swiss-franc-denominated securities issued to the Swiss National Bank as fiscal agent for the Swiss Confederation. (These repayments reduced the amount of outstanding Treasury securities denominated in Swiss francs to $304 million equivalent.) At the same time, the Treasury added $17 million equivalent to its Swiss franc balances.

During April, monetary conditions in Switzerland tightened and the Swiss franc began to strengthen. The rate reached its effective ceiling of $0.2317½ in early May, and the Swiss National Bank entered the market as a buyer of dollars for the first time in 1966. The franc remained at the ceiling in subsequent weeks as the Swiss banking community began to repatriate funds to meet midyear liquidity needs and as foreigners who had previously borrowed Swiss francs switched to less costly Euro-currencies—purchasing Swiss francs outright to pay off their franc borrowings. At the same time, mounting pressures on sterling added to the demand for Swiss francs. During May and June the Swiss National Bank took in $200 million through outright purchases and an additional $82 million in short-term swaps with Swiss commercial banks to help provide for their temporary mid-year requirements.

By July uncertainties generated by the pressures on sterling again dominated the foreign exchange markets, and the usual seasonal outflow of funds from Switzerland was replaced by an inflow. Accordingly, in July the Federal Reserve reactivated its swap facilities with the Swiss National Bank and with the BIS —drawing $75 million of francs from each bank to absorb dollars from the Swiss central bank. The Swiss authorities also purchased $20 million of gold from the U.S. Treasury.

Beginning in late July, Swiss francs gradually came on offer. As pressure on sterling subsided and high money market rates abroad induced extensive foreign investments on a short-term basis, the spot rate declined. By autumn, the rate had eased to $0.2305¼, and the Swiss National Bank began selling dollars to the market. In addition, Swiss reserves were drawn down in connection with fairly sizable official requirements between September and November. With its dollar holdings reduced the Swiss central bank once again purchased dollars from the System against francs. The System used the $60 million equivalent so acquired to reduce its $75 million franc swap drawing from the Swiss National Bank to $15 million equivalent. The System's Swiss franc swap drawing of $75 million equivalent from the BIS, however, remained unchanged through the year-end.

The facilities with the Swiss National Bank and with the BIS that provide for swaps against Swiss francs were each increased on September 13, 1966, from $150 million to $200 million; another swap facility with the BIS, which provides for swaps against European currencies other than Swiss francs, was increased from $150 million to $200 million on the same date.

In the final weeks of 1966, Swiss banks began to repatriate large amounts of funds to cover their usually heavy year-end requirements, and by November 23 the spot rate for the franc had again reached its ceiling. The Swiss National Bank first purchased $75 million spot, but toward the end of November it announced that it was ready to buy dollars from banks on a swap basis, as it had under similar circumstances on previous occasions. The spot rate thereupon quickly receded from its ceiling and held in a range of $0.2310½ to $0.2315½ throughout December; the Swiss National Bank purchased a total of $398 million on a swap basis from Swiss banks. In order to prevent these movements of funds from putting pressure on the Euro-currency markets, the Swiss National Bank, as usual, rechanneled to the Euro-dollar market the dollars it acquired during November and December. At the year-end the market for the Swiss franc was calm.

Italian lira. Italy's balance of payments surplus declined significantly in 1966 from its exceptionally high level of $1.6 billion in 1965. But it still remained large—$0.7 billion. The reduction stemmed in part from a wider trade deficit, but mainly from substantial outflows of capital associated with relatively easy conditions in Italian financial markets and active bidding for funds by foreigners, including industrial firms. Both Italian and U.S. authorities again employed a variety of techniques to moderate gains in Italian official dollar reserves.

At first Italy's reserve gains were moderate. The Italian authorities provided swap facilities to Italian commercial banks, and those banks reinvested in the Euro-dollar market a substantial amount of the funds they had repatriated late in 1965 in connection with year-end requirements; in addition, the Italian Government purchased some IBRD bonds.

Also during the first quarter U.S. authorities were able to reduce short-term lira commitments arising from an August 1965 System drawing of $100 million equivalent of lire under the swap facility with the Bank of Italy. In February the System liquidated this drawing by using $50 million equivalent of lire purchased in a special transaction with a foreign central bank and $50 million acquired through a sterling–lira swap with the BIS. In March and May there were some small offerings of lire in the New York market and the Federal Reserve purchased a total of $10 million equivalent. These lire were used on May 25 to reduce the third-currency swap with the BIS from $50 million to $40 million equivalent.

About midyear, however, demand for lire began to rise as Italy's tourist season moved into full swing, Italy's trade account improved seasonally, and the mounting sterling crisis precipitated flows of funds out of sterling into lire. By then, moreover, most Italian banks had eliminated any net liabilities to foreigners, and the Bank of Italy was no longer prepared to shift dollars abroad through short-term swaps with those commercial banks at preferential rates.

All these factors contributed to a marked rise in official Italian reserves. In July and early August the Federal Reserve drew $225 million of lire under its $450 million swap facility with the Bank of Italy and used the lire to absorb dollars that had accrued to the Italian authorities. These drawings were repaid on August 22 when the U.S. Treasury drew $250 million of lire from the IMF and sold the lire to the System. The System used the remaining $25 million of lire, plus $1 million equivalent in balances, to reduce its sterling–lira swap with the BIS from $40 million to $14 million.

Additional large amounts of dollars continued to flow into official Italian reserves during August. In early September the System reactivated its swap—drawing lire to absorb $100 million from the Italian authorities. Soon afterward, however, Italian reserves began to decline as strong seasonal inflows of funds subsided, a tighter Euro-dollar market exerted a renewed pull on Italian bank funds, and the Italian authorities prepaid $145 million of postwar debt to the United States. In late September the System purchased $14 million of lire from the Bank of Italy and extinguished its remaining sterling–lira swap with the BIS.

As the fall progressed, dollars were generally in demand in Italy in response to the conversion of lira borrowings by foreign firms and outflows to the Euro-dollar market. Lira quotations eased steadily toward par, offerings of lire in the market were sizable, and the System made large purchases in New York through the remainder of the year. By the year-end the swap commitment had been reduced from $100 million equivalent to $15 million.

Although the change in Italy's balance of payments in late

1966 was sufficient to make possible the reduction in System lira commitments, Italy's over-all reserve position strengthened over the year as a whole. In particular, its creditor position in the IMF increased some $336 million. In view of the substantial surplus in their payments position, the Italian authorities at the year-end purchased $60 million of gold from the U.S. Treasury in order to replenish their gold holdings.

Federal Reserve and Treasury technical forward commitments in Italian lire that had been undertaken in 1965 were rolled over periodically during 1966. As the year closed, U.S. commitments in lire—aside from technical forward commitments—consisted of: (1) $15 million under the $600 million swap facility with the Bank of Italy (this facility had been increased by $150 million in September 1966) and (2) $125 million equivalent in medium-term U.S. Treasury bonds issued to the Bank of Italy.

Netherlands guilder. The Dutch guilder was generally on offer during the first 4 months of 1966, as both seasonal weakness and some special factors contributed to a widening in the Netherlands trade deficit. As early as January the guilder was quoted below its par of $0.2762⅜, and by late April it had reached $0.2750¾, the lowest level since the revaluation of March 1961.

Effective May 2 the Netherlands Bank raised its discount rate to 5 per cent from 4½ per cent in an effort to curb the growth of domestic bank credit and stem the deterioration of the Dutch balance of payments. The guilder rallied at once and by early June had reached par. After midyear, increasingly tight money market conditions in Amsterdam and growing tensions in the sterling market led to a sizable inflow of funds. Dutch reserves increased by $94 million in July and rose further in early August. At that point the Federal Reserve reactivated its $100 million swap facility with the Netherlands Bank; it drew $65 million of guilders and used them, together with $2.5 million of guilder balances, to purchase an equivalent amount of dollars from the Netherlands Bank.

By mid-August, however, the Dutch money market had eased, and as increasingly attractive interest rates on dollar investments exerted a pull on Dutch funds, the spot guilder began to drift off and went below parity by mid-September. In order to moderate the decline, the Netherlands Bank sold some dollars to the market and later bought $10 million from the System against guilders. The System in turn used the guilders to reduce its swap commitment to $55 million equivalent. (As part of the September 1966 increase in the Federal Reserve's reciprocal swap facilities, the System and the Netherlands Bank agreed to increase their arrangements from $100 million to $150 million.)

During the autumn the guilder moved back to a level somewhat above par. It fluctuated within a narrow range during the remaining weeks of the year as the Dutch trade account displayed seasonal strength and as an intermittently tight money market in Amsterdam exerted a pull on funds. The Netherlands Bank intervened only sporadically during this period to relieve money market pressures in Amsterdam, which were particularly strong in early November and in mid-December. When it did intervene, it used the technique of market swaps, as on some earlier occasions—buying dollars spot from Dutch commercial banks and selling them forward for January 1967 delivery. To help moderate year-end pressures in the Euro-currency markets, the Netherlands Bank reinvested its December dollar purchases in the Euro-dollar market.

At the year-end foreign currency requirements of the Dutch Government led the Netherlands Bank to buy $20 million against guilders from the Federal Reserve. The Federal Reserve immediately used the guilders to reduce its outstanding swap drawings from that bank to $35 million equivalent.

Belgian franc. During the latter part of 1965 the National Bank of Belgium had intervened in the Brussels market in support of the franc on several occasions and had recouped its dollar losses by purchases from the Federal Reserve against Belgian francs. As a result, by January 1, 1966, the System's swap obligation to the National Bank had been reduced to $35 million equivalent. During the first 2 weeks of January 1966 the Belgian central bank continued these activities, thus enabling the System to repay its remaining swap drawings. The only remaining official U.S. debt in Belgian francs early in 1966 consisted of two U.S. Treasury bonds totaling $30 million equivalent held by the National Bank.

During the next few months the market was steady as the Belgian balance of payments was about in equilibrium. In the late spring, however, credit policy in Belgium tightened, the money market firmed, and the spot rate for the franc began to strengthen. The National Bank reinforced its existing measures of restraint by raising its discount rate by ½ of a percentage point to 5¼ per cent on June 2. Nevertheless, official reserve gains remained small until July. At that time funds were repatriated to Belgium as a result both of the domestic liquidity squeeze and of the speculative pressure on sterling. As the spot rate for the franc moved to its ceiling in late July, the National Bank began to buy fairly sizable amounts of dollars.

In order to absorb some of Belgium's rapidly increasing holdings of dollars, the Federal Reserve in August drew $30 million equivalent of funds under the $50 million standby portion of its $100 million swap facility with the National Bank of Belgium and used these funds to purchase dollars from the Belgian authorities. Later in August, however, the trade account moved into sizable deficit, and with an easing in the Belgian money market, funds again began to flow abroad in response to higher rates for dollar investments. The National Bank then began supplying foreign exchange to the market and later covered these losses by purchasing dollars from the Federal Reserve against Belgian francs. By late September such purchases totaled $30 million, and the System had no uncovered Belgian franc commitments to the National Bank of Belgium under the reciprocal swap facility; the facility had been increased from $100 million to $150 million earlier in the month.

During the early fall the Belgian franc drifted somewhat below par because of a continued deterioration on the trade account. In late November the Belgian central bank once again began to lose dollars. Because of these market losses, coupled with the exchange needs of the Belgian Treasury, the National Bank again needed dollars in the last few weeks of the year. It bought $30 million from the U.S. Treasury against Belgian francs, which the Treasury used to build up a balance for future contingencies. Thus, by the end of 1966 the U.S. authorities no longer had an uncovered position in Belgian francs; the Treasury's franc balances matched its franc-denominated bond indebtedness.

International Monetary Fund. During 1966 the United States made two types of drawings on the IMF. The first, designated "technical," extended the practice—initiated in February 1964—of obtaining currencies from the IMF for sale to other countries that were making repayments to the Fund. For this purpose the U.S. Treasury obtained drawing facilities totaling $400 million equivalent in Canadian dollars and $30 million equivalent in German marks. Whereas early in the year the facilities were fully used at the time they were arranged, later drawings were usually made as needed.

The second type of drawing was the conventional kind in which member countries obtain currencies for direct use in financing their international payments deficits. The United States first had such recourse to the Fund in July 1965. On August 22, 1966, the Treasury again went to the Fund for this purpose; this time it drew $250 million equivalent of Italian lire. As noted earlier, it sold the lire to the Federal Reserve, which used them to liquidate its $225 million equivalent outstanding swap drawings from the Bank of Italy and to repay part of a sterling–lira swap with the BIS. The Fund, whose lira balances were at a low level, borrowed the required lire from the Italian Government under an agreement outside the $6 billion General Arrangements to Borrow (GAB). This was the first occasion on which the IMF had employed its authority under the articles of agreement to borrow a needed currency from a member country other than under the GAB, and it marked another significant step in the evolution of the Fund's credit machinery.

U.S. drawings from the Fund between February 1964 and December 1966 totaled $1,640 million equivalent. During this period, other countries drew dollars from the Fund; thereby the Fund's holdings of dollars and this country's repayment obligation to the Fund were reduced. Consequently at the end of 1966, the net U.S. obligation to the Fund was $964 million.

The resources of the IMF were reinforced in February 1966. At that time a general Fund quota increase of 25 per cent or more, approved in 1964 by the Governors of the Fund, became effective for 58 members who had accepted the proposal and whose combined quotas as of February 23, 1965, constituted the requisite two-thirds majority for approval. By December 31 an additional 34 members had submitted their ratifications, and Fund resources had been increased from $16 billion to $20.6 billion—close to the $21 billion target for the Fund's entire 105-nation membership.

A member must pay a part of its quota increases to the Fund in its own currency and a part in gold. The gold payments have entailed gold losses for the two key-currency countries—the United States and the United Kingdom—because other members have converted dollar and sterling reserves into gold for payment of their gold subscriptions. In order to compensate for these losses, the quota increase arrangement provides that the Fund will deposit a total of up to $350 million of gold with the Federal Reserve Bank of New York and the Bank of England. As of December 31, 1966, the Federal Reserve Bank of New York held for U.S. Treasury account $211.5 million of gold so deposited by the IMF.

SPECIAL STUDIES BY THE FEDERAL RESERVE SYSTEM

From time to time the Federal Reserve System has undertaken extensive economic studies to reappraise the workings of its various instruments of monetary and regulatory policy. The broad aim of these studies has been to keep Federal Reserve policy and action adapted to the changing economic and financial scene. The four studies currently under way are described below.

Reappraisal of the Federal Reserve discount mechanism. The fundamental reappraisal of the Federal Reserve discount mechanism, announced in last year's ANNUAL REPORT (page 216), is still in progress. A number of research studies have been commissioned and are being brought to completion; included are historical and analytical studies of Federal Reserve experience, as well as of the activities of other governmental financial institutions in this country and of central banks in other major industrial nations.

Investigations to date have come to focus on several present and potential functions of discount operations that might, in combination, lead to a more active role for the discount mechanism in the future.

For the reappraisal of certain important uses of the discount window, it has proved useful to distinguish between what might be termed operational and strategic reserve demands within the banking system. Operational reserve needs of banks are regarded as those arising from such factors as random short-falls from money position projections, seasonal patterns of loan demand, and short-term deposit shifts. Strategic needs, on the other hand, are considered to include borrowing demands arising from changes in general monetary policy. In practice, of course, these two dimensions of discounting often blend together, since operational needs tend to increase somewhat during periods of credit restraint, and alternative means of adjustment become less readily available.

In addition to studying means of meeting these reserve needs as effectively as possible through a combination of open market operations and discount window assistance, consideration is being given to other means of contributing to better utilization of reserves and to better functioning of secondary markets for various types of bank assets.

One other basic function of the discount window that is receiving special attention is the provision of emergency credit assistance. Such assistance is being studied with a view to better definition and implementation of appropriate System responsibilities and objectives in this area.

A paramount consideration in these studies is the maintenance of an appropriate control of over-all reserve availability. A variety of methods for regulating discounting activity are being reviewed, some growing out of Federal Reserve experience and others drawn from the discount mechanisms employed by various other central banking systems. One early conclusion suggested by this review is the wisdom of maintaining a degree of flexibility in the design and operation of the discount window to make it adaptable to changing circumstances.

During the coming months the results of the research outlined above will be interpreted and evaluated by System authorities. The ultimate objective of this entire reappraisal is to insure that the means for provision of central bank credit through the discount window are kept up to date with the significant changes that are taking place in the financial system and in the economy that it serves.

U.S. Government securities market. Considerable progress was made during 1966 in the study of the U.S. Government securities market being undertaken jointly by the Treasury and the Federal Reserve. Questionnaires were sent to, and responses received from, dealers in U.S. Government securities and also several hundred financial and nonfinancial institutional investors in such securities. In addition, individual consultations were held with dealers. Moreover, a number of staff studies were undertaken on a variety of topics relating to the structure, performance, and financing of the market for direct U.S. Government and Federal agency securities. These studies were in varying stages of completion by the year-end.

It is anticipated that the results of the study will be made public in phases as they are completed during the course of 1967.

Foreign operations of member banks. The study on the foreign operations of member banks is intended to provide additional knowledge and understanding of the nature and expanded scope of the international lending and deposit activities of U.S. banks and of the forces influencing these operations. To obtain new and up-to-date information on these activities, extensive discussions were held during 1966 with U.S. banks and bankers—at offices in this country and abroad—and with their subsidiary corporations organized under Sections 25 and 25(a) of the Federal Reserve Act. The information obtained, supplemented by staff analyses, was to serve as a basis for a report of the study's findings. This report was in preparation at the end of the year.

Effects of monetary policy on economic activity. Work on the longer-run Federal Reserve research effort to fill the gaps in knowledge about the processes through which monetary policy affects the general economy, the so-called "linkage" project, continued in 1966.

It is still too early to give a comprehensive review of the results of the work to date on this project, but individual pieces of inquiry have been completed and in some cases have been made available to the public. Several have been summarized in the Staff Economic Studies section of the Federal Reserve *Bulletin* and have been made available in full in mimeograph form on request. Other papers will follow from time to time as they become available.

The Federal Reserve's research work in the general area of the effects of monetary policy on economic activity continues to involve System-wide working groups of economists. It also includes a large econometric project involving a number of economists on the Board's staff who are working with a group of university economists led jointly by Professor Modigliani of the Massachusetts Institute of Technology and Professor Ando of the University of Pennsylvania. The university portion of the project is being financed by the Board of Governors through the Social Science Research Council.

The group is involved in the construction and testing of a 50- to 60-equation quarterly model of the U.S. economy. The main purposes of the model are to establish the likely effects of alternative monetary policies on major economic aggregates and to aid in short-term forecasting. This quantitative model will be used as a supplement to, and in conjunction with, judgmental models now being used in policy formulation. It is hoped that the initial construction of the model will be completed and that testing will be begun in 1967.

INTERNATIONAL LIQUIDITY AND BALANCE OF PAYMENTS ADJUSTMENT

During 1966 the Federal Reserve continued its active participation with the Treasury Department in the international discussions and negotiations regarding arrangements for the future creation of reserve assets that would supplement gold and reserve currencies.

A major benchmark was passed in 1966 with the initiation of a second stage in the negotiations. Joint meetings of the Executive Directors of the International Monetary Fund and the Deputies of the Finance Ministers and Central Bank Governors of the Group of Ten were held in Washington in November 1966 and were continued in London in January 1967. It is hoped that these joint meetings, which have already shown great promise, will by the time of the next annual meeting of the Fund lead to a further convergence of views on the structure and major provisions of a contingency plan for creating reserve assets.

The need for drawing up such a contingency plan for deliberate reserve creation became increasingly evident in 1966. For one thing, there was a growing awareness of the fact that since 1964 deficits in the U.S. balance of payments had not made any net contribution to the rise in world reserves. Taking the two years 1965 and 1966 together, the declines in the U.S. gold stock and in the gold tranche position in the IMF were more than twice as large as the cumulative deficit on official settlements. Hence the manner in which the U.S. deficit was financed had the effect of reducing, rather than augmenting, the total of world reserves.

Another development contributing to the growing urgency of contingency planning was the sharply reduced flow of gold into monetary stocks. In 1965 only $240 million of new gold was taken into monetary holdings, and in 1966 monetary stocks actually showed a slight decline. By contrast, in the years preceding 1965 monetary gold stocks had increased on the order of $500 million to $600 million per year.

Given these considerations, it was encouraging to find that the international liquidity negotiations were making significant progress in 1966. Although much still remained to be done before complete agreement could be obtained on the details of machinery for deliberately creating new reserves, the principles and many of the characteristics of a possible agreement were beginning to emerge by the end of the year. For example, it was agreed that reserve creation should not be geared or directed to the financing of balance of payments deficits of individual countries, but rather should take place on the basis of a collective judgment of the reserve needs of the world as a whole. It was agreed that new reserve assets should be distributed to all members of the IMF, either on the basis of Fund quotas or some other objective standard.

There also seemed to be wide and growing acceptance of the view that the same type of reserve asset should be created for all countries, regardless of size or stage of development. In general, the principle of "universality"—treating all countries alike—seemed to gain broad acceptance. The major issues at the end of 1966 on which a consensus had not yet been reached were the provisions governing the holding and use of the new asset and the detailed procedures for voting, both for entry into force of the agreement and for subsequent activation.

In their statement of August 1964 the Ministers and Governors of the Group of Ten had requested Working Party 3 of the Organization for Economic Cooperation and Development to make a thorough study of the measures and instruments best suited for achieving faster and more effective adjustment of international imbalances without sacrificing the pursuit of essential domestic objectives and to report their findings. This important report, entitled "The Balance of Payments Adjustment Process," was completed and published in August 1966.

One significant aspect of the report was its emphasis on the need for the balance of payments objectives of individual countries to be mutually consistent. Working Party 3 has instituted informal arrangements under which it will continue to be informed of, and will discuss the implications of, the balance of payments aims of individual countries. The report also stressed the necessity for early identification and better diagnosis of payments imbalances, for the development of a set of informal guidelines regarding the appropriate use of various policy instruments in specified situations of payments imbalance, and for a continued development of intergovernmental consultation and cooperation. The report as agreed upon clearly recognized that the correction of payments imbalances is the responsibility of both surplus and deficit countries.

The Group of Ten countries have agreed that improvements in the adjustment process are needed and possible. It is important that further progress be made along these lines together with progress in achieving agreement on the creation of new reserve assets.

BANK SUPERVISION BY THE FEDERAL RESERVE SYSTEM

Examination of Federal Reserve Banks. The Board's Division of Examinations examined the 12 Federal Reserve Banks and their 24 branches during the year, as required by Section 21 of the Federal Reserve Act. In conjunction with the examination of the Federal Reserve Bank of New York, the Board's examiners also audited the accounts and holdings related to the System Open Market Account and foreign currency operations conducted by that Bank in accordance with policies formulated by the Federal Open Market Committee, and rendered reports thereon to the Committee. The procedures followed by the Board's examiners were surveyed and appraised by a private firm of certified public accountants, pursuant to the policy of having such reviews made on an annual basis.

Examination of member banks. National banks, all of which are members of the Federal Reserve System, are subject to examination by direction of the Board of Governors or the Federal Reserve Banks. However, as a matter of practice they are not examined by either, because the law charges the Comptroller of the Currency directly with that responsibility. The Comptroller provides reports of examinations of national banks to the Board of Governors upon request, and each Federal Reserve Bank purchases from the Comptroller copies of reports of examination of national banks in its district.

State member banks are subject to examinations made by direction of the Federal Reserve Bank of the district in which they are located by examiners selected or approved by the Board. The established policy is to conduct at least one regular examination of each State member bank, including its trust department, during each calendar year, with additional examinations if considered desirable. Wherever practicable, joint examinations are made in cooperation with the State banking authorities, or alternate independent examinations are made by agreement with State authorities. All but 27 of the 1,351 State member banks were examined during 1966.

The Board of Governors makes its reports of examination of State member banks available to the Federal Deposit Insurance Corporation, and the Corporation in turn makes its reports of insured nonmember State banks available to the Board upon request. Also, upon request, reports of examination of State member banks are made available to the Comptroller of the Currency.

In its supervision of State member banks, the Board receives, reviews, and analyzes reports of examination of State member banks and coordinates and evaluates the examination and supervisory functions of the System. It passes on applications for admission of State banks to membership in the System; administers the disclosure requirements of the Securities Exchange Act of 1934 with respect to equity securities of banks within its jurisdiction that are registered under the provisions of the 1934 Act; and under provisions of the Federal Reserve Act and other statutes, passes on applications for permission, among other things, to (1) merge banks, (2) form or expand bank holding companies, (3) establish domestic and foreign branches, (4) exercise expanded powers to create bank acceptances, (5) establish foreign banking and financing corporations, or (6) invest in bank premises in an amount in excess of 100 per cent of a bank's capital stock.

By Act of Congress approved September 12, 1964 (Public Law 88-593), insured banks are required to inform the appropriate Federal banking agency of any changes in control of management of such banks and of any loans by them secured by 25 per cent or more of the voting stock of any insured bank. In 1966, 38 instances of changes in ownership of the outstanding voting stock of State member banks were reported to the Reserve Banks as changes in control of such member banks. In addition, reports of 29 loans secured by 25 per cent or more of the stock of a State member bank were forwarded to the System. Arrangements continue among the three Federal supervisory agencies for appropriate exchanges of reports received by them pursuant to the Act. The Reserve Banks send copies of all the reports they receive to the appropriate district office of the Federal Deposit Insurance Corporation, the regional Comptroller of the Currency, and the State bank supervisor.

Upon receipt of reports involving changes in control of State member banks, the Reserve Banks are under instructions to forward such reports promptly to the Board, together with a statement (1) that the new owner and management are known and acceptable to the Reserve Bank or (2) that they are not known and that an investigation is being made. The findings of any investigation and the Reserve Bank's conclusions based on such findings are forwarded to the Board. The investigations made by the Reserve Banks have disclosed no instance where failure or serious deterioration in a bank's condition could be expected to result from the change in control reported.

Misleading advertising. Because of concern with respect to misleading advertising practices of some financial institutions in their quest for funds, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Home Loan Bank Board, and the Board of Governors of the Federal Reserve System sent a uniform letter in December to the executive officer of each of the institutions that they supervise. The letter emphasized the concern of the four agencies regarding the effect on the public's attitude toward the nation's financial system, and outlined the following principles that the institutions should follow in their efforts to attract funds:

(1) Interest or dividend rates should be stated in terms of annual rates of simple interest, and the advertisement should state whether such earnings are compounded and, if so, the basis of compounding. Neither the total percentage return if held to

final maturity nor the average annual rate achieved by compounding should be stated unless the annual rate of simple interest is presented with equal prominence.

(2) No reference should be made to "profit" to the investor for use of his funds over a period of time.

(3) If an advertised rate is payable only on investments or deposits that meet fixed time or amount requirements, such requirements should be stated.

(4) No statement should be made implying that more than $15,000 of Federal insurance is provided for each depositor in a bank or each member in a savings and loan association.

Federal Reserve membership. As of the end of December 1966, member banks accounted for 45 per cent of the number of all commercial banks in the United States and for 63 per cent of all commercial banking offices, and they held approximately 84 per cent of the total deposits in such banks. State member banks accounted for 15 per cent of the number of all State commercial banks and 30 per cent of the banking offices, and they held 60 per cent of total deposits in State commercial banks.

Of the 6,150 banks that were members of the Federal Reserve System at the end of 1966, 4,799 were national banks and 1,351 were State banks. During the year there were net declines of 16 national and 55 State member banks. The decline in the number of national banks reflected 48 conversions to branches incident to mergers and absorptions and 7 conversions to nonmember banks, which was partly offset by the organization of 25 new national banks and the conversion of 10 nonmember banks to national banks. The decrease in State member banks reflected mainly 18 conversions to branches incident to mergers and absorptions and 32 withdrawals from membership.

At the end of 1966 member banks were operating 12,900 branches, 837 more than at the close of 1965; this included 773 de novo establishments.

Detailed figures on changes in the banking structure during 1966 are shown in Table 19, page 348.

Bank mergers. Under Section 18(c) of the Federal Deposit Insurance Act (12 U.S.C. 1828(c)), the prior written consent of the Board of Governors of the Federal Reserve System must be obtained before a bank may merge, consolidate, or acquire the assets and assume the liabilities of another bank if the acquiring, assuming, or resulting bank is to be a State member bank. Before acting on each application the Board must request reports from the Attorney General, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation on the competitive factors involved in each transaction, unless it finds that it must act immediately to prevent the probable failure of one of the participating banks. The Board in turn responds to requests by the Comptroller or the Corporation for reports on competitive factors involved when the acquiring, assuming, or resulting bank is to be a national bank or an insured nonmember State bank.

During 1966 the Board disapproved 1 and approved 21 applications, and it submitted 101 reports on competitive factors to the Comptroller of the Currency and 52 to the Federal Deposit Insurance Corporation. As required by Section 18(c) of the Federal Deposit Insurance Act, a description of each of the 21 applications acted on and approved by the Board, together with other pertinent information, is shown in Table 21 on pages 352–78.

Statements and orders of the Board with respect to all bank merger applications, whether approved or disapproved, are released immediately to the press and the public and are published in the Federal Reserve *Bulletin*. These statements and orders set forth the factors considered, the conclusions reached, and the vote of each Board member present.

Bank holding companies. On July 1, 1966, the Bank Holding Company Act of 1956 was amended as described under "Legislation Enacted" (see page 308). As a result of the amendments thereto and pursuant to Section 5(a) of the Act, 5 bank holding companies registered with the Board prior to the year-end 1966.

Pursuant to Section 3(a)(1) of the Act, the Board approved 6 applications for prior approval to become a bank holding company and denied 2 applications. Pursuant to the provisions of Section 3(a)(2) of the Act and Section 3(a)(3), as amended, the Board approved applications by 12 bank holding companies, involving acquisition of shares in 15 banks, and denied 2 applications. Two of the approved acquisitions involved 2 affiliated bank holding companies, both of which were required to file applications. To provide necessary current information, annual reports for 1965 were obtained from all registered bank holding companies pursuant to the provisions of Section 5(c) of the Act.

Statements and orders of the Board with respect to applications to form or to expand bank holding companies, whether approved or disapproved, are released immediately to the press and the public and are published in the Federal Reserve *Bulletin*. These statements and orders set forth the factors considered, the conclusions reached, and the vote of each Board member present.

The July 1, 1966 Act that amended the Bank Holding Company Act also repealed the provisions of law relating to holding company affiliates. Therefore, since that date, no voting permits or determinations have been issued, and outstanding permits and determinations, including the conditions and agreements imposed for their issuance, are no longer in effect.

Before the Act was repealed—during the period January 1 to July 1, 1966—pursuant to Section 5144 of the Revised Statutes and Section 9 of the Federal Reserve Act, the Board authorized the issuance of 8 voting permits for general purposes and 6 for limited purposes to holding company affiliates of member banks. In accordance with established practice, several holding company affiliates were examined by examiners for the Federal Reserve Banks in whose districts the principal offices of the holding companies are located.

Until July 1, 1966, Section 301 of the Banking Act of 1935 provided that the term "holding company affiliate" should not include—except for the purposes of Section 23A of the Federal Reserve Act, which restricts loans to affiliates and loans on, or investments in, the stock or obligations of affiliates—any organization that is determined by the Board not to be engaged, directly or indirectly, as a business in holding the stock of, or managing or controlling, banks, banking associations, savings banks, or trust companies. During the period January 1 to July 1, 1966, the Board made such a determination with respect to 25 organizations.

Foreign branches of member banks. At the end of 1966, 13 member banks had in active operation a total of 244 branches in 53 foreign countries and overseas areas of the United States; 7 national banks were operating 230 of these branches, and 6 State member banks were operating 14 such branches. The number and location of these foreign branches were as shown in the tabulation on the following page.

Under the provisions of the Federal Reserve Act (Section 25 as to national banks and Sections 9 and 25 as to State member banks), the Board of Governors during the year 1966 approved 46 applications made by member banks for permission to establish branches in foreign countries and overseas areas of the United States.

During the year member banks opened branches in foreign countries as follows: 1 branch in Bombay and Calcutta, India; Lahore, Pakistan; Riyadh, Saudi Arabia; Tamuning, Guam; La Paz, Bolivia; Valparaiso, Chile; Quito, Ecuador; Callao and Lima, Peru; Santo Domingo, Dominican Republic; Puerto Rico; Tegucigalpa, Honduras; Colon, Panama; Antwerp and Brussels, Belgium; Duesseldorf and Frankfurt-am-Main, Germany; Zurich, Switzerland; and London, England; 2 branches in Panama, Republic of Panama; Saigon, South Vietnam; and Hong Kong; and 4 branches in Santiago, Chile. One member bank closed a branch in London, England.

Latin America	*102*
Argentina	17
Bahamas	3
Bolivia	1
Brazil	15
Chile	8
Colombia	6
Dominican Republic	5
Ecuador	3
El Salvador	1
Guatemala	2
Guyana	1
Honduras	1
Jamaica	1
Mexico	5
Nicaragua	1
Panama	15
Paraguay	2
Peru	4
Trinidad	3
Uruguay	2
Venezuela	4
Virgin Islands (British)	2
Continental Europe	*26*
Austria	1
Belgium	6
Germany	8
France	4
Greece	1
Italy	1
Netherlands	3
Switzerland	2
England	*21*
Ireland	*1*
Africa	*2*
Liberia	1
Nigeria	1
Near East	*6*
Dubai	1
Lebanon	3
Saudi Arabia	2
Far East	*57*
Hong Kong	8
India	8
Japan	12
Malaysia	5
Okinawa	2
Pakistan	3
Philippines	5
Singapore	8
Taiwan	2
Thailand	2
Vietnam	2
U.S. Overseas Areas and Trust Territories	*29*
Canal Zone	2
Guam	2
Puerto Rico	16
Truk Islands	1
Virgin Islands	8
Total	**244**

Acceptance powers of member banks. During the year the Board approved the application of 2 member banks, pursuant to the provisions of Section 13 of the Federal Reserve Act, for increased acceptance powers. The banks were granted permission to accept drafts or bills of exchange drawn for the purpose of furnishing dollar exchange as required by the usages of trade in such countries, dependencies, or insular possessions of the United States as may have been designated by the Board of Governors.

Foreign banking and financing corporations. At the end of 1966 there were 4 corporations operating under agreements with the Board pursuant to Section 25 of the Federal Reserve Act relating to investment by member banks in the stock of corporations engaged principally in international or foreign banking. Three of these "agreement" corporations with head offices in New York were examined during the year by examiners for the Board of Governors. The fourth "agreement" corporation is a national bank in the Virgin Islands and is owned by a State member bank in Philadelphia.

During 1966, under the provisions of Section 25(a) of the Federal Reserve Act, the Board issued final permits to 5 corporations to engage in international or foreign banking or other international or foreign financial operations. Four of these corporations commenced operations in 1966. At the end of the year there were 41 corporations in active operation under Section 25(a): 24 have home offices in New York City, 3 in Boston, 4 in Philadelphia, 1 in Pittsburgh, 1 in Winston–Salem, 1 in Atlanta, 2 in Chicago, 2 in Detroit, 2 in San Francisco, and 1 in Seattle. The corporation in Seattle has 4 active branches in Hong Kong. Examiners for the Board of Governors examined 39 of these corporations during 1966.

Bank Examination Schools and other training activities. In 1966 the Bank Examination School conducted three sessions of the School for Examiners, four sessions of the School for Assistant Examiners, and one session of the School for Trust Examiners. The Bank Examination School, established in 1952 by the three Federal bank supervisory agencies, has been conducted jointly by the Federal Reserve System and the Federal Deposit Insurance Corporation since withdrawal of the Office of the Comptroller of the Currency in 1962.

Since the establishment of this program, 3,033 persons have attended the various sessions. This number includes representatives of the Federal bank supervisory agencies; the State Banking Departments of California, Connecticut, Idaho, Indiana, Louisiana, Maine, Michigan, Mississippi, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont, Virginia, and Washington; the Treasury Department of the Commonwealth of Puerto Rico; and 13 foreign countries.

LEGISLATION ENACTED

Bank Merger Act amendments of 1966. An Act of Congress approved February 21, 1966 (Public Law 89-356), amended the Bank Merger Act of 1960 (Section 18(c) of the Federal Deposit Insurance Act) to (1) modify the standards for approval or disapproval of bank mergers by the Federal bank supervisory agencies, (2) make the modified standards applicable also in court actions under the antitrust laws challenging agency-approved bank mergers, and (3) exempt such mergers from the antitrust laws where not challenged by suit brought within 30 days following agency approval. The 1966 amendments also granted amnesty to certain bank mergers consummated pursuant to agency approval under the 1960 Act and subsequently challenged in antitrust court actions.

Asian Development Bank. An Act of Congress approved March 16, 1966 (Public Law 89-369), providing for participation of the United States in the Asian Development Bank, amended Section 5136 of the Revised Statutes to permit member banks to deal in and underwrite, subject to a specified limitation on amount, obligations issued by the Asian Development Bank that are eligible for purchase by a national bank for its own account.

The Act also authorized the Federal Reserve Banks to act as depositories and as fiscal agents for the Asian Development Bank.

Destruction of unfit Federal Reserve notes. An Act of Congress approved May 20, 1966 (Public Law 89-427), amended certain provisions of law, including Sections 11(d) and 16 of the Federal Reserve Act, so as to authorize decentralization of the destruction of Federal Reserve notes that are unfit for further circulation.

Defense Production Act of 1950. An Act of Congress approved June 30, 1966 (Public Law 89-482), extended through June 30, 1968, the termination date of the Defense Production Act of 1950, Section 301 of which is the basis for guarantees of loans for defense production.

Direct purchases of Government obligations by Federal Reserve Banks. An Act of Congress approved June 30, 1966 (Public Law 89-484), extended through June 30, 1968, the authority of Federal Reserve Banks, under Section 14(b) of the Federal Reserve Act, to purchase direct or fully guaranteed obligations of the United States directly from the United States.

Bank Holding Company Act and related statutes. An Act of Congress approved July 1, 1966 (Public Law 89-485), made numerous amendments to the Bank Holding Company Act of 1956, including (1) repeal of previous exemptions for certain registered investment companies and religious, charitable, and educational institutions; (2) inclusion within the coverage of the Act of long-term trusts; (3) redefinition of "bank" to limit the term to institutions accepting deposits withdrawable on demand; (4) application to the bank holding company field of the standards and antitrust procedures made applicable to bank mergers by the Act of February 21, 1966 (described earlier); and (5) repeal of the provisions of Section 6 of the Act relating to loans by holding company banks to other companies in the holding company system. In addition, the Act made a number of amendments to Section 23A of the Federal Reserve Act (which relates to loans by member banks to their affiliates) and extended the limitations of that section to nonmember insured banks; amended Section 25 of the Federal Reserve Act to permit direct investments by member banks in the stock of foreign banks under regulations of the Board of Governors; and repealed the provisions of Section 5144 of the Revised Statutes and of Section 9 of the Federal Reserve Act that required "holding company affiliates" to obtain permits to vote the stock of member banks.

Administrative Procedure Act. An Act of Congress approved July 4, 1966 (Public Law 89-487), amended Section 3 of the Administrative Procedure Act to broaden public access to Government records effective July 4, 1967.

Interest on deposits; reserves of member banks; open market operations. An Act of Congress approved September 21, 1966 (Public Law 89-597), (1) conferred on Federal supervisory agencies more flexible authority to regulate the maximum rates of interest or dividends payable by banks and certain other financial institutions on deposits or share accounts; (2) authorized higher reserve requirements on time deposits of member banks; and (3) authorized open market operations by Federal Reserve Banks in direct or fully guaranteed obligations of any agency of the United States. The additional powers granted by this law expire September 21, 1967.

Financial Institutions Supervisory Act; Federal deposit insurance. An Act of Congress approved October 16, 1966 (Public Law 89-695), strengthened the authority of the Federal agencies that supervise and regulate banks and savings and loan associations, and authorized such agencies to institute "cease and desist" proceedings and proceedings directed at the removal from office, in prescribed circumstances, of directors or officers of institutions under their supervision. The Act also provided for temporary cease and desist and removal orders, and for judicial relief therefrom on petition of the affected institution or party. The foregoing provisions will be effective only through June 30, 1972. The Act also increased from $10,000 to $15,000 the insurance coverage of deposits insured by the Federal Deposit Insurance

Corporation and accounts insured by the Federal Savings and Loan Insurance Corporation.

Member banks dealing in certain insured obligations; real estate loans by national banks. An Act of Congress approved November 3, 1966 (Public Law 89-754), entitled the "Demonstration Cities and Metropolitan Development Act of 1966," amended Section 5136 of the Revised Statutes of the United States so as to permit member banks to deal in and underwrite obligations that are insured under the new Title XI of the National Housing Act, which provides mortgage insurance on facilities for the group practice of medicine, dentistry, and optometry. Purchase of such securities for investment is also excepted from the usual limitation of 10 per cent of the bank's capital and surplus. The Act also amended Section 24 of the Federal Reserve Act so as to make certain limitations and restrictions on real estate loans by national banks inapplicable to such insured obligations.

Delegation of functions of Board of Governors. An Act of Congress approved November 5, 1966 (Public Law 89-765), amended Section 11 of the Federal Reserve Act by adding a new subsection (k) authorizing the Board of Governors to delegate certain of its functions to hearing examiners, members or employees of the Board, or Federal Reserve Banks.

LEGISLATIVE RECOMMENDATIONS

Lending authority of Federal Reserve Banks. Under present law, when a member bank borrows from its Reserve Bank on collateral other than U.S. Government obligations or paper (such as promissory notes of the member bank's customers) that meets certain "eligibility" requirements, it must pay interest at a rate one-half of 1 per cent higher than the Reserve Bank's normal discount rate. For several years the Board of Governors has urged legislation that would permit a member bank, in appropriate circumstances, to borrow on any collateral satisfactory to its Reserve Bank without the necessity of paying a higher rate of interest simply because "ineligible" collateral was presented.

The need for such legislation has increased as member banks have reduced their holdings of Government securities and broadened the scope of their lending in order to meet the expanding credit demands of their customers. Many of these loans cannot qualify as collateral for Federal Reserve advances except at the "penalty" rate of interest, although their quality may be equal to that of presently "eligible" paper.

To enable the Federal Reserve System always to be in a position to perform promptly and efficiently one of its principal responsibilities—the extension of credit assistance to enable the banking system to meet the legitimate needs of the economy—and to avoid penalizing those uses of credit that generate sound paper that is not "eligible" under existing law, the Board again urges legislation to permit member banks to borrow from Federal Reserve Banks, at current discount rates, on the security of any sound assets.

"Par clearance." Most banks pay the face amount of all checks presented to them for payment; this practice is frequently described as "par clearance." In certain areas of the country, however, many small banks deduct a so-called "exchange charge" from the face amount of checks presented by mail and remit only the balance. In such circumstances the drawee bank shifts all or a portion of the expense incurred by it in connection with the collection process to the payee of the check or to an indorsee. In the Board's view there is no justification for the increased costs, delays, and inefficiencies that result when banks do not pay all checks at their face amount. Accordingly, the Board reiterates the recommendation in its ANNUAL REPORT for 1965 that legislation be enacted to require all insured banks to pay the face amount of all valid checks drawn upon them.

Reserve requirements. In its ANNUAL REPORTS for 1964 and 1965 the Board of Governors favored legislation that would (1) authorize it to fix reserve requirements on a graduated basis according to the amount of a bank's deposits and (2) make such requirements applicable to all federally insured banks (rather than only to member banks). Legislation enacted in 1966 gave the Board increased flexibility in fixing reserve requirements; but that legislation is temporary in nature, it retains the outmoded differentiation between reserve city and "country" banks, and it does not apply to nonmember banks.

The reasons for changes in the structure of bank reserve requirements have become stronger with the passage of time. The classification of member banks into reserve city and "country" banks has become increasingly arbitrary as the differences between them, in both size and functions, have decreased. Since deposits in nonmember banks are part of the country's money supply just as are those in member banks, their exemption from federally imposed reserve requirements cannot be justified. It would be far more rational and equitable to require that every federally insured bank maintain reserves against deposits solely on the basis of their amount. Under such a requirement, all federally insured banks of the same size, in terms of demand deposits, would carry equal reserves against such deposits.

Accordingly, the Board renews its recommendation that legislation be enacted (1) to authorize the Board to fix graduated reserve requirements on the basis of the amount of a bank's demand deposits and (2) to bring all insured banks within the coverage of such requirements. In connection with the latter action, nonmember insured banks should be granted access to Federal Reserve discount facilities.

Margin requirements for securities transactions. The Board again urges enactment of legislation modifying Section 7 of the Securities Exchange Act of 1934 (15 U.S.C. 78g) to eliminate an unwarranted difference in the status, for credit purposes, of securities that are registered on a national securities exchange and securities that are traded only "over the counter."

Section 7 now authorizes the Board of Governors to limit the credit that brokers and dealers may extend on securities that are registered on exchanges and the credit that banks (and other lenders) may extend for the purpose of purchasing or carrying equity securities that are so registered. With respect to over-the-counter securities, that section, generally speaking, forbids brokers and dealers to extend any credit whatever, while permitting banks to extend credit unlimited by any governmentally imposed margin requirements.

This legislative arrangement is inequitable in its divergent treatment of brokers and banks; it unnecessarily deprives persons interested in purchasing over-the-counter securities of credit facilities that might appropriately be extended by brokers and dealers; and it limits the effectiveness of salutary controls over security credit. The growth of the over-the-counter securities market has given this problem increased importance, and the Securities and Exchange Commission's *Special Study of Securities Markets,* submitted to Congress in 1963, recommended amendment of the 1934 Act along the lines urged by the Board.

Purchase of obligations of foreign governments by Federal Reserve Banks; loans to bank examiners; loans to executive officers. The Board reiterates the recommendations included in its ANNUAL REPORTS for 1964 and 1965 that legislation be enacted to:

(1) Amend Section 14(e) of the Federal Reserve Act to permit Reserve Banks to invest in obligations of foreign governments or monetary authorities that will mature within 12 months and are payable in a convertible currency;

(2) Relax the criminal prohibition against bank loans to examiners in order to permit federally insured banks to make home mortgage loans up to $30,000 to bank examiners; and

(3) Modify the provisions of Section 22(g) of the Federal Reserve Act (a) to permit an executive officer of a member bank to borrow from his own bank up to $5,000, or in the case of a home mortgage loan up to $30,000; (b) to substitute, with respect to such borrowings, a requirement of a report by the officer to his board of directors in lieu of the present requirement of prior approval by such board; and (c) to require an executive officer to inform his board of directors of borrowings from other banks only where they would exceed $5,000 in the aggregate, rather than with respect to each such borrowing.

LITIGATION

Whitney Holding Corporation, New Orleans, Louisiana. A Louisiana Circuit Court of Appeal affirmed the decision of the lower State court, holding the Louisiana anti-bank holding company statute to be applicable to the Whitney proposal for becoming a bank holding company, and not unconstitutional as so applied (see ANNUAL REPORT for 1965, pp. 242 and 243).

On November 7, 1966, the Louisiana Supreme Court denied a petition for review of the holding of the Circuit Court of Appeal. Following the Louisiana Supreme Court decision, and on the basis of that decision, the opposing banks requested the Board to deny the Whitney application, subsequent to which counsel for Whitney filed a motion with the Board to withdraw the Whitney application.

On December 30, 1966, the Board granted the motion to withdraw and vacated the Board's Order of May 3, 1962. The May 3 Order had granted approval of the Whitney bank holding company plan and had been remanded to the Board by the Fifth Circuit Court of Appeals for reconsideration in the light of the U.S. Supreme Court opinion in *Whitney* v. *Saxon,* 379 U.S. 411, indicating that the Board should determine the applicability and effect of the Louisiana anti-bank holding company statute, which had become effective July 10, 1962. The Board's Order of December 30, 1966, concluded the administrative proceeding.

***Baker, Watts & Co. et al.* v. *Saxon*.** In 1966, a group of investment bankers filed suit in the U.S. District Court for the District of Columbia for a declaratory judgment and an injunction, seeking to restrain the Comptroller of the Currency from purporting to authorize national banks to underwrite and deal in governmental securities known as "revenue bonds." Revenue bonds are issued by governmental instrumentalities but are not supported by general powers of taxation; interest and principal are payable out of funds received from a specified source.

The problem arose out of interpretations by the Comptroller of provisions of paragraph Seventh of Section 5136 of the Revised Statutes (12 U.S.C. 24), which prohibit national banks from underwriting, purchasing, and dealing in securities, with certain exceptions including "general obligations of any State or of any political subdivision thereof." The question before the Court was whether revenue bonds qualify as such "general obligations."

Because the statutory provisions in question apply also to member State banks (under Section 9 of the Federal Reserve Act) and because the Board of Governors, in its interpretations and enforcement of the provisions in question, has taken a position different from that of the Comptroller, the Board was invited by the District Court to submit a memorandum of law on the subject, in the capacity of a "friend of the court" *(amicus curiae).*

The Court rejected the Comptroller's interpretation of the statute in question and adopted the position taken by the plaintiffs and the Board. In its final judgment, dated December 22, 1966, the Court concluded that the exception in Section 5136 of the Revised Statutes for "general obligations" of States and political subdivisions is limited to "obligations that are supported by an unconditional promise to pay, directly or indirectly, an aggregate amount which (together with any other funds available for the purpose) will suffice to discharge, when due, all interest on and principal of such obligations, which promise (1) is made by a governmental entity that possesses general powers of taxation, including property taxation, and (2) pledges or otherwise commits the full faith and credit of said promisor; said term does not include obligations not so supported that are to be repaid only from specified sources such as the income from designated facilities or the proceeds of designated taxes." This interpretation is identical with a legislative proposal urged by the Board in its ANNUAL REPORTS for 1964 and 1965 as a means of reaffirming and clarifying existing law on the subject of bank underwriting of revenue bonds and is the reason for omission of such recommendation in this year's REPORT.

Detroit Bank & Trust Co. et al.* v. *Saxon and Board of Governors of Federal Reserve System. Four Michigan banks, of which two are national banks and two are member State banks, filed suit in 1966 in the U.S. District Court for the District of Columbia, against the Comptroller of the Currency and the Board of Governors of the Federal Reserve System, for the purpose of preventing consummation of a proposal by Michigan National Bank, Detroit, Michigan, to increase its authorized common stock and to exchange shares of the new issue for outstanding shares of stock of Michigan Bank N.A. The court permitted Michigan National Bank to intervene as a co-defendant.

The complaint asserts that consummation of the proposed acquisition of stock would violate various Federal banking laws, including (1) Section 5136 of the Revised Statutes prohibiting a national bank from buying shares of stock for its own account, except as authorized by law, (2) Section 5155 of the Revised Statutes governing branch banking, (3) Section 5190 of the Revised Statutes specifying the locations where a national bank may conduct business, and (4) the Bank Holding Company Act of 1956. The complaint asserts also that consummation of the said proposal would be violative of the dual banking system concept as reflected by various provisions of the Michigan Financial Institutions Act and the Federal banking laws.

The plaintiffs have requested the Court to enter a declaratory judgment to the effect that Michigan National Bank has no lawful right to acquire, or hold for its own account, the capital stock of Michigan Bank N.A., and that neither the Comptroller nor the Board of Governors is authorized to approve the proposed acquisition of stock; the plaintiffs have also asked the Court to enjoin the Comptroller from issuing any certificate under 12 U.S.C. 57, or any approval purporting to authorize or validate the issuance of shares of Michigan National Bank for the purpose of the above-mentioned acquisition.

RESERVE BANK OPERATIONS

Earnings and expenses. The accompanying table summarizes the earnings, expenses, and distribution of net earnings of the Federal Reserve Banks for 1966 and 1965.

EARNINGS, EXPENSES, AND DISTRIBUTION OF NET EARNINGS OF FEDERAL RESERVE BANKS, 1966 AND 1965
(In thousands of dollars)

Item	1966	1965
Current earnings	1,908,500	1,559,484
Current expenses	207,401	204,290
Current net earnings	1,701,099	1,355,194
Net addition to current net earnings[1]	996	1,022
Net earnings before payments to U.S. Treasury	1,702,095	1,356,215
Dividends paid	33,696	32,352
Payments to U.S. Treasury (interest on F.R. notes)	1,649,455	1,296,810
Transferred to surplus	18,944	27,054

[1] Includes net losses on sales of U.S. Govt. securities of $2,476,000 in 1966 and of $9,000 in 1965.

Current earnings were $1,908 million, an increase of $349 million, or 22 per cent, from 1965. Of this increase $329 million was from U.S. Government securities, $9 million from discounts and advances, and $8 million from foreign currencies.

Current expenses were $3 million, or 1.5 per cent, more than in 1965. Statutory dividends to member banks amounted to $34 million, an increase of $1 million from 1965. This rise in dividends reflected an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Federal Reserve Banks.

Payments to the Treasury as interest on Federal Reserve notes totaled $1,649 million for the year, compared with $1,297 million in 1965. This amount consists of all net earnings after dividends and the amount necessary to bring surplus to the level of paid-in capital.

Expenses of the Federal Reserve Banks include costs of $866.19 for 11 regional meetings incident to the Treasury Department Savings Bond program.

A detailed statement of earnings and expenses of each Federal Reserve Bank during 1966 is shown in Table 7 on pages 336 and 337 and a condensed historical statement in Table 8 on pages 338 and 339.

Holdings of loans and securities. The accompanying table shows holdings, earnings, and average interest rates on loans and securities of the Federal Reserve Banks during the past 3 years.

Average daily holdings of loans and securities during 1966 amounted to $42,612 million—an increase of $3,382 million

RESERVE BANK EARNINGS ON LOANS AND SECURITIES, 1964–66

Item and year	Total	Discounts and advances	Accept-ances	U.S. Govt. securities
	In millions of dollars			
Average daily holdings:[1]				
1964	34,985	294	76	34,615
1965	39,230	492	77	38,661
1966	42,612	649	117	41,846
Earnings:				
1964	1,337.0	10.5	2.8	1,323.7
1965	1,545.0	19.8	3.2	1,522.0
1966	1,885.8	29.2	5.8	1,850.8
	In per cent			
Average rate of interest:				
1964	3.82	3.57	3.67	3.82
1965	3.94	4.03	4.14	3.94
1966	4.43	4.50	4.96	4.42

[1] Based on holdings at opening of business.

over 1965. U.S. Government securities accounted for $3,185 million of the increase, and discounts and advances for $157 million.

The average rates of interest on holdings were up from 4.03 per cent to 4.50 per cent on discounts and advances, from 4.14 per cent to 4.96 per cent on acceptances, and from 3.94 per cent to 4.42 per cent on U.S. Government securities.

Volume of operations. Table 10 on page 340 shows the volume of operations in the principal departments of the Federal Reserve Banks for 1963–66.

Discounts and advances were the highest in number since 1960 and the highest in dollar amount since 1959, as the number of banks borrowing rose to 1,658 against 1,157 in 1965.

The upward trend in volume of most of the other operations continued in 1966, particularly in food stamps redeemed and in the dollar amount of transfers of funds. Coin received and counted was almost back to the volume handled in 1962 before the coin shortage began.

Conversion of the check handling operation to high-speed electronic equipment, which was begun near the end of 1960, is now about completed, with the last of the 36 Federal Reserve Banks and branches scheduled to install such equipment early in 1967.

Loan guarantees for defense production. Under the Defense Production Act of 1950, the Departments of the Army, Navy, and Air Force, the Defense Supply Agency of the Department of Defense, the Departments of Commerce, Interior, and Agriculture, the General Services Administration, the National Aeronautics and Space Administration, and the Atomic Energy Commission are authorized to guarantee loans for defense production made by commercial banks and other private financing institutions. The Federal Reserve Banks act as fiscal agents of the guaranteeing agencies under the Board's Regulation V.

During 1966 the guaranteeing agencies authorized the issuance of 5 guarantee agreements covering loans totaling $9 million. Loan authorizations outstanding on December 31, 1966, totaled $58 million, of which $55 million represented outstanding loans and $3 million additional credit available to borrowers. Of total loans outstanding, 79 per cent on the average was guaranteed. During the year approximately $56 million was disbursed on guaranteed loans, most of which are revolving credits.

Authority for the V-loan program, unless extended, will terminate on June 30, 1968.

Table 14 (page 342) shows guarantee fees and maximum interest rates applicable to Regulation V loans. The current maximum permissible interest rate of 7½ per cent was increased from 6 per cent by the Board of Governors in September 1966, after consultation with the guaranteeing agencies, to bring the net return to financing institutions on loans under this program more in line with current lending and money market rates and thus help to assure financing from commercial sources for contractors and subcontractors engaged in defense work.

Foreign and international accounts. Assets held for foreign account at the Federal Reserve Banks declined $1,272 million in 1966. At the end of the year they amounted to $18,840 million: $10,407 million of earmarked gold; $7,036 million of U.S. Government securities (including securities payable in foreign currencies); $174 million in dollar deposits; $191 million of bankers' acceptances purchased through Federal Reserve Banks; and $1,032 million of miscellaneous assets. The latter item includes mainly dollar bonds issued by foreign countries and international organizations. Assets held for international organizations, including an IMF gold deposit, increased by $763 million to $9,517 million.

In 1966 new accounts were opened in the names of the central banks of Ethiopia, Guyana, and Tanzania. An account was opened also for the Asian Development Bank.

Gold collateral loans totaling $41 million, which were outstanding at the beginning of 1966, were repaid. New arrangements—including a standby commitment—amounted to $40 million. All drawings during the year under the loan arrangements were repaid by the end of the year. Loans on gold are made to foreign monetary authorities to help them meet dollar requirements of a temporary nature.

The Federal Reserve Bank of New York continued to act as depositary and fiscal agent for international organizations. As fiscal agent of the United States, the Bank continued to operate the Exchange Stabilization Fund pursuant to authorization and instructions of the Secretary of the Treasury. Also on behalf of the Treasury Department, it administered foreign assets control regulations pertaining to assets in the United States of North Vietnam, Cuba, Communist China, and North Korea, and their nationals, and to transactions with those countries and their nationals.

Bank premises. During 1966 the Board authorized construction of a communications and records center for the Federal Reserve Bank of Richmond, an addition to the Federal Reserve Bank building in Kansas City, and a new building for the Denver Branch.

Table 6 on page 335 shows the cost and book value of bank premises owned and occupied by the Federal Reserve Banks and of real estate acquired for banking-house purposes.

BOARD OF GOVERNORS

Building annex. The Board has authorized construction of an annex to its present building on property acquired as part of the original site in 1934. For this purpose it has employed Harbeson Hough Livingston and Larson, the architectural firm that is successor to Paul P. Cret, architect of the original building.

Income and expenses. The accounts of the Board for the year 1966 were audited by the public accounting firm of Haskins & Sells.

ACCOUNTANTS' OPINION

Board of Governors of the
Federal Reserve System:

We have examined the balance sheet of the Board of Governors of the Federal Reserve System as of December 31, 1966 and the related statement of assessments and expenditures for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements present fairly the financial position of the Board of Governors of the Federal Reserve System at December 31, 1966 and its assessments and expenditures for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Haskins & Sells

Washington, D. C.
January 27, 1967

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEET, DECEMBER 31, 1966

ASSETS

OPERATING FUND:		
Cash		$ 659,103
Miscellaneous receivables and travel advances		18,446
Stockroom and cafeteria inventories—at cost		22,697
Total operating fund		700,246
PROPERTY FUND—At cost:		
Land and improvements		792,852
Building		4,273,349
Furniture and equipment		1,405,091
Total property fund		6,471,292
TOTAL		$ 7,171,538

LIABILITIES AND FUND BALANCES

OPERATING FUND:		
Current liabilities:		
Accounts payable and accrued expenses	$ 395,211	
Income taxes withheld	275,533	
Accrued payroll	250,233	$ 920,977
Fund balance:		
Balance, January 1, 1966	(157,820)	
Excess of expenditures over assessments and special item for the year	(62,911)	(220,731)
Total operating fund		700,246
PROPERTY FUND:		
Fund balance, January 1, 1966	6,153,098	
Expenditures for additions	347,700	
Property adjustments and disposals	(29,506)	
Total property fund		6,471,292
TOTAL		$ 7,171,538

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF ASSESSMENTS AND EXPENDITURES FOR THE YEAR ENDED DECEMBER 31, 1966

ASSESSMENTS LEVIED ON FEDERAL RESERVE BANKS:		
For Board expenses and additions to property		$ 9,021,600
For expenditures made on behalf of the Federal Reserve Banks		19,158,370
Total assessments		28,179,970
EXPENDITURES:		
For printing, issue and redemption of Federal Reserve notes, paid on behalf of the Federal Reserve Banks		19,158,370
For expenses of the Board:		
Salaries	$6,104,175	
Retirement and insurance contributions	976,359	
Traveling expenses	327,566	
Consumer finances surveys	45,325	
Banking markets and other economic surveys	118,172	
Legal, consultant and audit fees	66,516	
Other contractual services	155,243	
Printing and binding—net	367,173	
Equipment and other rentals	206,107	
Telephone and telegraph	136,942	
Postage and expressage	99,405	
Stationery, office and other supplies	112,820	
Heat, light and power	54,937	
Operation of cafeteria—net	60,302	
Repairs, maintenance and alterations	101,702	
Books and subscriptions	25,900	
Insurance	2,755	
System membership, Center for Latin American Monetary Studies	25,500	
Miscellaneous—net	39,369	9,026,268
For property additions		347,700
Total expenditures		28,532,338
EXCESS OF EXPENDITURES OVER ASSESSMENTS BEFORE SPECIAL ITEM		352,368
SPECIAL ITEM (See Note)		289,457
EXCESS OF EXPENDITURES OVER ASSESSMENTS AND SPECIAL ITEM FOR THE YEAR		$ 62,911

NOTE.—During 1966 payment of $289,457 was received by the Board in settlement of a court judgment in favor of the United States (on the Board's behalf) for failure by the manufacturer to deliver an electronic digital computing system under a 1956 contract.

Tables

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1. DETAILED STATEMENT OF CONDITION OF ALL FEDERAL RESERVE BANKS COMBINED, DECEMBER 31, 1966

(In thousands of dollars)

ASSETS

Gold certificates on hand:				
Held by F.R. Banks		1,278		
Held by F.R. Agents		....		
Gold certificates due from U.S. Treasury:				
Interdistrict settlement fund		4,329,625		
F.R. Agents' fund		6,505,000	10,835,903	
Redemption fund for F.R. notes			1,837,860	
Total gold certificate reserves				12,673,763
F.R. notes of other F.R. Banks				857,513
Other cash:				
United States notes			14,305	
Silver certificates			8,745	
National bank notes and F.R. Bank notes			108	
Coin			277,525	
Total other cash				300,683
Discounts and advances secured by U.S. Govt. obligations:				
Discounted for member banks		73,325		
Discounted for others		....	73,325	
Other discounts and advances:				
Discounted for member banks		99,125		
Foreign loans on gold		....	99,125	
Total discounts and advances			172,450	
Acceptances:				
Bought outright			69,121	
Held under repurchase agreement			123,998	
Federal agency obligations:				
Held under repurchase agreement			33,800	
U.S. Govt. securities:				
Bought outright:				
Bills	11,803,658			
Certificates	4,351,015			
Notes	21,301,957			
Bonds	6,198,762			
Total bought outright		43,655,392		
Held under repurchase agreement		626,800		
Total U.S. Govt. securities			44,282,192	
Total loans and securities				44,681,561
Cash items in process of collection:				
Transit items			9,632,534	
Exchanges for clearing house			354,744	
Other cash items			308,882	
Total cash items in process of collection				10,296,160
Bank premises:				
Land			30,371	
Buildings (including vaults)		115,169		
Fixed machinery and equipment		61,649		
Total buildings		176,818		
Less depreciation allowances		100,688	76,130	
Total bank premises				106,501
Other assets:				
Claims account closed banks			1,121	
Denominated in foreign currencies			874,607	
Gold due from U.S. Treasury for account International Monetary Fund			211,490	
Reimbursable expenses and other items receivable			3,823	
Interest accrued			317,896	
Premium on securities			972	
Deferred charges			2,112	
Real estate acquired for banking-house purposes			1,134	
Suspense account			4,691	
All other			1,130	
Total other assets				1,418,976
Total assets				70,335,157

1. DETAILED STATEMENT OF CONDITION OF ALL FEDERAL RESERVE BANKS COMBINED, DECEMBER 31, 1966—Continued

(In thousands of dollars)

LIABILITIES

F.R. notes:			
Outstanding (issued to F.R. Banks)		42,217,291	
Less: Held by issuing F.R. Banks	1,856,224		
Forwarded for redemption	165,114	2,021,338	
F.R. notes, net (includes notes held by U.S. Treasury and by F.R. Banks other than issuing Bank)			**40,195,953**
Deposits:			
Member bank reserves		**19,791,748**	
U.S. Treasurer—General account		**415,774**	
Foreign		**174,045**	
Other deposits:			
Nonmember bank—Clearing accounts	70,566		
Officers' and certified checks	11,694		
Reserves of corporations doing foreign banking or financing	43,973		
International organizations	289,802		
All other	173,682		
Total other deposits		**589,717**	
Total deposits			**20,971,284**
Deferred availability cash items			**7,784,609**
Other liabilities:			
Accrued dividends unpaid		....	
Unearned discount		600	
Discount on securities		236,085	
Sundry items payable		6,230	
Suspense account		479	
All other		137	
Total other liabilities			**243,531**
Total liabilities			**69,195,377**

CAPITAL ACCOUNTS

Capital paid in	**569,890**
Surplus	**569,890**
Other capital accounts[1]	....
Total liabilities and capital accounts	**70,335,157**
Contingent liability on acceptances purchased for foreign correspondents	**190,554**

[1] During the year this item includes the net of earnings, expenses, profit and loss items, and accrued dividends which are closed out on December 31; see Table 7, pp. 336-37.

NOTE.—Amounts in boldface type indicate items shown in the Board's weekly statement of condition of the F.R. Banks.

2. STATEMENT OF CONDITION OF EACH FEDERAL RESERVE BANK, DECEMBER 31, 1966 and 1965

(In millions of dollars unless otherwise indicated)

Item	Total		Boston		New York		Philadelphia		Cleveland		Richmond	
	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965
ASSETS												
Gold certificate account	10,836	11,702	674	702	2,048	2,478	699	787	831	1,028	1,044	1,012
Redemption fund for F.R. notes	1,838	1,734	102	99	444	409	96	94	155	148	157	143
Total gold certificate reserves	12,674	13,436	776	801	2,492	2,887	795	881	986	1,176	1,201	1,155
F.R. notes of other Banks	857	876	58	74	189	151	48	66	98	70	87	102
Other cash	298	129	9	9	31	17	6	6	50	12	16	9
Discounts and advances:												
Secured by U.S. Govt. securities	74	82	1	....	7	19	1	2	....	*	4	1
Other	99	55	....	2	25	11	....	2	....	4	....	2
Acceptances:												
Bought outright	69	75	....	....	69	75	....	....	....	....	....	....
Held under repurchase agreements	124	112	....	....	124	112	....	....	....	....	....	....
Federal agency obligations held under repurchase agreements	34	....	....	....	34	....	....	....	....	....	....	....
U.S. Govt. securities:												
Bought outright	43,655	40,478	2,326	2,097	10,899	9,744	2,289	2,114	3,562	3,435	3,163	2,863
Held under repurchase agreements	627	290	....	....	627	290	....	....	....	....	....	....
Total loans and securities	44,682	41,092	2,327	2,099	11,785	10,251	2,290	2,118	3,562	3,439	3,167	2,866
Cash items in process of collection	10,281	8,758	615	519	1,994	1,677	542	484	723	586	811	700
Bank premises	107	103	3	3	9	9	3	3	5	5	6	5
Other assets:												
Denominated in foreign currencies	875	629	42	30	229	166	47	35	79	57	45	31
IMF gold deposited [1]	211	34	....	....	211	34	....	....	....	....	....	....
All other	332	314	17	16	86	76	17	16	27	27	22	21
Total assets	70,317	65,371	3,847	3,551	17,026	15,268	3,748	3,609	5,530	5,372	5,355	4,889

LIABILITIES												
F.R. notes	40,196	37,950	2,388	2,250	9,238	8,600	2,306	2,241	3,316	3,232	3,680	3,388
Deposits:												
Member bank reserves	19,779	18,447	844	702	5,278	4,804	896	858	1,458	1,445	962	825
U.S. Treasurer—General account	416	668	*	48	271	160	*	39	1	68	1	69
Foreign	174	150	8	7	56	40	9	8	14	13	8	8
Other:												
IMF gold deposit [1]	211	....	....	....	211	....	....	....	....	....	....	....
All other	377	355	9	6	185	184	9	6	13	12	14	12
Total deposits	20,957	19,620	861	763	6,001	5,188	914	911	1,486	1,538	985	914
Deferred availability cash items	7,786	6,510	532	474	1,418	1,142	457	387	608	487	615	518
Other liabilities	238	189	12	10	73	50	11	10	18	15	15	13
Total liabilities	69,177	64,269	3,793	3,497	16,730	14,980	3,688	3,549	5,428	5,272	5,295	4,833
CAPITAL ACCOUNTS												
Capital paid in	570	551	27	27	148	144	30	30	51	50	30	28
Surplus	570	551	27	27	148	144	30	30	51	50	30	28
Other capital accounts	....	....	....	....	....	....	....	....	....	....	....	....
Total liabilities and capital accounts	70,317	65,371	3,847	3,551	17,026	15,268	3,748	3,609	5,530	5,372	5,355	4,889
Ratio of gold certificate reserves to F.R. note liability	31.5%	35.4%	32.5%	35.6%	27.0%	33.6%	34.5%	39.3%	29.7%	36.4%	32.6%	34.1%
Contingent liability on acceptances purchased for foreign correspondents	191	144	9	7	49	38	10	8	17	13	10	7
F.R. NOTE STATEMENT												
F.R. notes:												
Issued to F.R. Bank by F.R. Agent and outstanding	42,218	40,350	2,494	2,372	9,687	9,095	2,359	2,338	3,577	3,483	3,803	3,573
Less held by issuing Bank, and forwarded for redemption	2,022	2,400	106	122	449	495	53	97	261	251	123	185
F.R. notes, net [2]	40,196	37,950	2,388	2,250	9,238	8,600	2,306	2,241	3,316	3,232	3,680	3,388
Collateral held by F.R. Agent for notes issued to Bank:												
Gold certificate account	6,505	6,625	500	440	1,000	1,000	483	500	600	600	795	853
Eligible paper	2	1	....	....	....	....	*	1	....	....	....	....
U.S. Govt. securities	36,956	34,700	2,016	1,945	8,900	8,200	2,000	1,900	3,050	2,950	3,045	2,750
Total collateral	43,463	41,326	2,516	2,385	9,900	9,200	2,483	2,401	3,650	3,550	3,840	3,603

For notes see end of table.

2. STATEMENT OF CONDITION OF EACH FEDERAL RESERVE BANK, DECEMBER 31, 1966 and 1965—Continued

(In millions of dollars unless otherwise indicated)

Item	Atlanta		Chicago		St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965
ASSETS														
Gold certificate account	621	662	1,827	2,210	470	463	213	258	401	479	655	368	1,353	1,255
Redemption fund for F.R. notes	103	98	331	318	64	65	32	32	72	67	62	57	220	204
Total gold certificate reserves	724	760	2,158	2,528	534	528	245	290	473	546	717	425	1,573	1,459
F.R. notes of other Banks	76	79	86	85	30	42	23	35	34	35	41	47	87	90
Other cash	37	13	46	22	31	7	8	4	14	7	18	6	32	17
Discounts and advances:														
Secured by U.S. Govt. securities	14	*	20	15	2	....	3	6	7	19	*	20	15	....
Other	31	15	....	6	....	1	*	1	*	3	*	2	43	6
Acceptances:														
Bought outright	....	....	....	....	....	....	....	....	....	....	....	....	....	....
Held under repurchase agreements	....	....	....	....	....	....	....	....	....	....	....	....	....	....
Federal agency obligations held under repurchase agreements	....	....	....	....	....	....	....	....	....	....	....	....	....	....
U.S. Govt. securities:														
Bought outright	2,470	2,314	7,322	6,742	1,491	1,547	897	839	1,661	1,584	1,592	1,666	5,983	5,533
Held under repurchase agreements	....	....	....	....	....	....	....	....	....	....	....	....	....	....
Total loans and securities	2,515	2,329	7,342	6,763	1,493	1,548	900	846	1,668	1,606	1,592	1,688	6,041	5,539
Cash items in process of collection	871	776	1,742	1,508	480	413	290	248	667	535	540	465	1,006	847
Bank premises	20	20	20	20	8	7	3	3	11	7	10	11	9	10
Other assets:														
Denominated in foreign currencies	52	37	125	89	31	21	21	14	38	28	51	37	115	84
IMF gold deposited [1]	....	....	....	....	....	....	....	....	....	....	....	....	....	....
All other	19	18	54	50	11	12	8	7	13	15	12	12	46	44
Total assets	4,314	4,032	11,573	11,065	2,618	2,578	1,498	1,447	2,918	2,779	2,981	2,691	8,909	8,090

LIABILITIES														
F.R. notes	2,327	2,257	7,293	6,891	1,471	1,451	706	700	1,511	1,433	1,278	1,194	4,682	4,313
Deposits:														
Member bank reserves	1,187	1,084	2,754	2,814	727	691	482	493	877	833	1,065	1,034	3,249	2,864
U.S. Treasurer—General account	1	14	*	49	1	55	1	37	1	52	137	21	2	56
Foreign	9	9	23	21	6	5	4	3	7	7	9	9	21	20
Other:														
IMF gold deposit [1]	....	....	....	....	....	....	....	....	....	....	....	....	....	....
All other	10	13	29	22	6	10	3	6	7	6	7	6	85	72
Total deposits	1,207	1,120	2,806	2,906	740	761	490	539	892	898	1,218	1,070	3,357	3,012
Deferred availability cash items	697	579	1,270	1,080	360	321	270	177	456	393	411	356	692	596
Other liabilities	13	10	38	30	7	7	4	5	9	7	8	7	30	25
Total liabilities	4,244	3,966	11,407	10,907	2,578	2,540	1,470	1,421	2,868	2,731	2,915	2,627	8,761	7,946
CAPITAL ACCOUNTS														
Capital paid in	35	33	83	79	20	19	14	13	25	24	33	32	74	72
Surplus	35	33	83	79	20	19	14	13	25	24	33	32	74	72
Other capital accounts	....	....	....	....	....	....	....	....	....	....	....	....	....	....
Total liabilities and capital accounts	4,314	4,032	11,573	11,065	2,618	2,578	1,498	1,447	2,918	2,779	2,981	2,691	8,909	8,009
Ratio of gold certificate reserves to F.R. note liability	31.1%	33.7%	29.6%	36.7%	36.3%	36.4%	34.7%	41.4%	31.3%	38.1%	56.1%	35.6%	33.6%	33.8%
Contingent liability on acceptances purchased for foreign correspondents	12	9	27	20	7	5	5	3	9	7	11	8	25	19
F.R. NOTE STATEMENT														
F.R. notes:														
Issued to F.R. Bank by F.R. Agent and outstanding	2,459	2,438	7,653	7,322	1,538	1,536	743	734	1,579	1,509	1,373	1,291	4,953	4,659
Less held by issuing Bank, and forwarded for redemption	132	181	360	431	67	85	37	34	68	76	95	97	271	346
F.R. notes, net [2]	2,327	2,257	7,293	6,891	1,471	1,451	706	700	1,511	1,433	1,278	1,194	4,682	4,313
Collateral held by F.R. Agent for notes issued to Bank:														
Gold certificate account	450	550	1,100	1,100	310	315	127	127	225	225	180	180	735	735
Eligible paper	....	....	....	....	2	....	....	....	....	....	....	....	....	....
U.S. Govt. securities	2,050	1,900	6,700	6,400	1,310	1,310	655	615	1,400	1,300	1,230	1,130	4,600	4,300
Total collateral	2,500	2,450	7,800	7,500	1,622	1,625	782	742	1,625	1,525	1,410	1,310	5,335	5,035

* Less than $500,000.

[1] Gold deposited by the IMF to mitigate the impact on the U.S. gold stock of purchases by foreign countries for gold subscriptions on increased IMF quotas. The United States has a corresponding gold liability to the IMF.

[2] Includes F.R. notes held by U.S. Treasury and by F.R. Banks other than the issuing bank.

3. FEDERAL RESERVE HOLDINGS OF U.S. GOVERNMENT SECURITIES, DECEMBER 31, 1964-66

(In thousands of dollars)

Type of issue and date	Rate of interest (per cent)	December 31			Increase or decrease (−) during—	
		1966	1965	1964	1966	1965
Treasury bonds:						
1962–67	2½	107,560	107,560	107,560	....	....
1963–68	2½	169,085	169,085	169,085	....	....
1964–69 June	2½	306,740	306,740	306,740	....	....
1964–69 Dec.	2½	335,199	335,199	335,199	....	....
1965–Feb.	2⅝	....	....	480,600	....	−480,600
1965–70	2½	573,540	573,540	573,540	....	....
1966–71	2½	144,007	144,007	144,007	....	....
1966 May	3¾	....	252,200	252,200	−252,200	....
1966 Aug.	3	....	36,550	36,550	−36,550	....
1966 Nov.	3⅜	....	232,100	209,100	−232,100	23,000
1967–72 June	2½	54,566	54,566	54,566	....	....
1967–72 Sept.	2½	44,052	44,052	44,052	....	....
1967–Nov.	3⅝	595,450	594,550	590,550	900	4,000
1967–72 Dec.	2½	95,858	95,858	95,858	....	....
1968 May	3⅞	291,065	278,100	253,700	12,965	24,400
1968 Aug.	3¾	315,200	295,000	224,100	20,200	70,900
1968 Nov.	3⅞	97,500	75,500	29,500	22,000	46,000
1969 Feb.	4	1,117,800	1,111,300	84,000	6,500	1,027,300
1969 Oct.	4	193,950	183,150	103,450	10,800	79,700
1970 Feb.	4	64,750	49,850	....	14,900	49,850
1970 Aug.	4	130,200	115,800	86,800	14,400	29,000
1971 Aug.	4	160,600	160,100	158,100	500	2,000
1971 Nov.	3⅞	203,450	198,450	153,900	5,000	44,550
1972 Feb.	4	138,000	133,000	132,000	5,000	1,000
1972 Aug.	4	102,900	102,900	97,600	....	5,300
1973 Aug.	4	117,650	113,450	83,200	4,200	30,250
1973 Nov.	4⅛	178,000	166,000	91,400	12,000	74,600
1974 Feb.	4⅛	74,700	66,200	....	8,500	66,200
1974 May	4¼	147,750	132,800	45,300	14,950	87,500
1974 Nov.	3⅞	37,150	37,150	37,150	....	....
1975–85	4¼	68,090	68,090	47,090	....	21,000
1978–83	3¼	3,250	1,250	500	2,000	750
1980 Feb.	4	34,800	34,800	34,800	....	....
1980 Nov.	3½	23,400	22,400	22,400	1,000	....
1985 May	3¼	23,800	20,800	20,800	3,000	....
1987–92	4¼	135,100	127,100	58,500	8,000	68,600
1988–93	4	13,500	13,500	13,500	....	....
1989–94	4⅛	24,400	21,400	21,400	3,000	....
1990 Feb.	3½	61,450	61,450	61,450	....	....
1998 Nov.	3½	14,250	14,250	14,250	....	....
Total		6,198,762	6,549,797	5,274,497	−351,035	1,275,300
Treasury notes:						
Apr. 1, 1965—EA	1½	....	....	15,000	....	−15,000
May 15, 1965—A	4⅝	....	....	206,700	....	−206,700
May 15, 1965—C	3⅞	....	....	3,911,506	....	−3,911,506
Aug. 13, 1965—D	3⅞	....	....	3,891,732	....	−3,891,732
Nov. 15, 1965—B	3½	....	....	76,500	....	−76,500
Nov. 15, 1965—E	4	....	....	6,282,232	....	−6,282,232
Feb. 15, 1966—B	3⅝	....	340,000	340,000	−340,000	....
Feb. 15, 1966—C	3⅞	....	1,892,950	1,892,950	−1,892,950	....
May 15, 1966—D	4	....	6,387,293	6,387,293	−6,387,293	....
Aug. 15, 1966—A	4	....	5,791,865	1,643,959	−5,791,865	4,147,906
Nov. 15, 1966—E	4	....	545,100	....	−545,100	545,100
Feb. 15, 1967—B	3⅝	342,900	251,000	244,000	91,900	7,000
Feb. 15, 1967—C	4	2,951,032	2,939,132	....	11,900	2,939,132
May 15, 1967—D	4¼	6,374,082	6,358,732	....	15,350	6,358,732
Aug. 15, 1967—A	3¾	338,850	321,650	295,650	17,200	26,000
Aug. 15, 1967—E	4⅞	1,245,000	....	....	1,245,000	....
Nov. 15, 1967—F	4⅞	6,694,993	....	....	6,694,993	....
Feb. 15, 1968—A	5⅝	837,100	....	....	837,100	....
Nov. 15, 1970—A	5	1,017,000	....	....	1,017,000	....
May 15, 1971—A	5¼	1,500,000	....	....	1,500,000	....
Nov. 15, 1971—B	5⅜	1,000	....	....	1,000	....
Total		21,301,957	24,827,722	25,187,522	−3,525,765	−359,800

3. FEDERAL RESERVE HOLDINGS OF U.S. GOVERNMENT SECURITIES, DECEMBER 31, 1964-66—Continued

(In thousands of dollars)

Type of issue and date	Rate of interest (per cent)	December 31			Increase or decrease (−) during—	
		1966	1965	1964	1966	1965
Certificates:						
Aug. 15, 1967	5¼	4,351,015			4,351,015	
Total		4,351,015			4,351,015	
Treasury bills:						
Tax anticipation		541,200	484,600	130,500	56,600	354,100
Other due—						
Within 3 mos.		6,432,194	4,723,263	3,818,045	1,708,931	905,218
3-6 mos.		3,440,750	2,624,726	1,534,480	816,024	1,090,246
After 6 mos.		1,389,514	1,268,080	561,250	121,434	706,830
Total		11,803,658	9,100,669	6,044,275	2,702,989	3,056,394
Repurchase agreements		626,800	289,900	537,500	336,900	−247,600
Total holdings		**44,282,192**	**40,768,088**	**37,043,794**	**3,514,104**	**3,724,294**
Maturing—						
Within 90 days		10,549,826	7,338,213	4,647,157	3,211,613	2,691,056
91 days to 1 year		24,881,514	17,530,414	16,798,888	7,351,100	731,526
Over 1 year to 5 years		7,458,186	14,065,888	13,505,586	−6,607,702	560,302
Over 5 yrs. to 10 yrs.		990,626	1,448,533	1,797,473	−457,907	−348,940
Over 10 years		402,040	385,040	294,690	17,000	90,350

4. FEDERAL RESERVE BANK HOLDINGS OF SPECIAL SHORT-TERM TREASURY CERTIFICATES PURCHASED DIRECTLY FROM THE UNITED STATES, 1953-66

(In millions of dollars)

Date	Amount	Date	Amount	Date	Amount	Date	Amount
1953		1953		1954		1958	
Mar. 18	110	June 15	999	Jan. 17*	169	Mar. 17	143
19	104	16	1,172	18	323	18	207
20	189	17	823	19	424		
21	189	18	364	20	323	1959	
22*	189	19	992	21	306	1960	
23	333	20	992	22	283	1961	
24	186	21*	992	23	283	1962	none
25	63	22	908	24*	283	1963	
26	49	23	608	25	203	1964	
June 5	196	24	296	26	3	1965	
6	196			Mar. 15	134		
7*	196	1954		16	190	1966	
8	374	Jan. 14	22			Dec. 9	169
9	491	15	169	1955		10	169
10	451	16	169	1956	none	11*	169
11	358			1957			
12	506						
13	506						
14*	506						

* Sunday or holiday.

NOTE.—Under authority of Section 14(b) of the Federal Reserve Act. On Nov. 9, 1953, the F.R. Banks sold directly to the Treasury $500 million of Treasury notes; this is the only use that has been made under the same authority to sell U.S. Govt. securities directly to the United States.

Interest rate ¼ per cent through Dec. 3, 1957, and ¼ per cent below prevailing discount rate of F.R. Bank of New York thereafter. Rate on purchases in 1958 was 2 per cent. For data for prior years beginning with 1942, see previous ANNUAL REPORTS. No holdings on dates not shown.

5. OPEN MARKET TRANSACTIONS OF THE FEDERAL RESERVE SYSTEM DURING 1966

(In millions of dollars)

Month	Outright transactions in U.S. Govt. securities by maturity — Total: Gross purchases	Total: Gross sales	Total: Redemptions	Treasury bills: Gross purchases	Treasury bills: Gross sales	Treasury bills: Redemptions	Other within 1 year: Gross purchases	Other within 1 year: Gross sales	Other within 1 year: Exch., maturity shift or redemp.
January	894	919	228	894	918	228	....	....	....
February	1,114	979	171	1,070	979	171	33	....	957
March	960	314	101	873	314	101	78	....	....
April	929	748	201	887	748	201	18	....	....
May	1,208	392	50	1,174	392	50	....	....	−281
June	1,448	650	110	1,296	650	110	55	....	108
July	2,607	2,489	....	2,526	2,489	....	....	....	....
August	1,602	1,273	98	1,602	1,273	98	....	....	84
September	1,976	1,419	170	1,976	1,415	170	....	....	....
October	1,281	893	320	1,281	893	320	....	....	....
November	860	223	323	860	223	323	....	....	6,456
December	771	....	405	736	....	405	15	....	....
Total	15,651	10,297	2,176	15,177	10,297	2,176	199	....	7,324

Month	1-5 years: Gross purchases	1-5 years: Gross sales	1-5 years: Exch. or maturity shifts	5-10 years: Gross purchases	5-10 years: Gross sales	5-10 years: Exch. or maturity shifts	Over 10 years: Gross purchases	Over 10 years: Gross sales	Over 10 years: Exch. or maturity shifts
January	....	....	....	....	....	....	....	....	....
February	11	....	−957	....	....	....	....	....	....
March	9	....	144	....	....	−144	....	....	....
April	25	....	....	....	....	....	....	....	....
May	34	....	281	....	....	....	....	....	....
June	88	....	−108	8	....	....	....	....	....
July	29	....	....	39	....	....	12	....	....
August	....	....	76	....	....	−160	....	....	....
September	....	....	....	....	....	....	....	....	....
October	....	....	....	....	....	....	....	....	....
November	....	....	....	....	....	−203	....	....	....
December	12	....	−6,253	3	....	....	5	....	....
Total	208	....	−6,816	50	....	−508	17	....	....

Month	Repurchase agreements (U.S. Govt. securities): Gross purchases	Repurchase agreements (U.S. Govt. securities): Gross sales	Net change in U.S. Govt. securities	Federal agency obligations (net repurchase agreements)	Bankers' acceptances: Net outright	Bankers' acceptances: Net repurchases	Net change [1]
January	1,595	1,545	−203	....	−2	−75	−280
February	272	611	−376	....	....	12	−365
March	222	222	545	....	3	1	549
April	682	682	−20	....	4	30	14
May	421	421	766	....	−1	20	786
June	185	185	689	....	2	58	748
July	120	26	212	....	−30	−157	24
August	364	457	138	....	−3	....	135
September	97	97	388	....	−1	....	387
October	275	275	69	....	4	21	94
November	1,775	1,153	937	....	3	56	996
December	3,751	3,746	370	34	15	47	466
Total	9,756	9,420	3,514	34	−5	12	3,555

[1] Net change in U.S. Govt. securities, Federal agency obligations, and bankers' acceptances.

NOTE.—Sales, redemptions, and negative figures reduce System holdings; all other figures increase such holdings.

6. BANK PREMISES OF FEDERAL RESERVE BANKS AND BRANCHES DECEMBER 31, 1966

(In dollars)

F.R. Bank or branch	Cost				Net book value
	Land	Buildings (including vaults)[1]	Fixed machinery and equipment	Total	
Boston	1,628,132	5,929,169	2,943,179	10,500,480	2,756,131
New York	5,215,656	14,850,321	4,927,858	24,993,835	6,089,026
Annex	592,679	1,451,569	673,458	2,717,706	539,946
Buffalo	406,069	2,555,197	1,565,400	4,526,666	2,728,880
Philadelphia	1,884,357	4,839,506	2,154,452	8,878,315	2,509,968
Cleveland	1,295,490	6,619,378	3,571,958	11,486,826	1,042,759
Cincinnati	400,891	1,171,259	1,587,495	3,159,645	549,870
Pittsburgh	1,667,994	3,006,088	2,525,243	7,199,325	3,353,054
Richmond	469,944	4,164,663	2,497,936	7,132,543	1,735,629
Annex 1	299,758	387,722	....	687,480	587,221
Annex 2	24,045	547,802	....	571,847	571,847
Baltimore	250,487	2,009,381	1,068,445	3,328,313	1,436,433
Charlotte	347,071	1,069,026	625,121	2,041,218	1,183,640
Atlanta	988,562	5,804,778	3,514,144	10,307,484	8,515,786
Birmingham	410,775	1,989,111	1,019,618	3,419,504	2,224,810
Jacksonville	164,004	1,706,794	772,071	2,642,869	1,450,611
Annex	107,925	76,236	15,842	200,003	191,972
Nashville	592,342	1,474,678	1,098,924	3,165,944	2,117,181
New Orleans	1,268,878	4,517,204	....	5,786,082	5,786,082
Chicago	6,275,490	17,615,460	9,846,057	33,737,007	16,919,290
Detroit	1,147,734	2,851,558	1,376,442	5,375,734	2,665,361
St. Louis	1,675,780	3,171,719	2,285,317	7,132,816	1,620,867
Little Rock	871,699	2,730,568	206,575	3,808,842	3,367,159
Louisville	700,075	2,859,819	1,041,202	4,601,096	3,254,109
Memphis	128,542	294,763	218,883	642,188	184,253
Minneapolis	600,521	4,689,718	2,688,921	7,979,160	2,852,372
Helena	15,709	126,401	62,977	205,087	57,851
Kansas City	1,251,213	5,574,110	1,337,725	8,163,048	3,721,840
Denver	2,828,465	763,078	91,693	3,683,236	3,181,828
Oklahoma City	592,435	1,511,600	834,845	2,938,880	2,362,875
Omaha	445,663	1,491,117	731,925	2,668,705	1,711,777
Dallas	713,302	4,826,831	3,570,804	9,110,937	5,362,670
El Paso	262,477	787,728	393,301	1,443,506	947,745
Houston	695,615	1,408,574	714,187	2,818,376	1,961,458
San Antonio	448,596	1,400,390	570,847	2,419,833	1,568,908
San Francisco	473,235	3,783,530	1,458,028	5,714,793	687,551
Annex	247,201	124,000	30,000	401,201	351,361
Los Angeles	777,614	4,103,844	1,608,306	6,489,764	2,938,383
Portland	207,380	1,678,512	649,432	2,535,324	1,359,959
Salt Lake City	480,222	1,878,238	707,575	3,066,035	2,199,457
Seattle	274,772	1,890,966	1,049,264	3,215,002	1,853,577
Total	39,128,799	129,732,406	62,035,450	230,896,655	106,501,497

OTHER REAL ESTATE ACQUIRED FOR BANKING-HOUSE PURPOSES

F.R. Bank or branch	Land	Buildings (including vaults)[1]	Fixed machinery and equipment	Total	Net book value
Cincinnati	341,293	412,500	100,000	853,793	788,734
Richmond	137,953	....	....	137,953	137,953
Atlanta	93,931	137,100	103,867	334,898	206,959
Total	573,177	549,600	203,867	1,326,644	1,133,646

[1] Includes expenditures for construction at some offices pending allocation to appropriate accounts.

7. EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS DURING 1966

(In dollars)

Item	Total	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Francisco
CURRENT EARNINGS													
Discounts and advances	29,248,764	1,618,229	7,881,794	649,459	534,669	1,353,104	3,243,016	6,050,335	1,454,975	686,729	1,971,613	2,184,634	1,620,2
Acceptances	5,764,167	...	5,764,167	...	...	...	...	...	...	...	...	...	...
U.S. Govt. securities	1,850,809,375	96,255,481	465,754,256	95,513,283	150,967,301	129,428,481	101,018,982	309,998,076	65,929,753	38,020,021	70,779,540	71,722,638	255,421,5
Foreign currencies	21,986,545	1,054,797	5,760,474	1,188,387	1,978,789	1,120,757	1,318,636	3,143,519	768,972	527,121	967,965	1,275,220	2,881,9
All other	691,045	19,324	186,112	24,444	41,064	30,208	76,090	108,538	22,390	29,787	56,153	35,483	61,4
Total	1,908,499,896	98,947,831	485,346,803	97,375,573	153,521,823	131,932,549	105,656,724	319,300,468	68,176,091	39,263,658	73,775,271	75,217,975	259,985,1
CURRENT EXPENSES													
Salaries:													
Officers	8,536,990	482,822	1,539,616	633,022	618,354	737,160	665,483	853,511	647,462	475,302	577,175	588,124	718,9
Employees	103,121,311	6,099,158	25,095,823	4,856,224	7,997,048	7,146,483	6,904,978	14,915,743	6,063,918	3,402,868	5,776,683	4,559,781	10,302,6
Retirement and other benefits	18,401,945	1,160,692	4,220,849	902,024	1,471,139	1,298,204	1,228,834	2,522,814	1,050,915	640,542	1,077 648	827,475	2,000,8
Fees—Directors and others	653,959	34,035	78,759	30,468	63,216	51,365	72,551	42,101	61,766	42,284	38,233	42,611	96,5
Traveling expenses	2,528,592	151,913	469,489	97,487	179,385	171,684	206,191	303,504	147,794	169,344	158,896	143,138	329,7
Postage and expressage	25,052,905	1,635,983	3,131,379	1,091,868	2,088,219	2,728,074	2,289,330	3,312,662	1,472,868	966,902	1,968,685	1,424,875	2,942,0
Telephone and telegraph	2,126,531	98,759	450,513	85,692	144,287	155,941	248,947	248,659	111,751	82,644	139,498	148,617	211,2
Printing and supplies	8,956,124	619,462	1,707,928	476,246	657,270	717,567	752,550	1,335,406	619,167	256,845	614,344	425,074	774,2
Insurance	327,840	21,371	38,311	15,018	38,826	26,485	24,373	36,254	27,790	18,646	11,985	20,437	48,3
Taxes on real estate	5,328,784	501,973	977,344	179,902	484,087	215,246	338,603	953,022	210,265	311,079	299,055	293,754	564,4
Depreciation (building)	5,491,623	130,423	464,642	76,596	471,511	195,795	792,270	1,358,739	237,225	343,370	284,954	690,260	445,8
Light, heat, power, and water	2,085,994	137,152	285,004	90,189	253,471	165,447	185,969	314,104	134,588	91,214	149,397	127,128	152,3
Repairs and alterations	1,170,683	53,398	75,651	104,849	83,492	100,766	105,491	150,950	175,871	37,085	56,814	99,721	126,5
Rent	153,730	12,844	7,314	7,567	26,214	11,727	34,117	43,951	1,574	1,301	3,883	1,687	1,5
Furniture and equipment:													
Purchases	3,447,193	88,498	1,181,382	235,719	219,669	229,644	504,499	288,152	173,245	121,439	77,627	118,433	208,8
Rentals	8,287,079	468,146	912,267	308,766	668,796	828,264	483,750	1,586,702	596,309	336,466	688,469	562,722	846,4
All other	3,415,019	123,977	769,777	134,554	531,371	130,537	181,875	617,762	158,032	138,152	204,858	285,962	138,1
Inter-Bank expenses	...	62,178	−901,274	69,264	117,146	−4,867	82,673	186,266	47,897	32,049	59,811	77,472	171,3
Subtotal	199,086,302	11,882,784	40,504,774	9,395,455	16,113,501	14,905,522	15,102,484	29,070,302	11,938,437	7,467,532	12,188,015	10,437,271	20,080,2
F.R. currency	20,167,481	1,059,141	2,592,136	1,294,988	1,399,194	2,128,880	2,159,967	4,078,113	742,481	517,660	794,780	929,795	2,470,34
Assessment for expenses of Board of Governors	9,021,600	435,100	2,359,700	483,300	813,900	462,000	541,700	1,292,300	313,000	215,800	399,000	524,400	1,181,40
Total	228,275,383	13,377,025	45,456,610	11,173,743	18,326,595	17,496,402	17,804,151	34,440,715	12,993,918	8,200,992	13,381,795	11,891,466	23,731,97

Less reimbursement for certain fiscal agency and other expenses	20,874,256	1,186,127	4,061,258	894,380	2,130,899	1,184,214	1,465,685	3,805,131	1,184,516	626,882	1,454,696	848,953	2,031,51
Net expenses	207,401,127	12,190,898	41,395,352	10,279,363	16,195,696	16,312,188	16,338,466	30,635,584	11,809,402	7,574,110	11,927,099	11,042,513	21,700,45

PROFIT AND LOSS

Current net earnings	1,701,098,770	86,756,933	443,951,452	87,096,210	137,326,127	115,620,361	89,318,258	288,664,884	56,366,688	31,689,548	61,848,172	64,175,463	238,284,67
Additions to current net earnings:													
Profits on foreign exchange transactions	1,320,486	63,383	345,967	71,306	118,844	67,345	79,229	188,830	46,217	31,692	58,101	76,588	172,98
All other	2,294,836	340	48,800	21,817	26,284	12,985	2,072,651	78,399	633	11,806	10,744	....	10,37
Total additions	3,615,322	63,723	394,767	93,123	145,128	80,330	2,151,880	267,229	46,850	43,498	68,845	76,588	183,36
Deductions from current net earnings:													
Losses on sales of U.S. Govt. securities	2,476 204	129,795	621,750	127,324	203,594	173,245	134,906	414,108	87,218	50,221	93,832	95,832	344,37
All other	142,886	19,383	6,738	2,619	37,924	1,817	51,330	1,229	3,076	783	3,557	7,241	7,18
Total deductions	2,619,090	149,178	628,488	129,943	241,518	175,062	186,236	415,337	90,294	51,004	97,389	103,073	351,56
Net addition to or deduction from (−) current net earnings	996,230	−85,454	−233,721	−36,820	−96,391	−94,732	1,965,644	−148,108	−43,444	−7,506	−28,544	−26,485	−168,20
Net earnings before payments to U.S. Treasury	1,702,095,000	86,671,478	443,717,731	87,059,390	137,229,737	115,525,629	91,283,901	288,516,775	56,323,245	31,682,041	61,819,628	64,148,978	238,116,46
Dividends paid	33,696,336	1,619,326	8,770,056	1,790,167	3,027,907	1,747,438	2,059,913	4,855,838	1,168,015	806,108	1,495,215	1,965,116	4,391,23
Payments to U.S. Treasury (interest on F.R. notes)	1,649,455,164	84,347,453	431,063,425	84,885,673	132,810,629	112,294,941	87,066,838	279,707,237	54,536,279	30,501,382	59,327,964	60,937,912	231,975,42
Transferred to surplus	18,943,500	704,700	3,884,250	383,550	1,391,200	1,483,250	2,157,150	3,953,700	618,950	374,550	996,450	1,245,950	1,749,80
Surplus, January 1	550,946,700	26,598,900	144,463,400	29,545,550	49,737,550	28,092,450	32,914,650	78,663,400	19,129,750	13,180,400	24,347,800	31,968,050	72,304,80
Surplus, December 31	569,890,200	27,303,600	148,347,650	29,929,100	51,128,750	29,575,700	35,071,800	82,617,100	19,748,700	13,554,950	25.344,250	33,214,000	74,054,60

NOTE.—Details may not add to totals because of rounding.

8. EARNINGS AND EXPENSES OF FEDERAL RESERVE BANKS, 1914–66

(In dollars)

Period or Bank	Current earnings	Current expenses	Net earnings before payments to U.S. Treasury[1]	Dividends paid	Payments to U.S. Treasury			Transferred to surplus (Sec. 13b)	Transferred to surplus (Sec. 7)
					Franchise tax	Under Sec. 13b	Interest on F.R. notes		
All F.R. Banks, by years:									
1914–15	2,173,252	2,320,586	−141,459	217,463	...	...	...	...	...
1916	5,217,998	2,273,999	2,750,998	1,742,774	...	...	...	...	...
1917	16,128,339	5,159,727	9,582,067	6,804,186	1,134,234	...	...	...	1,134,234
1918	67,584,417	10,959,533	52,716,310	5,540,684	...	...	...	...	48,334,341
1919	102,380,583	19,339,633	78,367,504	5,011,832	2,703,894	...	...	...	70,651,778
1920	181,296,711	28,258,030	149,294,774	5,654,018	60,724,742	...	...	...	82,916,014
1921	122,865,866	34,463,845	82,087,225	6,119,673	59,974,466	...	...	...	15,993,086
1922	50,498,699	29,559,049	16,497,736	6,307,035	10,850,605	...	...	...	−659,904
1923	50,708,566	29,764,173	12,711,286	6,552,717	3,613,056	...	...	...	2,545,513
1924	38,340,449	28,431,126	3,718,180	6,682,496	113,646	...	...	...	−3,077,962
1925	41,800,706	27,528,163	9,449,066	6,915,958	59,300	...	...	...	2,473,808
1926	47,599,595	27,350,182	16,611,745	7,329,169	818,150	...	...	...	8,464,426
1927	43,024,484	27,518,443	13,048,249	7,754,539	249,591	...	...	...	5,044,119
1928	64,052,860	26,904,810	32,122,021	8,458,463	2,584,659	...	...	...	21,078,899
1929	70,955,496	29,691,113	36,402,741	9,583,913	4,283,231	...	...	...	22,535,597
1930	36,424,044	28,342,726	7,988,182	10,268,598	17,308	...	...	...	−2,297,724
1931	29,701,279	27,040,664	2,972,066	10,029,760	...	...	...	...	−7,057,694
1932	50,018,817	26,291,381	22,314,244	9,282,244	2,011,418	...	...	...	11,020,582
1933	49,487,318	29,222,837	7,957,407	8,874,262	...	...	...	...	−916,855
1934	48,902,813	29,241,396	15,231,409	8,781,661	...	...	...	−60,323	6,510,071
1935	42,751,959	31,577,443	9,437,758	8,504,974	...	297,667	...	27,695	607,422
1936	37,900,639	29,874,023	8,512,433	7,829,581	...	227,448	...	102,880	352,524
1937	41,233,135	28,800,614	10,801,247	7,940,966	...	176,625	...	67,304	2,616,352
1938	36,261,428	28,911,608	9,581,954	8,019,137	...	119,524	...	−419,140	1,862,433
1939	38,500,665	28,646,855	12,243,365	8,110,462	...	24,579	...	−425,653	4,533,977
1940	43,537,805	29,165,477	25,860,025	8,214,971	...	82,152	...	−54,456	17,617,358
1941	41,380,095	32,963,150	9,137,581	8,429,936	...	141,465	...	−4,333	570,513
1942	52,662,704	38,624,044	12,470,451	8,669,076	...	197,672	...	49,602	3,554,101
1943	69,305,715	43,545,564	49,528,433	8,911,342	...	244,726	...	135,003	40,237,362
1944	104,391,829	49,175,921	58,437,788	9,500,126	...	326,717	...	201,150	48,409,795
1945	142,209,546	48,717,271	92,662,268	10,182,851	...	247,659	...	262,133	81,969,625
1946	150,385,033	57,235,107	92,523,935	10,962,160	...	67,054	...	27,708	81,467,013
1947	158,655,566	65,392,975	95,235,592	11,523,047	...	35,605	75,223,818	86,772	8,366,350
1948	304,160,818	72,710,188	197,132,683	11,919,809	...	...	166,690,356	...	18,522,518
1949	316,536,930	77,477,676	226,936,980	12,329,373	...	...	193,145,837	...	21,461,770

1950	275,838,994	80,571,771	231,561,340	13,082,992	....	....	196,628,858	....	21,849,490
1951	394,656,072	95,469,086	297,059,097	13,864,750	....	....	254,873,588	....	28,320,759
1952	456,060,260	104,694,091	352,950,157	14,681,788	....	....	291,934,634	....	46,333,735
1953	513,037,237	113,515,020	398,463,224	15,558,377	....	....	342,567,985	....	40,336,862
1954	438,486,040	109,732,931	328,619,468	16,442,236	....	....	276,289,457	....	35,887,775
1955	412,487,931	110,060,023	302,162,452	17,711,937	....	....	251,740,721	....	32,709,794
1956	595,649,092	121,182,496	474,443,160	18,904,897	....	....	401,555,581	....	53,982,682
1957	763,347,530	131,814,003	624,392,613	20,080,527	....	....	542,708,405	....	61,603,682
1958	742,068,150	137,721,655	604,470,670	21,197,452	....	....	524,058,650	....	59,214,569
1959	886,226,116	144,702,706	839,770,663	22,721,687	....	....	910,649,768	....	−93,600,791
1960	1,103,385,257	153,882,275	963,377,684	23,948,225	....	....	896,816,359	....	42,613,100
1961	941,648,170	161,274,575	783,855,223	25,569,541	....	....	687,393,382	....	70,892,300
1962	1,048,508,335	176,136,134	872,316,422	27,412,241	....	....	799,365,981	....	45,538,200
1963	1,151,120,060	187,273,357	964,461,538	28,912,019	....	....	879,685,219	....	55,864,300
1964	1,343,747,303	197,395,889	1,147,077,362	30,781,548	....	....	1,582,118,614	....	−465,822,800
1965	1,559,484,027	204,290,186	1,356,215,455	32,351,602	....	....	1,296,810,053	....	27,053,800
1966	1,908,499,896	207,401,126	1,702,095,000	33,696,336	....	....	1,649,455,164	....	18,943,500
Total 1914–66	17,233,286,629	3,569,596,656	13,725,475,775	655,877,409	149,138,300	2,188,893	12,219,712,429	−3,657	698,562,399
Aggregate for each F.R. Bank, 1914–66:									
Boston	967,921,360	244,832,669	728,427,135	38,069,804	7,111,395	280,843	645,431,254	135,411	37,398,425
New York	4,367,742,619	770,277,465	3,617,564,489	202,900,953	68,006,262	369,116	3,161,117,349	−433,413	185,604,221
Philadelphia	1,019,310,141	218,889,434	808,191,469	47,646,781	5,558,901	722,406	709,713,399	290,661	44,259,322
Cleveland	1,483,295,739	317,131,893	1,169,996,845	63,045,493	4,842,447	82,930	1,037,673,338	−9,906	64,362,543
Richmond	1,096,175,601	245,812,428	854,585,190	29,389,431	6,200,189	172,493	783,439,083	−71,517	35,455,508
Atlanta	920,906,521	221,610,374	701,354,271	29,478,540	8,950,561	79,264	622,502,074	5,491	40,338,340
Chicago	2,819,859,064	506,451,642	2,318,159,046	84,562,138	25,313,526	151,045	2,110,174,802	11,682	97,945,854
St. Louis	718,042,279	194,976,553	523,947,811	22,545,442	2,755,629	7,464	473,797,462	−26,515	24,868,328
Minneapolis	413,562,591	123,902,133	292,167,929	15,323,735	5,202,900	55,615	254,088,646	64,874	17,432,163
Kansas City	745,281,323	193,177,609	554,090,671	24,993,753	6,939,100	64,213	492,618,079	−8,674	29,484,200
Dallas	693,709,710	169,917,757	526,118,680	30,029,941	560,049	102,083	457,879,790	55,337	37,491,478
San Francisco	1,987,479,681	362,616,699	1,630,872,239	67,891,398	7,697,341	101,421	1,471,277,153	−17,089	83,922,017
Total	17,233,286,629	3,569,596,656	13,725,475,775	655,877,409	149,138,300	2,188,893	12,219,712,429	−3,657	[2] 698,562,399

[1] Current earnings less current expenses, plus or minus adjustment for profit and loss items.

[2] The $698,562,399 transferred to surplus was reduced by direct charges of $500,000 for charge-off on bank premises (1927), $139,299,557 for contributions to capital of the Federal Deposit Insurance Corporation (1934), and $3,657 net upon elimination of Sec. 13b surplus (1958), and was increased by $11,131,013 transferred from reserves for contingencies (1945), leaving a balance of $569,890,200 on Dec. 31, 1966.

NOTE.—Details may not add to totals because of rounding.

9. NUMBER AND SALARIES OF OFFICERS AND EMPLOYEES OF FEDERAL RESERVE BANKS, DECEMBER 31, 1966

Federal Reserve Bank (including branches)	President	Other officers		Employees[1]		Total	
	Annual salary	Number	Annual salaries	Number	Annual salaries	Number	Annual salaries
Boston	$ 40,000	24	$ 448,000	1,181	$ 6,233,337	1,206	$ 6,721.337
New York	75,000	71	1,525,500	3,865	25,197,578	3,937	26,798,078
Philadelphia	45,000	31	557,000	875	4,807,957	907	5 409,957
Cleveland	45,000	34	579,500	1,337	7,701,707	1,372	8,326,207
Richmond	45,000	41	715,500	1,387	7,147,251	1,429	7,907,751
Atlanta	35,000	37	601,450	1,358	6,795,397	1,396	7,431,847
Chicago	55,000	44	791,000	2,866	14,714,738	2,911	15,560,738
St. Louis	35,000	37	623,660	1,183	5,874,393	1,221	6,533,053
Minneapolis	37,500	28	447,000	616	3,234,681	645	3,719,181
Kansas City	42,500	34	518,900	1,160	5,652,157	1,195	6,213,557
Dallas	45,000	36	545,720	937	4,434,353	974	5,025,073
San Francisco	46,000	42	678,500	1,895	10,117,014	1,938	10,841,514
Total	$546,000	459	$8,031,730	18,660	$101,910,563	19,131	$110,488,293

1 Includes 1,140 part-time employees.

10. VOLUME OF OPERATIONS IN PRINCIPAL DEPARTMENTS OF FEDERAL RESERVE BANKS, 1963–66

(Number in thousands; amounts in thousands of dollars)

Operation	1966	1965	1964	1963
NUMBER OF PIECES HANDLED[1]				
Discounts and advances	16	11	10	9
Currency received and counted	5,232,806	5,144,345	5,026,311	4,831,516
Coin received and counted	9,304,120	5,855,884	4,561,704	8,704,412
Checks handled:				
U.S. Govt. checks	504,049	491,848	467,288	454,576
Postal money orders	217,473	223,337	234,094	243,999
All other[2]	5,021,454	4,601,128	4,318,708	4,069,111
Collection items handled:				
U.S. Govt. coupons paid	14,305	14,087	15,042	15,430
All other	26,712	26,820	27,271	26,839
Issues, redemptions, and exchanges of U.S. Govt. securities	235,555	222,477	212,267	204,213
Transfers of funds	4,832	4,389	4,010	3,603
Food stamps redeemed	166,615	81,885	50,481	46,129
AMOUNTS HANDLED				
Discounts and advances	90,667,647	75,684,394	46,551,402	44,894,170
Currency received and counted	37,001,390	36,075,114	34,548,507	32,350,089
Coin received and counted	957,282	496,582	559,588	1,007,532
Checks handled:				
U.S. Govt. checks	160,014,331	134,806,438	134,585,725	131,795,729
Postal money orders	4,626,573	4,507,801	4,578,853	4,707,908
All other[2]	1,893,974,522	1,630,931,492	1,475,038,258	1,363,949,957
Collection items handled:				
U.S. Govt. coupons paid	5,916,485	5,380,748	5,371,153	5,213,610
All other	12,624,804	10,723,571	7,851,274	7,143,665
Issues, redemptions, and exchanges of U.S. Govt. securities	793,261,958	763,248,392	738,062,697	683,736,756
Transfers of funds	5,555,075,862	4,496,230,723	3,953,186,948	3,442,100,310
Food stamps redeemed	226,508	116,498	73,182	66,514

1 Packaged items handled as a single item are counted as one piece.
2 Exclusive of checks drawn on the F.R. Banks.

11. MAXIMUM INTEREST RATES PAYABLE ON TIME AND SAVINGS DEPOSITS

(Per cent per annum)

<table>
<tr><th colspan="9">Rates Nov. 1, 1933—July 19, 1966</th></tr>
<tr><th rowspan="2">Type of deposit</th><th colspan="8">Effective date</th></tr>
<tr><th>Nov. 1, 1933</th><th>Feb. 1, 1935</th><th>Jan. 1, 1936</th><th>Jan. 1, 1957</th><th>Jan. 1, 1962</th><th>July 17, 1963</th><th>Nov. 24, 1964</th><th>Dec. 6, 1965</th></tr>
<tr><td>Savings deposits:</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>12 months or more</td><td rowspan="2">3</td><td rowspan="2">2½</td><td rowspan="2">2½</td><td rowspan="2">3</td><td>4</td><td>4</td><td rowspan="2">4</td><td rowspan="2">4</td></tr>
<tr><td>Less than 12 months</td><td>3½</td><td>3½</td></tr>
<tr><td>Postal savings deposits:</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>12 months or more</td><td rowspan="2">3</td><td rowspan="2">2½</td><td rowspan="2">2½</td><td rowspan="2">3</td><td>4</td><td>4</td><td rowspan="2">4</td><td rowspan="2">4</td></tr>
<tr><td>Less than 12 months</td><td>3½</td><td>3½</td></tr>
<tr><td>Other time deposits:[1]</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>12 months or more</td><td rowspan="2">3</td><td rowspan="2">2½</td><td rowspan="2">2½</td><td rowspan="2">3</td><td>4</td><td rowspan="3">4</td><td rowspan="3">4½</td><td rowspan="4">5½</td></tr>
<tr><td>6 months to 12 months</td><td>3½</td></tr>
<tr><td>90 days to 6 months</td><td>3</td><td>2½</td><td>2</td><td>2½</td><td>2½</td></tr>
<tr><td>Less than 90 days
(30-89 days)</td><td>3</td><td>2½</td><td>1</td><td>1</td><td>1</td><td>1</td><td>4</td></tr>
</table>

<table>
<tr><th colspan="3">Rates beginning July 20, 1966</th></tr>
<tr><th rowspan="2">Type of deposit</th><th colspan="2">Effective date</th></tr>
<tr><th>July 20, 1966</th><th>Sept. 26, 1966</th></tr>
<tr><td>Savings deposits</td><td>4</td><td>4</td></tr>
<tr><td>Postal savings deposits:</td><td></td><td></td></tr>
<tr><td>12 months or more</td><td rowspan="2">4</td><td rowspan="2">4</td></tr>
<tr><td>Less than 12 months</td></tr>
<tr><td>Other time deposits:[1]</td><td></td><td></td></tr>
<tr><td>Multiple-maturity:</td><td></td><td></td></tr>
<tr><td>90 days or more</td><td>5</td><td>5</td></tr>
<tr><td>Less than 90 days
(30-89 days)</td><td>4</td><td>4</td></tr>
<tr><td>Single-maturity:</td><td></td><td></td></tr>
<tr><td>$100,000 or more</td><td>5½</td><td>5½</td></tr>
<tr><td>Less than $100,000</td><td>5½</td><td>5</td></tr>
</table>

[1] For exceptions with respect to foreign time deposits, see ANNUAL REPORTS for 1962, p. 129, and 1965, p. 233.

NOTE.—Maximum rates that may be paid by member banks as established by the Board of Governors under provisions of Regulation Q. Under this Regulation the rate payable by a member bank may not in any event exceed the maximum rate payable by State banks or trust companies on like deposits under the laws of the State in which the member bank is located. Effective Feb. 1, 1936, maximum rates that may be paid by insured nonmember commercial banks, as established by the FDIC, have been the same as those in effect for member banks.

12. MARGIN REQUIREMENTS—EFFECTIVE DATE OF CHANGE

(Per cent of market value)

Regulation	July 5, 1945	Jan. 21, 1946	Feb. 1, 1947	Mar. 30, 1949	Jan. 17, 1951	Feb 20, 1953	Jan. 4, 1955	Apr. 23, 1955	Jan. 16, 1958	Aug. 5, 1958	Oct. 16, 1958	July 28, 1960	July 10, 1962	Nov. 6, 1963
Regulation T:														
For extension of credit by brokers and dealers on listed securities	75	100	75	50	75	50	60	70	50	70	90	70	50	70
For short sales	75	100	75	50	75	50	60	70	50	70	90	70	50	70
Regulation U:														
For loans by banks on stocks	75	100	75	50	75	50	60	70	50	70	90	70	50	70

NOTE.—Regulations T and U, prescribed in accordance with Securities Exchange Act of 1934, limit the amount of credit that may be extended on a security by prescribing a maximum loan value, which is a specified percentage of its market value at the time of extension; margin requirements are the difference between the market value (100%) and the maximum loan value. Changes on Feb. 20, 1953, and Jan. 4, 1955, were effective after close of business on these dates. For earlier data, see *Banking and Monetary Statistics*, 1943, Table 145, p. 504.

13. FEDERAL RESERVE BANK DISCOUNT RATES DECEMBER 31, 1966

(Per cent per annum)

Federal Reserve Bank	Discounts for and advances to member banks		Advances to all others under last par. Sec. 13[3]
	Advances and discounts under Secs. 13 and 13a[1]	Advances under Sec. 10(b)[2]	
Boston	4½	5	5½
New York	4½	5	5½
Philadelphia	4½	5	5½
Cleveland	4½	5	6
Richmond	4½	5	5½
Atlanta	4½	5	6½
Chicago	4½	5	5½
St. Louis	4½	5	5½
Minneapolis	4½	5	5½
Kansas City	4½	5	5½
Dallas	4½	5	5½
San Francisco	4½	5	5½

[1] Discounts of eligible paper and advances secured by such paper or by U.S. Govt. obligations. Rates shown also apply to advances secured by obligations of Federal intermediate credit banks maturing within 6 months. Maximum maturity: 90 days except that discounts of certain bankers' acceptances and of agricultural paper may have maturities not over 6 months and 9 months, respectively, and advances secured by Federal intermediate credit bank obligations are limited to 15 days.

[2] Advances secured to the satisfaction of the F.R. Bank. Maximum maturity: 4 months.

[3] Advances to individuals, partnerships, or corporations other than member banks secured by U.S. Govt. direct obligations. Maximum maturity: 90 days.

14. FEES AND RATES UNDER REGULATION V ON LOANS GUARANTEED PURSUANT TO DEFENSE PRODUCTION ACT OF 1950, DECEMBER 31, 1966

Fees Payable to Guaranteeing Agency by Financing Institution on Guaranteed Portion of Loan

Percentage of loan guaranteed	Guaranteed fee (percentage of interest payable by borrower)	Percentage of any commitment fee charged borrower
70 or less	10	10
75	15	15
80	20	20
85	25	25
90	30	30
95	35	35
Over 95	40–50	40–50

Maximum Rates Financing Institution May Charge Borrower

Interest rate	7½ per cent per annum
Commitment rate	½ per cent per annum

NOTE.—In any case in which the rate of interest on the loan is in excess of 6 per cent, the guarantee fee shall be computed as though the interest rate were 6 per cent.

15. MEMBER BANK RESERVE REQUIREMENTS

(Per cent of deposits)

Effective date	Net demand deposits[1]			Time deposits	
	Central reserve city banks[2]	Reserve city banks	Country banks	Central reserve and reserve city banks[2]	Country banks
1917—June 21	13	10	7	3	3
1936—Aug. 16	19½	15	10½	4½	4½
1937—Mar. 1	22¾	17½	12¼	5¼	5¼
May 1	26	20	14	6	6
1938—Apr. 16	22¾	17½	12	5	5
1941—Nov. 1	26	20	14	6	6
1942—Aug. 20	24	.....	.....	.....	.....
Sept. 14	22	.....	.....	.....	.....
Oct. 3	20	.....	.....	.....	.....
1948—Feb. 27	22	.....	.....	.....	.....
June 11	24	.....	.....	.....	.....
Sept. 16	.....	.....	16	.....	7½
24	26	22	.....	7½	.....
1949—May 1	.....	.....	15	.....	7
5	24	21	.....	7	.....
June 30	.....	20	.....	6	.....
July 1	.....	.....	14	.....	6
Aug. 1	.....	.....	13	.....	.....
11	23½	19½	.....	5	.....
16	.....	.....	12	.....	5
18	23	19	.....	.....	.....
25	22½	18½	.....	.....	.....
Sept. 1	22	18	.....	.....	.....
1951—Jan. 11	23	19	.....	6	.....
16	.....	.....	13	.....	6
25	24	20	.....	.....	.....
Feb. 1	.....	.....	14	.....	.....
1953—July 1	.....	.....	13	.....	.....
9	22	19	.....	.....	.....
1954—June 16	.....	.....	.....	.....	5
24	21	.....	.....	5	.....
July 29	20	18	.....	.....	.....
Aug. 1	.....	.....	12	.....	.....
1958—Feb. 27	19½	17½	.....	.....	.....
Mar. 1	.....	.....	11½	.....	.....
20	19	17	.....	.....	.....
Apr. 1	.....	.....	11	.....	.....
17	18½	.....	.....	.....	.....
24	18	16½	.....	.....	.....
1960—Sept. 1	17½	.....	.....	.....	.....
Nov. 24	.....	.....	12	.....	.....
Dec. 1	16½	.....	.....	.....	.....
1962—July 28	(2)	.....	.....	(2)	.....
Oct. 25		.....	.....	4	.....
Nov. 1		.....	.....	.....	4
1966—July 14		.....	.....	(3)	.....
21		.....	.....	.....	(3)
Sept. 8		.....	.....	(4)	.....
15		.....	.....	.....	(4)
In effect Jan. 1, 1967		16½	12	(4)	(4)
Present legal requirements:					
Minimum		10	7	3	3
Maximum		22	14	10	10

1 Demand deposits subject to reserve requirements, which, beginning with Aug. 23, 1935, have been total demand deposits minus cash items in process of collection and demand balances due from domestic banks (also minus war loan and Series E bond accounts during the period Apr. 13, 1943–June 30, 1947).

2 Authority of the Board of Governors to classify or reclassify cities as central reserve cities was terminated effective July 28, 1962.

3 On savings deposits—4 per cent; on other time deposits up to $5 million—4 per cent; on other time deposits in excess of $5 million—5 per cent.

4 On savings deposits—4 per cent; on other time deposits up to $5 million—4 per cent; on other time deposits in excess of $5 million—6 per cent.

NOTE.—All required reserves were held on deposit with F.R. Banks, June 21, 1917, until late 1959. Since then, member banks have also been allowed to count vault cash as reserves, as follows: country banks—in excess of 4 and 2½ per cent of net demand deposits effective Dec. 1, 1959, and Aug. 25, 1960, respectively; central reserve city and reserve city banks—in excess of 2 and 1 per cent effective Dec. 3, 1959, and Sept. 1, 1960, respectively; all member banks were allowed to count all vault cash as reserves effective Nov. 24, 1960.

16. MEMBER BANK RESERVES, FEDERAL RESERVE BANK CREDIT, AND RELATED ITEMS—END OF YEAR 1918–66 AND END OF MONTH 1966

(In millions of dollars)

Period	Factors supplying reserve funds									Factors absorbing reserve funds									
	F.R. Bank credit outstanding							Gold stock [2]	Treasury currency outstanding [3]	Currency in circulation	Treasury cash holdings [4]	Deposits other than member bank reserves, with F.R. Banks			Other F.R. accounts [5]	Member bank reserves			
	U.S. Govt. securities			Discounts and advances	Float	All other [1]	Total												
	Total	Bought outright	Repurchase agreements									Treasury	Foreign	Other		With F.R. Banks	Currency and coin [6]	Required [7]	Excess [7]
1918	239	239	....	1,766	199	294	2,498	2,873	1,795	4,951	288	51	96	25	118	1,636	....	1,585	51
1919	300	300	....	2,215	201	575	3,292	2,707	1,707	5,091	385	31	73	28	208	1,890	....	1,822	68
1920	287	287	....	2 687	119	262	3,355	2,639	1,709	5,325	218	57	5	18	298	1,781	....	....	.....
1921	234	234	....	1,144	40	146	1,563	3,373	1,842	4,403	214	96	12	15	285	1,753	....	1,654	99
1922	436	436	....	618	78	273	1,405	3,642	1,958	4,530	225	11	3	26	276	1,934	....	....	.....
1923	134	80	54	723	27	355	1,238	3,957	2,009	4,757	213	38	4	19	275	1,898	....	1,884	14
1924	540	536	4	320	52	390	1,302	4,212	2,025	4,760	211	51	19	20	258	2,220	....	2,161	59
1925	375	367	8	643	63	378	1,459	4,112	1,977	4,817	203	16	8	21	272	2,212	....	2,256	−44
1926	315	312	3	637	45	384	1,381	4,205	1,991	4,808	201	17	46	19	293	2,194	....	2,250	−56
1927	617	560	57	582	63	393	1,655	4,092	2,006	4,716	208	18	5	21	301	2,487	....	2,424	63
1928	228	197	31	1,056	24	500	1,809	3,854	2,012	4,686	202	23	6	21	348	2,389	....	2,430	−41
1929	511	488	23	632	34	405	1,583	3,997	2,022	4,578	216	29	6	24	393	2,355	....	2,428	−73
1930	729	686	43	251	21	372	1,373	4,306	2,027	4,603	211	19	6	22	375	2,471	....	2,375	96
1931	817	775	42	638	20	378	1,853	4,173	2,035	5,360	222	54	79	31	354	1,961	....	1,994	−33
1932	1,855	1,851	4	235	14	41	2,145	4,226	2,204	5,388	272	8	19	24	355	2,509	....	1,933	576
1933	2,437	2,435	2	98	15	137	2,688	4,036	2,303	5,519	284	3	4	128	360	2,729	....	1,870	859
1934	2,430	2,430	....	7	5	21	2,463	8,238	2,511	5,536	3,029	121	20	169	241	4,096	....	2,282	1,814
1935	2,431	2,430	1	5	12	38	2,486	10,125	2,476	5,882	2,566	544	29	226	253	5,587	....	2,743	2,844
1936	2,430	2,430	....	3	39	28	2,500	11,258	2,532	6,543	2,376	244	99	160	261	6,606	....	4,622	1,984
1937	2,564	2,564	....	10	19	19	2,612	12,760	2,637	6,550	3,619	142	172	235	263	7,027	....	5,815	1,212
1938	2,564	2,564	....	4	17	16	2,601	14,512	2,798	6,856	2,706	923	199	242	260	8,724	....	5,519	3,205
1939	2,484	2,484	....	7	91	11	2,593	17,644	2,963	7,598	2,409	634	397	256	251	11,653	....	6,444	5,209
1940	2,184	2,184	....	3	80	8	2,274	21,995	3,087	8,732	2,213	368	1,133	599	284	14,026	....	7,411	6,615
1941	2,254	2,254	....	3	94	10	2,361	22,737	3,247	11,160	2,215	867	774	586	291	12,450	....	9,365	3,085
1942	6,189	6,189	....	6	471	14	6,679	22,726	3,648	15,410	2,193	799	793	485	256	13,117	....	11,129	1,988
1943	11,543	11,543	....	5	681	10	12,239	21,938	4,094	20,449	2,303	579	1,360	356	339	12,886	....	11,650	1,236
1944	18,846	18,846	....	80	815	4	19,745	20,619	4,131	25,307	2,375	440	1,204	394	402	14,373	....	12,748	1,625

1945	24,262	24,262	....	249	578	2	25,091	20,065	4,339	28,515	2,287	977	862	446	495	15,915	....	14,457	1,458
1946	23,350	23,350	....	163	580	1	24,093	20,529	4,562	28,952	2,272	393	508	314	607	16,139	....	15,577	562
1947	22,559	22,559	....	85	535	1	23,181	22,754	4,562	28,868	1,336	870	392	569	563	17,899	....	16,400	1,499
1948	23,333	23,333	....	223	541	1	24,097	24,244	4,589	28,224	1,325	1,123	642	547	590	20,479	....	19,277	1,202
1949	18,885	18,885	....	78	534	2	19,499	24,427	4,598	27,600	1,312	821	767	750	706	16,568	....	15,550	1,018
1950	20,778	20,725	53	67	1,368	3	22,216	22,706	4,636	27,741	1,293	668	895	565	714	17,681	....	16,509	1,172
1951	23,801	23,605	196	19	1,184	5	25,009	22,695	4,709	29,206	1,270	247	526	363	746	20,056	....	19,667	389
1952	24,697	24,034	663	156	967	4	25,825	23,187	4,812	30,433	1,270	389	550	455	777	19,950	....	20,520	−570
1953	25,916	25,318	598	28	935	2	26,880	22,030	4,894	30,781	761	346	423	493	839	20,160	....	19,397	763
1954	24,932	24,888	44	143	808	1	25,885	21,713	4,985	30,509	796	563	490	441	907	18,876	....	18,618	258
1955	24,785	24,391	394	108	1,585	29	26,507	21,690	5,008	31,158	767	394	402	554	925	19,005	....	18,903	102
1956	24,915	24,610	305	50	1,665	70	26,699	21,949	5,066	31,790	775	441	322	426	901	19,059	....	19,089	−30
1957	24,238	23,719	519	55	1,424	66	25,784	22,781	5,146	31,834	761	481	356	246	998	19,034	....	19,091	−57
1958	26,347	26,252	95	64	1,296	49	27,755	20,534	5,234	32,193	683	358	272	391	1,122	18,504	....	18,574	−70
1959	26,648	26,607	41	458	1,590	75	28,771	19,456	5,311	32,591	391	504	345	694	841	18,174	310	18,619	−135
1960	27,384	26,984	400	33	1,847	74	29,338	17,767	5,398	32,869	377	485	217	533	941	17,081	2,544	18,988	637
1961	28,881	28,722	159	130	2,300	51	31,362	16,889	5,585	33,918	422	465	279	320	1,044	17,387	2,823	20,114	96
1962	30,820	30,478	342	38	2,903	110	33,871	15,978	5,567	35,338	380	597	247	393	1,007	17,454	3,262	20,071	645
1963	33,593	33,582	11	63	2,600	162	36,418	15,513	5,578	37,692	361	880	171	291	1,065	17,049	4,099	20,677	471
1964	37,044	36,506	538	186	2,606	94	39,930	15,388	5,405	39,619	612	820	229	321	1,036	18,086	4,151	21,663	574
1965	40,768	40,478	290	137	2,248	187	43,340	13,733	5,575	42,056	760	668	150	355	211	18,447	4,163	22,848	−238
1966—																			
Jan.	40,565	40,225	340	239	2,171	110	43,085	13,733	5,639	41,092	817	823	283	241	447	18,751	3,591	22,026	316
Feb.	40,189	40,189	....	315	2,091	122	42,717	13,730	5,679	41,252	800	805	140	246	869	18,014	3,656	21,744	−74
Mar.	40,734	40,734	....	327	1,653	126	42,840	13,634	5,739	41,469	898	521	329	383	613	18,000	4,268	21,946	322
Apr.	40,713	40,713	....	452	1,961	159	43,285	13,632	5,792	41,538	922	512	192	401	408	18,736	3,437	22,336	−163
May	41,480	41,480	....	441	1,839	180	43,940	13,532	5,882	42,102	976	902	263	389	603	18,119	3,574	21,799	−106
June	42,169	42,169	....	292	1,957	238	44,656	13,434	5,978	42,554	1,049	766	313	437	379	18,567	4,433	22,680	320
July	42,380	42,287	93	877	2,508	51	45,816	13,331	5,997	42,708	1,038	1,232	548	419	46	19,155	3,574	23,612	−883
Aug.	42,518	42,518	....	386	1,485	48	44,437	13,259	6,053	42,910	1,037	1,614	170	395	224	17,399	4,507	22,406	−500
Sept.	42,907	42,907	....	773	1,748	47	45,475	13,258	6,109	42,802	1,077	760	159	430	73	19,538	4,332	23,225	645
Oct.	42,975	42,975	....	410	2,044	72	45,501	13,257	6,182	43,113	1,144	809	194	426	−84	19,338	3,766	22,237	867
Nov.	43,912	43,290	622	458	1,780	131	46,281	13,159	6,244	44,246	1,151	299	196	399	301	19,093	4,871	22,134	1,830
Dec.	44,316	43,655	661	173	2,495	193	47,177	13,159	6,317	44,663	1,176	416	174	588	−147	19,779	4,310	24,321	−232

[1] Principally acceptances and industrial loans; authority for industrial loans expired Aug. 21, 1959.

[2] Before Jan. 30, 1934, included gold held by F.R. Banks and in circulation.

[3] The stock of currency, other than gold, for which the Treasury is primarily responsible—silver bullion at monetary value and standard silver dollars, subsidiary silver and minor coin, and United States notes; also, F.R. Bank notes and national bank notes for the retirement of which lawful money has been deposited with the Treasurer of the United States. Includes currency of these kinds held in the Treasury and the F.R. Banks as well as that in circulation.

[4] Gold other than that held against gold certificates and gold certificate credits, including the reserve against United States notes and Treasury notes of 1890, monetary silver other than that held against silver certificates and Treasury notes of 1890, and the following coin and paper currency held in the Treasury: subsidiary silver and minor coin, United States notes, F.R. notes, F.R. Bank notes, and national bank notes.

[5] The total of F.R. Bank capital paid in, surplus, other capital accounts, and other liabilities and accrued dividends, less the sum of bank premises and other assets.

[6] Part allowed as reserves Dec. 1, 1959–Nov. 23, 1960; all allowed thereafter.

[7] These figures are estimated through 1958. Before 1929 available only on call dates (in 1920 and 1922, the call dates were Dec. 29).

NOTE.—For description of figures and discussion of their significance, see "Member Bank Reserves and Related Items," Section 10 of *Supplement to Banking and Monetary Statistics*, Jan. 1962.

17. PRINCIPAL ASSETS AND LIABILITIES, AND NUMBER OF COMMERCIAL AND MUTUAL SAVINGS BANKS, BY CLASS OF BANK DECEMBER 31, 1966 AND DECEMBER 31, 1965

(In millions of dollars)

Item	All banks	Commercial banks							Mutual savings banks		
		Total	Member banks			Nonmember banks			Total	Insured	Noninsured
			Total	National	State	Total	Insured	Noninsured			
December 31, 1966[1]											
Loans and investments, total	382,140	322,940	264,373	n.a.	n.a.	58,567	n.a.	n.a.	59,200	n.a.	n.a.
Loans	267,580	219,100	183,795	n.a.	n.a.	35,305	n.a.	n.a.	48,480	n.a.	n.a.
Investments	114,560	103,840	80,578	n.a.	n.a.	23,262	n.a.	n.a.	10,720	n.a.	n.a.
U.S. Govt. securities	60,420	55,600	41,618	n.a.	n.a.	13,982	n.a.	n.a.	4,820	n.a.	n.a.
Other securities	54,140	48,240	38,960	n.a.	n.a.	9,280	n.a.	n.a.	5,900	n.a.	n.a.
Cash assets	69,660	68,750	60,072	n.a.	n.a.	8,678	n.a.	n.a.	910	na..	n.a.
Deposits, total	403,090	348,100	287,004	n.a.	n.a.	61,096	n.a.	n.a.	54,990	n.a.	n.a.
Interbank	25,430	25,430	23,509	n.a.	n.a.	1,921	n.a.	n.a.	....	n.a.	n.a.
Other demand	165,070	165,010	135,514	n.a.	n.a.	29,496	n.a.	n.a.	60	n.a.	n.a.
Other time	212,590	157,660	127,981	n.a.	n.a.	29,679	n.a.	n.a.	54,930	n.a.	n.a.
Total capital accounts	36,870	32,000	26,223	n.a.	n.a.	5,777	n.a.	n.a.	4,870	n.a.	n.a.
Number of banks	14,274	13,770	6,149	4,799	1,350	7,621	7,385	236	504	330	174
December 31, 1965											
Loans and investments, total	362,320	306,060	251,577	176,605	74,972	54,483	52,028	2,455	56,260	48,735	7,526
Loans	246,946	201,658	169,800	118,537	51,262	31,858	30,310	1,549	45,288	39,964	5,325
Investments	115,373	104,402	81,777	58,067	23,710	22,625	21,718	906	10,971	8,770	2,201
U.S. Govt. securities	65,016	59,547	44,992	32,347	12,645	14,555	14,137	418	5,470	3,760	1,710
Other securities	50,357	44,855	36,785	25,720	11,065	8,070	7,581	489	5,501	5,010	491
Cash assets	61,916	60,899	52,814	36,880	15,934	8,085	7,513	572	1,017	904	113
Deposits, total	385,196	332,436	275,517	193,860	81,657	56,919	54,806	2,113	52,760	45,887	6,874
Interbank	18,235	18,234	17,315	12,077	5,238	919	735	185	1	1	....
Other demand	167,668	167,294	137,846	96,234	41,612	29,448	28,181	1,267	374	366	8
Other time	199,293	146,908	120,356	85,550	34,806	26,552	25,890	662	52,385	45,520	6,865
Total capital accounts	34,935	30,272	24,926	17,434	7,492	5,345	4,912	434	4,663	3,957	706
Number of banks	14,309	13,804	6,221	4,815	1,406	7,583	7,320	263	505	328	177

n.a. Not available.
[1] Estimated.

NOTE.—All banks in the United States.

18. MEMBER BANK INCOME, EXPENSES, AND DIVIDENDS, BY CLASS OF BANK, 1966 AND 1965

Item	Total		Reserve city banks						Country banks	
			New York City		City of Chicago		Other			
	1966	1965	1966	1965	1966	1965	1966	1965	1966	1965
	In millions of dollars									
Revenue	**16,107**	**13,842**	**2,793**	**2,296**	**689**	**576**	**6,035**	**5,240**	**6,590**	**5,730**
On U.S. Govt. securities	1,740	1,686	176	180	58	60	519	549	987	897
On other securities	1,261	1,079	212	204	52	52	447	374	550	448
On loans	11,087	9,295	1,997	1,563	478	382	4,284	3,616	4,328	3,734
All other	2,019	1,781	408	349	101	82	785	700	725	651
Expenses	**11,986**	**10,206**	**1,988**	**1,607**	**479**	**401**	**4,500**	**3,871**	**5,019**	**4,327**
Salaries and wages	3,284	3,024	484	441	109	100	1,238	1,139	1,453	1,345
Interest on deposits	5,271	4,214	952	713	231	192	1,992	1,632	2,096	1,677
All other	3,431	2,968	552	454	139	110	1,270	1,100	1,470	1,305
Net current earnings before income taxes	**4,120**	**3,635**	**805**	**688**	**209**	**175**	**1,535**	**1,369**	**1,571**	**1,403**
Recoveries and profits [1]	......	270	......	22	......	18	......	93	......	137
Losses and charge-offs [2]	......	572	......	68	......	23	......	206	......	276
Net increase (or decrease, +) in valuation reserves	......	351	......	137	......	5	......	111	......	97
Net income before related taxes	3,076	2,983	**544**	**506**	**161**	**165**	**1,160**	**1,144**	**1,211**	**1,168**
Taxes on net income	**882**	**880**	**155**	**131**	**51**	**51**	**351**	**358**	**325**	**340**
Net income	**2,193**	**2,103**	**389**	**375**	**110**	**114**	**808**	**787**	**886**	**828**
Cash dividends declared [3]	1,135	1,056	**259**	**240**	**49**	**45**	**452**	**426**	**375**	**347**
	In per cent									
Ratios:										
Net current earnings before income taxes to—										
Average total capital accounts	16.1	15.1	15.5	14.1	18.1	16.0	16.6	15.6	15.7	15.1
Average total assets	1.28	1.21	1.30	1.21	1.43	1.28	1.29	1.22	1.24	1.20
Net income to—										
Average total capital accounts	8.6	8.7	7.5	7.7	9.5	10.4	8.7	9.0	8.9	8.9
Average total assets	.68	.70	.63	.66	.75	.83	.67	.70	.70	.71
Average return on—										
U.S. Govt. securities	4.12	3.69	3.64	3.32	3.64	3.38	3.95	3.69	4.37	3.80
Loans	6.25	5.85	5.71	5.13	5.64	5.05	6.33	5.90	6.54	6.28

[1] Includes recoveries credited to valuation reserves.
[2] Includes losses charged to valuation reserves.
[3] Includes interest on capital notes and debentures.
NOTE.—Data for 1966 are preliminary; final figures will be published in the May 1967 F.R. *Bulletin*.

19. CHANGES IN NUMBER OF BANKING OFFICES IN THE UNITED STATES DURING 1966[1]

Type of office and change	All banks	Commercial banks (incl. stock savings banks and nondeposit trust companies)						Mutual savings banks	
		Total	Member			Nonmember			
			Total	National[1]	State[2]	Insured	Noninsured[2]	Insured	Noninsured
Banks, Dec. 31, 1965	**14,309**	**13,804**	**6,221**	**4,815**	**1,406**	**7,320**	**263**	**328**	**177**
Changes during 1966									
New banks[3]	119	118	30	25	5	70	18	1	......
Suspensions	−1	−1	......	......	......	−1	......	......	......
Consolidations and absorptions:									
Banks converted into branches	−115	−113	−66	−48	−18	−46	−1	−1	−1
Other	−24	−24	−9	−6	−3	−6	−9	......	......
Voluntary liquidations[4]	−4	−4	......	......	......	......	−4	......	......
Ceased banking operations	−10	−10	−1	−1	......	......	−9	......	......
Interclass changes:									
Nonmember to:									
National	......	......	10	10	......	−10	......	......	......
State member	......	......	4	......	4	−4	......	......	......
State member to:									
National	......	......	......	13	−13	......	......	......	......
Nonmember	......	......	−32	......	−32	32	......	......	......
National to:									
State member	......	......	......	−2	2	......	......	......	......
Nonmember	......	......	−7	−7	......	7	......	......	......
Noninsured to insured	......	......	......	......	......	23	−23	2	−2
Net change	−35	−34	−71	−16	−55	65	−28	2	−3
Number of banks Dec. 31, 1966	**14,274**	**13,770**	**6,150**	**4,799**	**1,351**	**7,385**	**235**	**330**	**174**
Branches and additional offices, Dec. 31, 1965	**16,201**	**15,486**	**12,063**	**8,754**	**3,309**	**3,369**	**54**	**583**	**132**
Changes during 1966									
De novo	1,139	1,096	773	546	227	307	16	33	10
Banks converted	114	113	89	69	20	24	......	......	1
Discontinued	−54	−52	−34	−22	−12	−17	−1	−2	......
Facilities reclassified as branches	5	5	2	2	......	3	......	......	......
Interclass changes:									
Nonmember to:									
National	......	......	33	33	......	−33	......	......	......
State member	......	......	15	......	15	−15	......	......	......
State member to:									
National	......	......	......	45	−45	......	......	......	......
Nonmember	......	......	−37	......	−37	37	......	......	......
National to:									
State member	......	......	......	−16	16	......	......	......	......
Nonmember	......	......	−4	−4	......	4	......	......	......
Noninsured to insured	......	......	......	......	......	7	−7	......	......
Net change	1,204	1,162	837	653	184	317	8	31	11
Number of branches and additional offices, Dec. 31, 1966	**17,405**	**16,648**	**12,900**	**9,407**	**3,493**	**3,686**	**62**	**614**	**143**

19. CHANGES IN NUMBER OF BANKING OFFICES IN THE UNITED STATES DURING 1966[1]—Continued

Type of office and change	All banks	Commercial banks (incl. stock savings banks and nondeposit trust companies)						Mutual savings banks	
		Total	Member			Nonmember			
			Total	National[1]	State[2]	Insured	Noninsured[2]	Insured	Noninsured
Banking facilities, Dec. 31, 1965[5]	270	270	235	210	25	35	....	....	....
Changes during 1966									
Established	2	2	1	1	....	1	....	....	....
Discontinued	−7	−7	−7	−7	....	....	....	....	....
Facilities reclassified as branches	−5	−5	−2	−2	....	−3	....	....	....
Interclass change:									
Nonmember to national	....	....	2	2	....	−2	....	....	....
Net change	−10	−10	−6	−6	....	−4	....	....	....
Number of banking facilities, Dec. 31, 1966	260	260	229	204	25	31	....	....	....

[1] Includes a national bank (3 branches) in the Virgin Islands; other banks or branches located in the possessions are excluded.
[2] State member bank figures include and noninsured bank figures exclude 1 noninsured trust company without deposits.
[3] Exclusive of new banks organized to succeed operating banks.
[4] Exclusive of liquidations incident to the succession, conversion, or absorption of banks.
[5] Provided at military and other Government establishments through arrangements made by the Treasury.

20. NUMBER OF PAR AND NONPAR BANKING OFFICES DECEMBER 31, 1966

F.R. district, State, or other area	Total		Par						Nonpar (nonmember)	
			Total		Member		Nonmember			
	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices
DISTRICT										
Boston	385	1,227	385	1,227	248	952	137	275	...	...
New York	512	2,861	512	2,861	400	2,523	112	338	...	...
Philadelphia	522	1,127	522	1,127	387	846	135	281	...	...
Cleveland	836	1,561	836	1,561	498	1,335	338	226	...	...
Richmond	812	2,213	732	2,134	399	1,412	333	722	80	79
Atlanta	1,561	1,025	1,091	932	524	717	567	215	470	93
Chicago	2,537	1,789	2,537	1,789	995	1,181	1,542	608	...	...
St. Louis	1,507	644	1,272	572	480	371	792	201	235	72
Minneapolis	1,355	215	760	154	494	94	266	60	595	61
Kansas City	1,919	211	1,919	211	835	141	1,084	70	...	...
Dallas	1,287	241	1,220	232	673	140	547	92	67	9
San Francisco	454	3,920	452	3,920	216	3,440	236	480	2	...
Total	**13,687**	**17,034**	**12,238**	**16,720**	**6,149**	**13,152**	**6,089**	**3,568**	**1,449**	**314**
STATE										
Alabama	267	186	199	178	111	152	88	26	68	8
Alaska	12	55	10	55	5	47	5	8	2	...
Arizona	17	261	17	261	5	206	12	55	...	...
Arkansas	246	119	157	97	85	81	72	16	89	22
California	187	2,533	187	2,533	105	2,302	82	231	...	...
Colorado	215	9	215	9	134	6	81	3	...	...
Connecticut	65	336	65	336	36	271	29	65	...	...
Delaware	20	70	20	70	7	34	13	36	...	...
District of Columbia	14	94	14	94	12	88	2	6	...	...
Florida	441	19	409	19	206	12	203	7	32	...
Georgia	426	211	183	196	71	162	112	34	243	15
Hawaii	7	119	7	119	2	43	5	76	...	...
Idaho	25	140	25	140	16	126	9	14	...	...
Illinois	1,058	5	1,058	5	525	5	533	...	...	...
Indiana	418	507	418	507	206	337	212	170	...	...
Iowa	673	250	673	250	159	55	514	195	...	...
Kansas	601	53	601	53	211	34	390	19	...	...
Kentucky	348	243	348	243	94	161	254	82	...	...
Louisiana	220	286	119	247	57	173	62	74	101	39
Maine	41	180	41	180	27	127	14	53	...	...
Maryland	122	415	122	415	56	254	66	161	...	...
Massachusetts	161	613	161	613	107	493	54	120	...	...
Michigan	347	989	347	989	213	812	134	177	...	...
Minnesota	722	9	323	8	223	6	100	2	399	1
Mississippi	190	259	78	184	42	112	36	72	112	75
Missouri	658	71	615	71	177	38	438	33	43	...
Montana	131	3	131	3	91	3	40	...	...	...
Nebraska	434	28	434	28	139	19	295	9	...	...
Nevada	9	70	9	70	6	63	3	7	...	...
New Hampshire	74	33	74	33	53	28	21	5	...	...
New Jersey	229	713	229	713	192	636	37	77	...	...
New Mexico	64	101	64	101	41	62	23	39	...	...
New York	336	2,054	336	2,054	273	1,945	63	[1]109	...	...
North Carolina	132	790	87	716	31	383	56	333	45	74
North Dakota	166	61	67	26	45	12	22	14	99	35
Ohio	537	1,009	537	1,009	351	873	186	136	...	...
Oklahoma	419	42	419	42	243	35	176	7	...	...
Oregon	51	273	51	273	15	230	36	43	...	...
Pennsylvania	541	1,338	541	1,338	391	1,055	150	283	...	...
Rhode Island	11	128	11	128	5	80	6	48	...	...

20. NUMBER OF PAR AND NONPAR BANKING OFFICES
DECEMBER 31, 1966—Continued

F.R. district, State, or other area	Total		Par						Nonpar (nonmember)	
			Total		Member		Nonmember			
	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices	Banks	Branches & offices
STATE—Cont.										
South Carolina	128	302	93	297	32	200	61	97	35	5
South Dakota	167	83	70	58	59	49	11	9	97	25
Tennessee	298	377	237	362	86	258	151	104	61	15
Texas	1,145	53	1,122	53	616	23	506	30	23	....
Utah	55	111	55	111	25	87	30	24	......	....
Vermont	47	59	47	59	27	33	20	26	......	....
Virginia	251	612	251	612	165	487	86	125	......	....
Washington	95	424	95	424	38	387	57	37	......	....
West Virginia	190	....	190	....	114	....	76	....	......	....
Wisconsin	590	173	590	173	164	39	426	134	......	....
Wyoming	69	1	69	1	54	1	15	....	......	....
OTHER AREA										
Puerto Rico[2]	12	153	12	153	......	16	12	137	......	....
Virgin Islands[2]	5	11	5	11	1	11	4	....	......	....

[1] Includes 7 N.Y.C. branches of 2 insured nonmember Puerto Rican banks.

[2] Puerto Rico and the Virgin Islands assigned to the N.Y. District for check clearing and collection purposes. All member branches in Puerto Rico and all except 3 in the Virgin Islands are branches of N.Y.C. banks. Certain branches of Canadian banks (2 in Puerto Rico and 3 in Virgin Islands) are included above as nonmember banks; and nonmember branches in Puerto Rico include 7 other branches of Canadian banks.

NOTE.—Comprises all commercial banking offices on which checks are drawn, including 260 banking facilities. Number of banks and branches differs from that in Table 19 because this table includes banks in Puerto Rico and the Virgin Islands but excludes banks and trust companies on which no checks are drawn.

21. DESCRIPTION OF EACH MERGER, CONSOLIDATION, ACQUISITION OF ASSETS OR ASSUMPTION OF LIABILITIES APPROVED BY THE BOARD OF GOVERNORS DURING 1966

CONTENTS

CONTENTS—Continued

21. DESCRIPTION OF EACH MERGER, CONSOLIDATION, ACQUISITION OF ASSETS OR ASSUMPTION OF LIABILITIES APPROVED BY THE BOARD OF GOVERNORS DURING 1966[1]

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated
No. 1—**The County Trust Company,** White Plains, N.Y.	750.0	53	57
to merge with **The Goshen National Bank,** Goshen, N.Y.	5.5	1	
and **Intercounty Trust Company,** Monticello, N.Y.	22.0	3	

Summary Reports by Attorney General (10-15-65)

(1) The Goshen National Bank, Goshen, New York:

Under the proposed merger County Trust, already a dominant institution in Westchester, Putnam, and Rockland Counties, New York, will extend that position of dominance to Orange County. In our opinion, County Trust would possess significant advantages over existing competitors in Orange County, and its expansion into that county may tend to discourage new entrants. While the effect of the merger, standing alone, may not have significant anticompetitive effects, it is part of a trend whereby County Trust reaches a dominant position in expanding areas via the merger route.

(2) Intercounty Trust Company, Monticello, New York:

Under the proposed merger County Trust, already a dominant institution in Westchester, Putnam, and Rockland Counties, New York, will extend that position of dominance to Sullivan and Orange Counties. In our opinion, County Trust would possess significant advantages over existing competitors in Sullivan and Orange Counties, and this expansion may tend to discourage new entrants. While the merger standing alone does not appear to have significant anticompetitive effects, it is part of a trend whereby County Trust reaches a dominant position via merger.

Basis for Approval by Board of Governors (1-21-66)

Goshen Bank is located in Orange County, a rapidly expanding area lying immediately west of the Hudson River and north of New York City. Intercounty Bank is located in Sullivan County, a resort area of the Catskill Mountains enjoying a rapid increase in year-round activities. Goshen Bank's size has not permitted it to keep pace with the expansion in Orange County, nor does it offer several services that would help meet the needs and promote the convenience of the communities in the area. Intercounty Bank, with a relatively moderate lending limit, has also not been able to satisfy numerous credit demands. The intensive competition in the resort industry requires the constant improvement and expansion of facilities, causing a chronic condition of credit tightness that has been aggravated by attempts to diversify the economy. Intercounty Bank, like Goshen Bank, makes no FHA or VA loans, but this is apparently not unusual in either Sullivan or Orange Counties. Indications are that the deficit of credit in these areas is likely to continue in coming years.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

The areas now served by County Trust, Goshen Bank, and Intercounty Bank are separate and distinct, and there is no significant direct competition between the 3 banks. While County Trust is a forceful competitor, its entry into Sullivan and Orange Counties should not have a significantly adverse effect on the smaller locally based banks.

There is a need in both Sullivan and Orange Counties for an increased supply of credit and other banking services, which Goshen Bank, Intercounty, and the other locally based banks have not been able to supply. The entry of County Trust into these counties should help meet the need for additional credit, while the smaller banks now located in the 2 counties should continue to have sufficient demand for their services to enable them to compete successfully.

No. 2—**The Reading Trust Company,** Reading, Pa.	81.8	5	6
to merge with			
The National Bank of Hamburg, Hamburg, Pa.	7.3	1	

SUMMARY REPORT BY ATTORNEY GENERAL (12-23-65)

The Reading Trust Company (hereinafter Reading Trust), with its main office and a branch in Reading, Pennsylvania, and with branches in Shillington and West Lawn, Pennsylvania, had deposits of $71.4 million as of June 30, 1965.

The National Bank of Hamburg (hereinafter Hamburg National), Hamburg, Pennsylvania, had deposits of $6.6 million as of June 30, 1965.

The proposed merger, if consummated, would result in the elimination of some competition between the merging banks and would increase the already very high concentration of banking resources held by the 3 largest of the 11 banking institutions in the service area by 1.67 per cent to 82.32 per cent. However, in view of Hamburg National's inability to provide vigorous competition, its failure to offer a complete range of banking services to its customers, and its alleged management succession difficulties, any adverse competitive effects that would arise as a result of the merger would not appear to be serious. In addition, the merger would enable the resulting bank to provide better banking services to the residents of the Hamburg area as well as permit it to compete more effectively with 2 larger banks in the Reading area due to its resulting increased lending limit.

Taking all factors presented into consideration, although the proposed merger would produce some adverse competitive effects, these effects would not appear serious.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (1-24-66)

The town of Hamburg (population about 4,000) is located in the northeast sector of Berks County about 17 miles north of Reading and 77 miles northwest of Philadelphia. Although supported by agriculture in the surrounding area, the economy of the town is based on diversified small industry. Within the area served by Hamburg National are 3 other independent banks and offices of 2 larger banks headquartered outside the area; however, Hamburg itself has only 1 other bank, an institution about twice the size of Hamburg National. The latter does not offer a complete range of banking services, and customers who desire an alternative source for several services must seek them in other towns. Hamburg National's lending limit is only $42,500 and inadequate to meet the needs of several local industries.

While Reading Trust competes to some extent throughout Berks County, the nearest offices of the merging banks are some 15 miles apart, with offices of other banks located in the intervening area. Consummation of the merger would have no adverse competitive effects on the well-established other local bank or on the other 2 banks located in the area served by Hamburg National. Effecting the proposal would provide the Hamburg area with a higher lending limit, greater depth in management, and broader banking services, all of which would result in the introduction of stronger competition into the northern sector of Berks County for business of the kinds now serviced by the 2 larger banks having offices in the area.

No. 3—**United California Bank,** Los Angeles, Calif.	3,300.0	187	193
to merge with **Security National Bank of Monterey County,** Pacific Grove, Calif.	16.3	6	

SUMMARY REPORT BY ATTORNEY GENERAL (12-9-65)

The proposed merger would combine Security National, with deposits of $14.9 million, operating 6 offices in Monterey County communities, with United California, 1 of 5 huge, statewide banks in California, with current deposits of $2.8 billion. The merger will have the effect of eliminating the sole remaining local, independent bank in the communities of Pacific Grove, Monterey, Carmel, and Marina. Security National has shown exceptional vigor and competitive strength in recent years, and there is evidence that it has been a truly independent competitor in the area, providing services and following rate schedules much different from

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

SUMMARY REPORT BY ATTORNEY GENERAL—Cont.

the other, larger banks which operate in Monterey County. Since it appears, therefore, that Security National has been a significant, independent competitive factor in the area, this merger, by ending that bank's independence, will have the effect of lessening competition in Monterey County.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (2-7-66)

Security National Bank's 6 offices serve primarily the Monterey Peninsula of California. This area, also served by 14 offices of 4 of the largest banks in California, has a population of approximately 114,000, including the some 30,000 persons connected with Fort Ord. United California has no office on the peninsula; its closest office is at Salinas, located about 15 miles from the nearest office of Security National and separated from the peninsula by the vast expanse of the military base.

Since the acquisition of control of Security National in October of 1961 by the present chief executive officer, Security National has experienced unusually rapid growth both in deposits and banking offices, but such growth has caused several severe problems for the bank. Although capital funds have been provided in recent years, the bank's capital position has steadily deteriorated, and recent efforts to raise additional capital have been unsuccessful. The bank's earnings, adversely affected by heavy expenses, are not expected to improve sufficiently in the near future to provide capital funds adequate in relation to need. In addition, while Security National's management has been satisfactory, the present chief executive officer must withdraw from active management for reasons of health. No other officer in the bank has the necessary experience and demonstrated ability to cope with present problems, and an extended search for a qualified replacement has been unsuccessful.

Part of Security National's growth is attributed to its efforts to provide residents of the peninsula with locally oriented banking services and its response to an area need for a service that none of the larger banks has provided—extended and more convenient banking hours. Consummation of the merger would thus not aid the convenience and needs of the public on the peninsula and would deprive the area of its only small, locally based bank. While consummation would eliminate little present competition between the 2 banks, it would further add to the concentration of banking resources in the State, although by an insignificant amount. Nevertheless, the proposed merger would solve Security National's problems of low capital, below-average earnings, and lack of an individual capable of succeeding in the very near future to the position of chief executive. The benefits expected to flow to the public through the resulting solution to these problems more than offset the adverse considerations.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated
No. 4—**Lake City Bank,** Warsaw, Ind.	19.7	2	3
to merge with **Commercial State Bank,** Silver Lake, Ind.	3.2	1	

SUMMARY REPORT BY ATTORNEY GENERAL (2-28-66)

The Lake City Bank proposes to acquire Commercial State Bank. As of December 31, 1965, the latter had total assets of $3.2 million, total deposits of $2.9 million, and net loans and discounts of $1 million.

Lake City Bank functions through a head office and a branch, located at Warsaw and Winona Lake, Indiana. As of December 31, 1965, Lake City had total assets of $19.7 million, total deposits of $17.9 million, and net loans and discounts of $9.6 million. The service areas for the constituent banks are entirely encompassed within Kosciusko County, Indiana, and overlap only to a slight extent. Areas served by the resulting bank will overlap marginally with areas served by nearly every other bank in the county.

Of the 9 commercial banks operating in Kosciusko County, the acquiring bank ranks second, and the bank to be acquired is the smallest.

It is our view that the effect of the proposed merger on competition will not be adverse.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (3-31-66)

Lake City Bank, located in Warsaw (population 8,000), operates its sole branch in nearby Winona Lake, a community with an estimated population of 1,900. Warsaw is the seat and principal community of Kosciusko County (population over 40,000). Commercial State Bank's sole office is in the town of Silver Lake (population 500), which is also in Kosciusko County about 12 miles south of Warsaw. While the areas served by the 2 banks overlap slightly, neither bank derives any significant amount of deposits or loans from the area served by the other. A branch of the county's largest bank is situated between offices of Lake City Bank and Commercial State Bank. In addition to Lake City Bank, second largest in the area, and Commercial State Bank, the smallest, there are 9 other banks in the relevant area. With the exception of the largest of the 9 banks, which has 4 offices, each of these banks operates a single office and each serves primarily its own community.

Consummation of the proposal would not have adverse competitive effects. Silver Lake and the surrounding area would benefit most from consummation of the merger as the resulting bank would be in a position to improve the earnings prospects of the office now occupied by Commercial Bank and also be able to provide more complete and convenient banking services to the Silver Lake area.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices: In operation	Banking offices: To be operated
No. 5—**Springville Banking Company,** Springville, Utah	12.2	1	
to merge with			
State Bank of Provo, Provo, Utah	8.3	1	2
and change its title to			
Central Bank and Trust Company			

Summary Report by Attorney General (12-15-65)

State Bank of Provo, Provo, Utah, and Springville Banking Company, Springville, Utah, are located some 6 miles apart in north-central Utah. As of June 30, 1965, Springville Banking Company reported total assets of $12.2 million, net loans and discounts of $7.8 million, and total deposits of $11.3 million. State Bank of Provo reported total assets of $8.3 million, net loans and discounts of $5.7 million, and total deposits of $7.8 million.

Six commercial banks (including Springville Banking Company and State Bank of Provo) operate 7 banking offices in the trade area of the merging banks. This trade area is composed of the north-central Utah communities of Orem, Provo, and Springville and has a population of 69,000 persons.

The proposed merger would eliminate substantial direct competition between Springville Banking Company and State Bank of Provo. The resulting bank would become the largest bank in the market area in terms of loans and would rank in a virtual tie for second place in terms of IPC[3] deposits, where the percentage of concentration of the 3 largest banks would increase from 79.2 per cent to 92.4 per cent.

We conclude that the effect of the proposed merger on competition would be adverse.

Basis for Approval by Board of Governors (4-8-66)

Provo (population 36,000), the largest town in Utah County, is located about 44 miles south of Salt Lake City and 6 miles north of Springville (population 8,000). Utah County, the leading agricultural county of the State, has a population of about 120,000, over half of which is located in Provo, Springville, and in Orem, a city of 20,000 located 4 miles north of Provo. The areas served by Springville Bank and State Bank overlap but, because of common management, there is no present competition between them.

The relevant area, Utah County, is also served by 8 other banks operating 11 offices in the county. These include the 2 largest banks in the State: First Security Bank of Utah, N.A., Ogden, which operates 4 offices in the county, including 1 in Provo and 1 in Orem, and holds 30 per cent of the

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

total deposits in the county; and Walker Bank and Trust Company, Salt Lake City, which operates 1 office in the county (a branch in Provo) and holds 18 per cent of the total deposits in the county. The applicant, which holds 12 per cent of the total deposits of Utah County, is the third largest bank in the county, and the resultant bank, holding slightly less than 20 per cent, would be the second largest in the country.

As a result of State Bank's recent rapid growth, its capital position has deteriorated. The present chairman of the board of State Bank (formerly its chief executive officer) is well past the normal retirement age and recently found it necessary to curtail his activity at the bank. As the bank lacked personnel of management caliber, the president of Springville Bank was elected president of State Bank. Consummation of the proposal would result in operating economies, hasten needed improvement at the smaller bank, and provide Utah County with a third bank capable of providing enhanced service and more effective competition for the 2 largest banks. These results would offset the slight and potentially adverse competitive effects of the merger.

No. 6—**The Harter Bank & Trust Company,** Canton, Ohio	122.7	9	10
to merge with			
The Waynesburg Bank, Waynesburg, Ohio	4.8	1	

SUMMARY REPORT BY ATTORNEY GENERAL (3-2-66)

The Harter Bank & Trust Company, Canton, Ohio, proposes to merge with The Waynesburg Bank, Waynesburg, Ohio, under the charter of The Harter Bank & Trust Company and with this name.

Harter Bank presently is the largest bank in its own service area, closely followed in size and number of branch offices by the First National Bank of Canton. The Waynesburg Bank, 15 miles southeast of Canton, is a small single-unit bank with local business only. The merger, if approved, will not eliminate any substantial competition between the 2 banks. We conclude that the effect on competition will not be adverse.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (4-20-66)

Canton (population 113,000), the largest city in Stark County, is about 60 miles southeast of Cleveland and 15 miles northwest of Waynesburg (population 1,230). Harter Bank operates its 9 offices in Canton and its

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

suburbs. The sole office of Waynesburg, also located in Stark County, serves only the small town of Waynesburg and, although Harter Bank competes to some extent throughout Stark County, competition between the 2 banks is quite moderate.

Harter Bank could more adequately serve the banking needs of the Waynesburg community. Waynesburg Bank, the only bank in Waynesburg, has a relatively low ratio of loans to deposits and about two-thirds of its loan portfolio is in real estate loans. Moreover, a sizable portion of its loans are to borrowers who reside outside the Waynesburg area. Evidence indicates there is an unfilled demand in Waynesburg for personal instalment loans and for business credit.

In the relevant market area—Stark County and the northwest corner of Carroll County—18 banks operate 46 offices. Harter Bank, holding about 22 per cent of the IPC[3] deposits of the area, ranks 1st in size; Waynesburg Bank, with less than 1 per cent ranks 16th. The second largest bank, First National Bank of Canton, holds about 21 per cent of the IPC[3] deposits held by all banking offices in the area. A single office bank, located 3 miles west of Waynesburg, and a branch of First National Bank of Canton, located 5 miles east of Waynesburg, are the chief competitors of Waynesburg Bank. There is no evidence that either of these offices would be adversely affected by the merger.

The replacement of Waynesburg Bank by an office of Harter Bank would benefit the banking convenience and needs of the Waynesburg area by making available a full-service banking office. It would not result in any significantly adverse consequences for banking competition.

No. 7—**Citizens Bank and Trust Company,** Clare, Mich.	15.2	2	3
to consolidate with			
The State Bank of Coleman, Coleman, Mich.	3.2	1	

SUMMARY REPORT BY ATTORNEY GENERAL (4-18-66)

The Citizens Bank and Trust Company (hereinafter Citizens), with its main office in Clare, Michigan, and a branch in Rosebush, Michigan, proposes to consolidate with The State Bank of Coleman (hereinafter State), Coleman, Michigan, under the former's title. The 2 banks are 10 miles apart. As of December 31, 1965, Citizens had total deposits of approxi-

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

SUMMARY REPORT BY ATTORNEY GENERAL—Cont.

mately $13.5 million, and State had total deposits of $2.9 million. State suffered a sharp decline in earnings in 1965 and is experiencing management succession problems.

At present, 6 independent sources of commercial banking services are located within 15 miles from an office of the resulting bank. This area is served by modern highways, making the banks located therein easily accessible to any potential banking customer of the resulting bank. The effect of the consolidation would be to reduce to 5 the number of independent banking facilities available to customers in this geographical market. The resulting bank would operate 3 of the area's 10 banking offices.

While the consolidation will result in the elimination of some competition between the consolidating banks and an increase in concentration in the resulting geographical competitive market, State does not appear to have been a particularly aggressive competitor, and the resulting bank will remain subject to competition from a number of other banks in the area.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (5-17-66)

Citizens Bank operates its main office in Clare (population 2,500) and its sole branch in Rosebush (population 300), about 9 miles south. Coleman Bank's 1 office is located in Coleman, a community of about 1,300 persons, situated 10 miles southeast of Clare on the interstate highway connecting Clare and Midland (population 28,000). There are no banking offices between the 2 banks, and the areas served by them overlap somewhat. However, the extent of the competition existing between them is greatly reduced by the nonaggressiveness of Coleman Bank.

Major portions of the 4 counties of Clare, Isabella, Midland, and Gladwin comprise the relevant market area, and within this area are 17 offices of 10 banks competing with the consolidating banks. Citizens Bank and Coleman Bank, respectively, rank 4th and 10th in terms of deposit size. After consolidation with Coleman Bank, Citizens Bank would hold 12.5 per cent of total deposits in the relevant area, and its rank would be unaltered.

Compared to banks with which it competes, Coleman Bank has a low ratio of loans to deposits, and there is evidence that, due to the restrictive lending policies of Coleman Bank, many residents of the area it serves have had to secure loans elsewhere. While a variety of banking services are available from competing banks in the relevant area, the proposed consolidation would benefit the convenience of the residents of the Coleman area by affording them easy access to a more progressively operated banking office. This would be accomplished without significant adverse consequences for banking competition.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated
No. 8—**The State Bank and Trust Company,** Defiance, Ohio	20.4	2	3
to merge with **The Ney State Bank,** Ney, Ohio	2.0	1	

Summary Report by Attorney General (3-15-66)

The State Bank and Trust Company ("State Bank"), Defiance, Ohio, proposes to merge The Ney State Bank ("Ney"), Ney, Ohio.

State Bank operates its main office and a drive-in branch office in Defiance, Ohio, and as of October 25, 1965, reported total assets of $20.4 million, net loans and discounts of $9.6 million, and total deposits of $17.7 million. Ney operates its only office in Ney, Ohio, which is 12 miles northwest of the State Bank. As of October 25, 1965, Ney reported total assets of $2 million, net loans and discounts of $.5 million, and total deposits of $1.8 million.

Although State Bank undoubtedly provides an alternative source of banking services for individuals, businesses, and farms located in Ney's service area, the location of a number of other banks within approximately the same distance from Ney, together with Ney's very small size, indicates that the proposed merger will not have an adverse effect on competition.

Basis for Approval by Board of Governors (6-1-66)

Defiance, the location of both offices of State Bank, is located in rural Defiance County in northwestern Ohio. The city and its environs (population 17,000) are becoming increasingly developed and industrialized. Ney is a small village of about 350 persons located in a rural area 12 miles northwest of Defiance. The 2 banks serve overlapping areas but the volume of business obtained by each from the area served by the other is relatively small. Ney Bank is not an aggressive competitor—it does not actively seek new business and offers a limited range of loans and banking services.

In addition to the merging banks there are 6 banks operating offices within the relevant market area. State Bank, holding 30 per cent of total area deposits, is the largest, and Ney Bank, with 3 per cent, ranks seventh.

The resulting benefits to the village of Ney and the surrounding area would be the principal consequences that would flow from consummation of the proposal. Residents of the Ney area who must now seek a number of banking services elsewhere would be provided with a true alternative source of services commensurate with the community's needs. Moreover, the substitution of an office of State Bank for that of Ney Bank would be expected to have a further beneficial effect by stimulating competition with other banks in the northern part of the relevant area while not increasing importantly the market power of State Bank.

For notes see p. 378.

21. DESCRIPTION OF EACH MERGER, CONSOLIDATION, ACQUISITION OF ASSETS OR ASSUMPTION OF LIABILITIES APPROVED BY THE BOARD OF GOVERNORS DURING 1966[1]—Continued

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices: In operation	Banking offices: To be operated
No. 9—**Rockbridge Bank & Trust Company,** Lexington, Va. (an organizing bank)	0.0	0	2
to merge with			
Rockbridge National Bank of Lexington, Lexington, Va.	10.5	2	

Summary Report by Attorney General (4-28-66)

Rockbridge National Bank, located in Lexington, Virginia, has assets of $9.2 million, deposits of $8.1 million, and loans and discounts of $5.7 million. Rockbridge Bank & Trust Company was incorporated on March 16, 1966, under Virginia banking laws but will not engage in business until the Federal Reserve Board approves the acquisition by United Virginia Bankshares, Incorporated, a registered bank holding company, of all the stock in new Rockbridge Bank & Trust Company. The effect of this entire transaction is to convert Rockbridge National Bank into a State bank under the name of Rockbridge Bank & Trust Company. The merger itself is a change in form and not in substance, and there are therefore no competitive factors involved in the proposed merger.

United Virginia Bankshares is the largest banking institution in Virginia; its subsidiary banks having deposits in excess of $587.0 million. Sixty-three banking offices are operated in 22 communities in Virginia. This holding company through its subsidiary banks controls 11.6 per cent of total bank deposits in the State of Virginia. Through its acquisition of the new Rockbridge Bank & Trust Company its percentage of deposits of all Virginia banks will be increased by less than one-fifth of 1 per cent, and the number of its banking offices will be increased from 63 to 65. Because of the distances involved, there appears to be no competition between any present subsidiary of United Virginia Bankshares and the Rockbridge Bank.

It is our view that standing alone this contemplated transaction of converting the Rockbridge Bank from a national bank to a newly organized State bank and the acquisition of such newly organized State bank by United Virginia Bankshares will not affect competition adversely. However, this transaction may encourage the constantly increasing concentration of banking in Virginia in the hands of a few large organizations.

Basis for Approval by Board of Governors (7-26-66)

United Virginia Bankshares Incorporated, Richmond, Virginia, filed with the Board, pursuant to Section 3(a) of the Bank Holding Company Act of 1956, as amended, an application for approval of the acquisition of at least 90 per cent of the voting shares of Rockbridge Bank & Trust

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

Company, a proposed new bank into which would be merged Rockbridge National Bank of Lexington under the charter and title of Rockbridge Bank & Trust Company.

The proposed merger is only a procedural device to effect the affiliation of Rockbridge National Bank of Lexington with United Virginia Bankshares as a State member bank subsidiary. Apart from this, the merger has no significance. Under the proposal, the merger transaction will not be effected unless United Virginia Bankshares' acquisition of Rockbridge Bank & Trust Company is approved.

No. 10—**Central State Bank,** Elkader, Iowa	7.5	2	3
to acquire the assets and assume the liabilities of			
Volga State Bank, Volga, Iowa	.7	1	

SUMMARY REPORT BY ATTORNEY GENERAL (7-20-66)

Central State Bank (hereinafter referred to as the Charter Bank), with deposits of $6.9 million, proposes to acquire the Volga State Bank (hereinafter referred to as the Acquired Bank), which has deposits of $639,774. The banks, located in northeastern Iowa, are 12 miles apart and their service areas overlap in considerable degree. Volga State Bank, established in 1947, has total loans outstanding of $137,043.

The competition between the Charter Bank and the Acquired Bank, which would be eliminated by the proposed acquisition, does not appear extensive, and the acquisition would not materially alter the structure of banking competition in the area.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (8-15-66)

The sole office of Volga Bank is situated about 12 miles southwest of Elkader, the location of Central Bank's main office. Volga is a small rural community of less than 400 persons that has experienced a marked decline in population in recent years, and since it does not serve as a trading or marketing center, its prospects for growth appear limited. Volga Bank's earnings are below average, and in these circumstances it seems improbable that a capable successor can be found for the bank's chief executive officer who is well past the normal retirement age.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

There is competition between Central Bank and Volga Bank but, because of the size of Volga Bank and its nonaggressive policies, the extent of such competition is limited. Other banking offices in the relevant area, because of their size and location in an agricultural region, tend to draw the preponderance of their business from the communities in which they are situated. It does not appear that any of these offices would be adversely affected by the proposed transaction or that the structure of banking competition in the area would be materially altered. In view of the prospects for Volga Bank and for the community it serves, and in light of the bank's management succession problem, there is considerable question as to how long Volga Bank can realistically be expected to continue as a unit bank. Thus, in addition to the resulting benefit to the banking convenience and needs of the Volga area, the proposal would assure the continuance of a banking facility for the Volga community.

No. 11—**Wachovia Bank and Trust Company,** Winston-Salem, N.C.	1,156.7	99	103
to merge with			
Bank of Ahoskie, Ahoskie, N.C.	11.6	4	

SUMMARY REPORT BY ATTORNEY GENERAL (7-27-66)

Wachovia Bank and Trust Company, Winston-Salem, North Carolina, has applied for permission to merge Bank of Ahoskie, Ahoskie, North Carolina. Wachovia is the State's largest bank, operating 91 offices in 32 North Carolina communities and having net loans and total deposits of $661.7 million and $977 million, respectively. Bank of Ahoskie operates 4 offices and has net loans and total deposits of $5.9 million and $10.5 million, respectively.

Wachovia presently owns 50.41 per cent of the merging bank's stock as a result of the 1960 merger of Wachovia and Guaranty Bank and Trust Company, Greenville, North Carolina. Guaranty acquired the stock in 1937. This common ownership and the distance between the participants indicates that the proposed merger will eliminate little, if any, competition.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (8-30-66)

In May 1960, prior to enactment of the Bank Merger Act, Wachovia Bank acquired a majority interest in Ahoskie Bank through merger with another bank that had held slightly more than 50 per cent of the stock of Ahoskie Bank since 1937. A senior officer of Wachovia serves as chair-

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

man of the board of Ahoskie Bank, and several of the latter's officers formerly served with Wachovia. The 2 affiliated banks have a close operating relationship, and customers of Ahoskie Bank are frequently referred to Wachovia for banking accommodations unavailable at the smaller bank.

Three offices of Ahoskie Bank are in Ahoskie (population 4,600), the largest city in Hertford County (population 22,700), situated near the eastern end of the Virginia–North Carolina border. The bank's fourth office is in Aulander (population 1,100), 8 miles southwest of Ahoskie in Bertie County (population 24,400). Ahoskie is centrally located in the two-county area and serves as the trade center for both counties. The nearest office of Wachovia is located 34 miles south of Aulander. None of the areas served by either bank overlaps.

The relevant area for considering the remaining competitive effects of the proposal contains the offices of 8 banks, including Ahoskie Bank. Aulander is served only by Ahoskie Bank, while Ahoskie is served also by a branch of The Planters National Bank and Trust Company, Rocky Mount, North Carolina, having total deposits of $56 million at its 20 offices. The smaller banks in the relevant area serve chiefly their own communities, and consummation of the proposal would not be expected to have adverse effects on any of the banks that compete with Ahoskie Bank.

Due to the distances between the closest offices of Wachovia and Ahoskie Bank, consummation of the merger would eliminate little, if any, competition even if the 2 banks were not affiliated. The merger would formalize the relationship between the 2 banks and, while Wachovia has been supplementing Ahoskie Bank's services, the operation of Ahoskie's offices as branches of Wachovia would make the full range of complete banking services of the larger bank more conveniently available to bank customers in Ahoskie and Aulander.

No. 12—**Bank of the Commonwealth,** Detroit, Mich.	649.6	40	51
to acquire the assets and assume the liabilities of			
Public Bank, Detroit, Mich.	120.0	11	

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (9-23-66)

Approval of this merger promptly and without delay, as provided in Public Law 89-356, was necessitated by an emergency situation existing at Public Bank. According to information before the Board—including communications from the Federal Deposit Insurance Corporation (FDIC)

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

and the Commissioner of Banking of the State of Michigan—Public Bank had problems that seriously threatened depositors' funds and only prompt approval of the application to merge would prevent the probable failure of the bank.

The Board concluded that any anticompetitive effects attributable to effectuation of the proposal would be clearly outweighed in the public interest by the considerations supporting and requiring its immediate action on the application and that any other disposition of the application would be inconsistent with the best interests of the depositors of Public Bank. The merger was consummated following appointment of the FDIC as receiver pursuant to court proceedings under Michigan law.

No. 13—**The Ohio Citizens Trust Company,** Toledo, Ohio	155.9	10	12
to merge with			
The Whitehouse State Savings Bank, Whitehouse, Ohio	5.7	2	

SUMMARY REPORT BY ATTORNEY GENERAL (8-9-66)

The Ohio Citizens Trust Company, Toledo, Ohio, the third largest bank in the Greater Toledo area, proposes to acquire by merger the Whitehouse Savings Bank, which has its head office 18½ miles southwest of downtown Toledo and a small branch office in Holland, about 8 miles northeast of Whitehouse and halfway between Whitehouse and downtown Toledo.

Although there is some competition between the 2 banks in the area east and northeast of Holland, the very small size of Whitehouse Savings Bank leads us to the conclusion that the proposed merger will not materially affect the structure of commercial banking in either of their service areas.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (10-4-66)

Whitehouse, a small residential and farm community of about 1,300 population, is located approximately 18 miles southwest of downtown Toledo (population 318,000). Whitehouse Bank operates its main office in Whitehouse and its sole branch in Holland (population 1,300), about 12 miles northeast of Whitehouse. The nearest offices of the 2 banks are 6 miles apart, and there are 3 other banking offices in the intervening area.

The principal effect of the merger would be on banking needs and convenience in the Whitehouse–Holland area, a growing suburb of Toledo, which has an increasing demand for mortgage loans and also potential

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

for industrial development. Whitehouse Bank operates under a restrictive policy with respect to mortgage loans, does not aggressively pursue instalment loan business and, due to its small size, is unable to meet the credit needs of several businesses in its area. The conversion of the 2 offices of Whitehouse Bank into branches of Ohio Citizens would provide for the Whitehouse and Holland communities more convenient access to broader credit accommodations and to a generally wider range of banking services. This would be accomplished without any significantly adverse consequences for banking competition.

Name of bank	Resources	In operation	To be operated
No. 14—**Upper Main Line Bank,** Paoli, Pa.	30.3	4	5
to merge with **Farmers Bank of Parkesburg,** Parkesburg, Pa.	4.9	1	
and change its title to **Community Bank and Trust Company**			

SUMMARY REPORT BY ATTORNEY GENERAL (8-22-66)

The Upper Main Line Bank (hereinafter referred to as the Charter Bank) has total assets of $27.9 million and is located in the town of Paoli, Chester County, Pennsylvania, an urban area of 23,000 population located about 18 miles east of Philadelphia. The Farmers Bank of Parkesburg, Parkesburg, Chester County, Pennsylvania (hereinafter referred to as the Merging Bank) has total assets of $4.9 million and is located in the town of Parkesburg, a town with a population of 3,000 located 27 miles southwest of Paoli. The Charter Bank was established in 1927 and merged once with the Berwyn National Bank in 1957. The Merging Bank was established in 1912 and has no previous merger history.

Because of their distance apart and different service areas, the merging banks do not presently compete with one another. However, any possibility of future competition due to the proximity of their present service areas (they are within 3 miles of each other) would be foreclosed by the merger.

There will be no appreciable competitive impact on the Charter Bank's service area from the merger. Its ranking as the second largest locally headquartered bank will be unchanged. It will continue to face competition from numerous other banks in the area, including the recently merged National Bank of Chester County and Trust Company with $54 million in IPC[3] deposits.

Aside from eliminating the potential competition of the Charter Bank, there will be no appreciable adverse competitive impact in the Merging Bank's service area. The resulting bank may be able to compete more effectively through a greater lending limit, greater resources, and more complete services.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (10-10-66)

Main Line Bank and Farmers Bank are not competitors, and it does not appear that significant competition would develop between them if they did not merge. The main office of Main Line Bank in Paoli (population 5,000) is about 27 miles from Parkesburg (population 3,000), and the nearest office of that bank to Parkesburg is located 21 miles from Farmers Bank's sole office.

The merger would have no material effect on banking competition in the area served by Main Line Bank. The bank would continue to rank as the second largest locally headquartered bank in the Paoli area and would be faced with competition from numerous other banking offices, including branches of large Philadelphia-based banks. The conversion of Farmers Bank into an office of the larger and more progressive Main Line Bank would benefit the banking convenience and needs of Parkesburg and should stimulate competition among the banks in the area.

No. 15—**The Brazil Trust Company of Brazil, Indiana,** Brazil, Ind.	12.7	2	3
to merge with			
Farmers and Merchants Bank, Clay City, Ind.	6.0	1	
and change its title to **First Bank and Trust Company of Clay County, Indiana**			

SUMMARY REPORT BY ATTORNEY GENERAL (8-23-66)

The Brazil Trust Company (hereinafter referred to as the Charter Bank) has total assets of $12.7 million and is located in the town of Brazil, Indiana, a community of 8,750 population located about 50 miles southwest of Indianapolis and 16 miles northeast of Terre Haute. The Farmers and Merchants Bank (hereinafter referred to as the Merged Bank) has total assets of $6.0 million and is located in Clay City, a town with a population of 722 located 18 miles south of Brazil. The Charter Bank was established in 1899 and the Merged Bank in 1895. Neither has a previous merger history.

The Charter Bank and the Merged Bank do not presently compete with each other to any significant degree, and the distance separating them, together with their extensive common ownership, indicates that there is little likelihood that the 2 banks will become competitors in the future. The bank resulting from their merger will probably be in a better position to meet the competition moving into the area from larger banks in Terre Haute.

It appears that the proposed merger is not likely to have an adverse competitive effect.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (10-10-66)

The 2 offices of Brazil Bank are in Brazil (population approximately 8,900), the Clay County seat, about 50 miles southwest of Indianapolis and 16 miles northeast of Terre Haute. The sole office of the Clay City bank in Clay City (population about 950) is about 18 miles south of Brazil. There are other banking offices in the communities located on the highway connecting the 2 towns, and competition to any meaningful extent does not exist between the 2 banks. Shareholders who own approximately 34 per cent of the stock of Brazil Bank also own 37 per cent of the stock of the Clay City bank. There is no evidence to indicate that the banks would become significant competitors even if the common ownership were terminated.

The relevant market for the resulting bank is Clay County and portions of Vigo, Parke, and Owen Counties. In this area, 12 banks operate 24 offices, which hold total deposits of over $200 million. Following the merger, Brazil Bank would hold less than 10 per cent of total area deposits. Brazil Bank is faced with competition from the larger Terre Haute banks, in part because numerous residents of Brazil commute to work in Terre Haute. The nearest banking office to the Clay City bank is located approximately 7 miles southeast of Clay City and is a branch of a bank that has total deposits of about $8 million. The proposed merger would not adversely affect banking competition, and the resulting bank would be able to offer improved services that, in particular, would benefit the banking needs and convenience of the Clay City community.

No. 16—**Depositors Trust Company,** Augusta, Maine	132.9	29	
to merge with			29
First Maine Trust Company, Augusta, Maine (an organizing bank)	.2	0	

SUMMARY REPORT BY ATTORNEY GENERAL (8-19-66)

Depositors Trust Company, Augusta, Maine, with assets of $132.9 million, proposes to merge with First Maine Trust Company, Augusta, Maine, recently organized, with assets of $156,000.

Since the application states that First Maine Trust Company will not be open for business until December 30, 1966, it is not possible to discern any impact upon competition which would result from consummation of the proposed merger.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (10-24-66)

Depositors Corporation, Augusta, Maine, filed with the Board, pursuant to Section 3(a)(1) of the Bank Holding Company Act of 1956, as amended, an application for approval of action to become a bank holding company through the acquisition of 100 per cent of the outstanding voting shares of Depositors Trust Company, Augusta, Maine, and at least 80 per cent of the outstanding voting shares of The Liberty National Bank in Ellsworth, Ellsworth, Maine. Incident to the holding company proposal, the Board's approval was also requested, pursuant to the Bank Merger Act of 1960, as amended, of the proposed merger of Depositors Trust with First Maine Trust Company, Augusta, Maine (a newly organized bank not yet in operation), under the charter and title of Depositors Trust Company.

The merger proposal is primarily one of form—its purpose is to facilitate the acquisition of all the outstanding stock of Depositors Trust Company by the newly formed bank holding company. It is not planned that First Maine Trust Company will engage in the business of banking as a separate corporate entity prior to the merger. The merger, in itself, will have no effect on competition.

No. 17—**The Colonial Bank and Trust Company,** Waterbury, Conn.	145.8	12	15
to merge with			
Puritan Bank and Trust Company, Meriden, Conn.	11.8	3	

SUMMARY REPORT BY ATTORNEY GENERAL (8-9-66)

The Colonial Bank and Trust Company, with deposits of $136.1 million, proposes to merge with the Puritan Bank and Trust Company, which has deposits of $10.5 million. The banks are located in west-central Connecticut and have offices as close together as 5 miles.

The merger would eliminate existing and potential competition between the merging banks, would eliminate a vigorous independent bank, would enhance Colonial Bank's position as the dominant bank in the area, and would increase the already high level of banking concentration in the area.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (10-31-66)

Colonial Bank operates its main office and 3 of its branches in Waterbury (population 110,000), the fourth largest city in Connecticut. Its other 8 offices are located within a radius of 12 miles of the city. The main office and 1 branch of Puritan Bank are 16 miles east of Waterbury in Meriden, a community of about 55,000. Its other office is 6 miles south of Meriden in Wallingford, which has a population of about 30,000. The

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

2 banks draw the vast bulk of their business from separate geographical markets, and there is only minor competition between them.

The principal effect of the merger on banking competition would be in the area served by Puritan Bank. In Meriden, Puritan Bank and 2 other banks operate a total of 7 offices; Wallingford is served by 1 office of each of these 3 banks and by 2 offices of a New Haven-based bank. Puritan Bank holds about 11 per cent of the deposits held by the 12 banking offices in the Meriden–Wallingford area. The other Meriden-headquartered bank holds about 37 per cent of area deposits. The remaining deposits in the area are held by offices of the State's 2d and 10th largest banks. Thus, the extension of Colonial Bank with its greater resources than Puritan Bank into the Meriden–Wallingford area would tend to strengthen banking competition in that market. Moreover, the replacement of Puritan Bank, the smallest bank in the Meriden–Wallingford area, by offices of Colonial Bank would provide the Meriden and Wallingford communities with an alternative source of full banking services and an additional facility for meeting the growing credit needs produced by the area's rapid economic development.

No. 18—**The Bank of New York,** New York, N.Y.	932.0	6	8
to merge with			
Empire Trust Company, New York, N.Y.	341.1	2	

SUMMARY REPORT BY ATTORNEY GENERAL (9-23-66)

The Bank of New York is the 9th largest of the 45 commercial banks with head offices in New York City, and it has assets of $932 million, deposits of $822.8 million, and loans of $432.7 million. Empire ranks 13th among the 45 banks in New York City, and has assets of $341.1 million, deposits of $294.6 million, and loans of $199.4 million. The Bank of New York operates 6 offices and Empire has 2, all of which are located in Manhattan. Both banks are engaged primarily in providing services to large- and medium-sized depositors and borrowers, and both have extensive amounts of personal and corporate trust business. In addition, The Bank of New York, but not Empire, offers a range of retail banking services.

The banking structure in New York City and in the metropolitan area in which both merging banks are vigorous competitors reflects a high degree of concentration. The 5 largest banks in New York City have approximately 75 per cent of IPC[3] deposits and loans and discounts and over 72 per cent of the banking offices in New York City. This concen-

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

SUMMARY REPORT BY ATTORNEY GENERAL—Cont.

tration is largely attributable to past merger activity. Since 1950, when there were 70 banks in New York City, 35 have disappeared by way of merger and there have been only 5 entirely new banks organized—none of which have achieved or can be expected to achieve the competitive stature of the larger merged banks.

The proposed merger would eliminate existing competition between the merging banks, eliminate a vigorous competitive alternative source of credit for large- and medium-sized customers, and reinforce the existing high level of concentration in commercial banking in New York City and the metropolitan area.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (11-7-66)

The head office of each bank is situated in the downtown financial district of New York City. The 5 branch offices of Bank of New York are in the midtown section of Manhattan, as is the single branch of Empire. Although Bank of New York has made an effort to attract retail business, both banks are essentially wholesale institutions, dealing in large loan and deposit relationships and offering specialized services. The retail market is considered to be preponderantly local in character and dependent largely on branching locations. In that market, Empire and Bank of New York are not present competitors. Nor is it probable that the two would compete in this field in the future, were the application denied, since neither bank has the resources to acquire the branches that would be needed for any important expansion into retail banking. After consummation of the merger, both offices of Empire would offer retail services, and the addition of 2 offices to its present system would make Bank of New York a slightly stronger competitor in the retail banking field. Nevertheless, the effect on competition in the relevant market, whether regarded as the metropolitan area, the City of New York (comprising the 5 boroughs), or the borough of Manhattan, would be minimal. The resulting bank would operate 8 out of some 700 banking offices in New York City and some 350 in Manhattan. Moreover, each of the 8 offices of the 2 banks is located in a highly competitive area with numerous offices of commercial banks in the immediate vicinity.

In the wholesale banking field, there is competition between Bank of New York and Empire, but such competition is not regarded as important as the 2 banks have specialized and developed expertise in different fields of industry. While changes in emphasis could bring the 2 into more active competition in the future both now compete with other institutions of comparable and larger size in a market that is not only far broader than New York City, but that is national, and at times international, in scope. In this broader market, each plays a relatively minor role. After consummation of the merger, the resultant bank would rank 9th among commercial banks headquartered in New York City compared with a rank of 10th for Bank of New York at present. Accordingly, the merger would tend

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

BASIS FOR APPROVAL BY BOARD OF GOVERNORS—Cont.

to create a slightly stronger competitor for the largest banks not only in New York but in other financial centers as well.

Customers of the 2 banks would benefit to some extent from the availability of a larger lending limit as a result of consummation of the merger. Both Bank of New York and Empire have experienced some difficulty in serving corporate customers that have grown to a size where banking prudence or statutory limits prevented 1 bank or the other from maintaining its "lead" position in loans to such customers. In addition, strengthening of the international department of the combined bank, as a result of the merger, would be of some benefit to that segment of the community that is interested in international trade.

On balance, the effect of the merger on banking competition would not be significantly adverse, and there would be some benefit to the community as a result of the increased lending limit and improved international department of the resulting bank.

No. 19—**St. Joseph Valley Bank,** Elkhart, Ind.	64.2	6	8
to merge with			
First Old State Bank, Elkhart, Ind.	21.1	2	

SUMMARY REPORT BY ATTORNEY GENERAL (7-19-66)

The merging banks are 2 of the 3 commercial banks headquartered and operating offices in the city of Elkhart, the seat of Elkhart County.

St. Joseph Valley Bank (hereinafter referred to as the Charter Bank) is the second largest commercial bank in Elkhart County. Its primary service area is the northwest corner of said county. It also serves an area in the southern part of the county through a branch in Nappanee. Charter Bank holds about 20 per cent and 25 per cent, respectively, of the total IPC[3] deposits and loans of the banks apparently competing within these areas. The merged bank would have about 27 per cent and 34 per cent, respectively, of such deposits and loans, while together with First National Bank of Elkhart County, it would have about 60 per cent of the deposits and 70 per cent of the loans.

The merger would result in a substantial increase in the already high level of concentration in commercial banking in the area; would eliminate 1 of the 3 banking institutions in the city of Elkhart; and would eliminate existing competition between the merging banks. According to the application, the merging bank is experiencing serious capital and management problems. However, we question whether these problems are insoluble except through merger with a direct competitor. So long as the possibility exists that State Bank's problems can be solved in some way other than

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

SUMMARY REPORT BY ATTORNEY GENERAL—Cont.

by merger with 1 of its 2 principal competitors, we believe that such a merger would have a substantially adverse effect on competition.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (11-30-66)

Elkhart, population about 45,000, is the location of the main office and 4 branches of St. Joseph Bank, the main office and sole branch of Old State Bank, and the main office and 3 branches of The First National Bank of Elkhart County (deposits $95.4 million). The area served by each of these 3 banks encompasses the city of Elkhart and its immediate environs. Competition between them is substantial.

Old State Bank, smallest of the 3 Elkhart banks, has experienced substantial growth in both deposits and loans during the past few years and has also enjoyed gross operating revenues that are considerably above the average for banks of comparable size in Indiana. The bank's growth in deposits and loans, however, has been disproportionate to the growth of its capital accounts. Moreover, due to loan losses resulting from imprudent lending policies, net income since 1964 has been much less than the average for similar size banks. While the bank has sold capital twice within the past 5 years, its ability to sell additional capital is seriously affected by its recent record of less-than-average net earnings and by its greater-than-average asset weaknesses. At the same time, these factors impede the ability of the bank to attract the personnel needed to strengthen the lending practices if both net earnings and asset condition are to be improved.

Evidence indicates that the directors of Old State Bank have endeavored—although not to the point of precipitating open discord, which could well prove harmful—to effect reforms in the lending practices of the bank. The failure of this effort must be attributed in part to the fact that the directors and their families altogether hold only about 35 per cent of the bank's voting shares. The largest stockholder of the bank is its chief operating officer who enjoys a wide following among the bank's other stockholders and in the community and is the dominant force in the bank. Thus, it seems unlikely that Old State Bank will veer from its potentially hazardous course, given the bank's present ownership. A solution by means other than merger with 1 of the 2 remaining Elkhart banks is patently desirable but, because of State law, the only other possibilities for Old State Bank to be acquired by merger lie with 2 Elkhart County banks that are far too small to materially alter the prospects for Old State Bank.

The merger would eliminate an alternative source of banking services from the Elkhart community and would have a substantial adverse effect on competition. However, it would result in an orderly disposition of the serious capital and management problems faced by Old State Bank and, considered in the light of the likely ramifications for the bank and the community it serves if the merger is not allowed, the anticompetitive consequences would be clearly outweighed in the public interest.

For notes see p. 378.

Name of bank, and type of transaction[2] (in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated
No. 20—**Security Bank,** Webster, S. Dak.	4.6	1	2
to merge with			
Farmers and Merchants State Bank, Roslyn, S. Dak.	.9	1	

SUMMARY REPORT BY ATTORNEY GENERAL (11-8-66)

The proposed merger of Security Bank (deposits of $4.2 million), and Farmers and Merchants (deposits of $820,000), involves 2 small banks about 12 miles apart. The application shows that Farmers and Merchants is the only bank located within its service area although 2 other banks may be competing on the periphery of this area. There appears to be no substantial competition between Security Bank and Farmers and Merchants.

We conclude that the merger would not have an adverse effect on competition.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (12-22-66)

Webster, population about 2,700, is located in northeastern South Dakota about 12 miles south of Roslyn (population 260). Each of the 2 banks serves primarily its own community, and there is no significant competition between them. In June of 1966, control of the Roslyn bank was acquired by interests controlling Security Bank.

The nearest other banking offices to Roslyn and Webster are operated by 6 small banks, which are situated from 11 to 24 miles distant and range in deposit size from about $1 million to $4 million. These banks draw the vast bulk of their business from their own communities and would not be adversely affected by the merger.

The replacement of the Roslyn bank by an office of Security Bank would have no adverse effect on competition and would bring to the Roslyn area par banking, an increased lending limit, and other improved banking services.

No. 21—**The Bank of Virginia,** Richmond, Va.	260.1	28	30
to merge with			
The Bank of LaCrosse, LaCrosse, Va.	6.5	2	

SUMMARY REPORT BY ATTORNEY GENERAL (10-31-66)

The Bank of Virginia (hereinafter referred to as the Charter Bank), with assets of $260 million, operates 27 offices in 7 cities and 4 counties

For notes see p. 378.

Name of bank, and type of transaction[2] in chronological order of determination)	Resources (in millions of dollars)	Banking offices	
		In operation	To be operated

SUMMARY REPORT BY ATTORNEY GENERAL—Cont.

in Virginia. The Charter Bank proposes to merge with LaCrosse Bank, which has assets of $6.9 million. The closest branch of the Charter Bank is 13 miles distant. The application states there is virtually no competition between the 2 banks. Moreover, applicable State law would prevent the Charter Bank from entering LaCrosse Bank's service area through the establishment of a de novo branch. Accordingly, the proposed merger would not appear to eliminate any significant actual or potential competition between the applicant banks.

BASIS FOR APPROVAL BY BOARD OF GOVERNORS (12-29-66)

Virginia Bank is one of the 7 subsidiary banks of Virginia Commonwealth Bankshares, Inc., a registered bank holding company and the fourth largest banking organization in the State. The holding company's subsidiaries hold about 6 per cent of the deposits held by the approximately 250 banks in Virginia, and the proposal would increase its share of State deposits by about .1 per cent. No affiliate of the holding company has offices nearer to LaCrosse Bank than Virginia Bank.

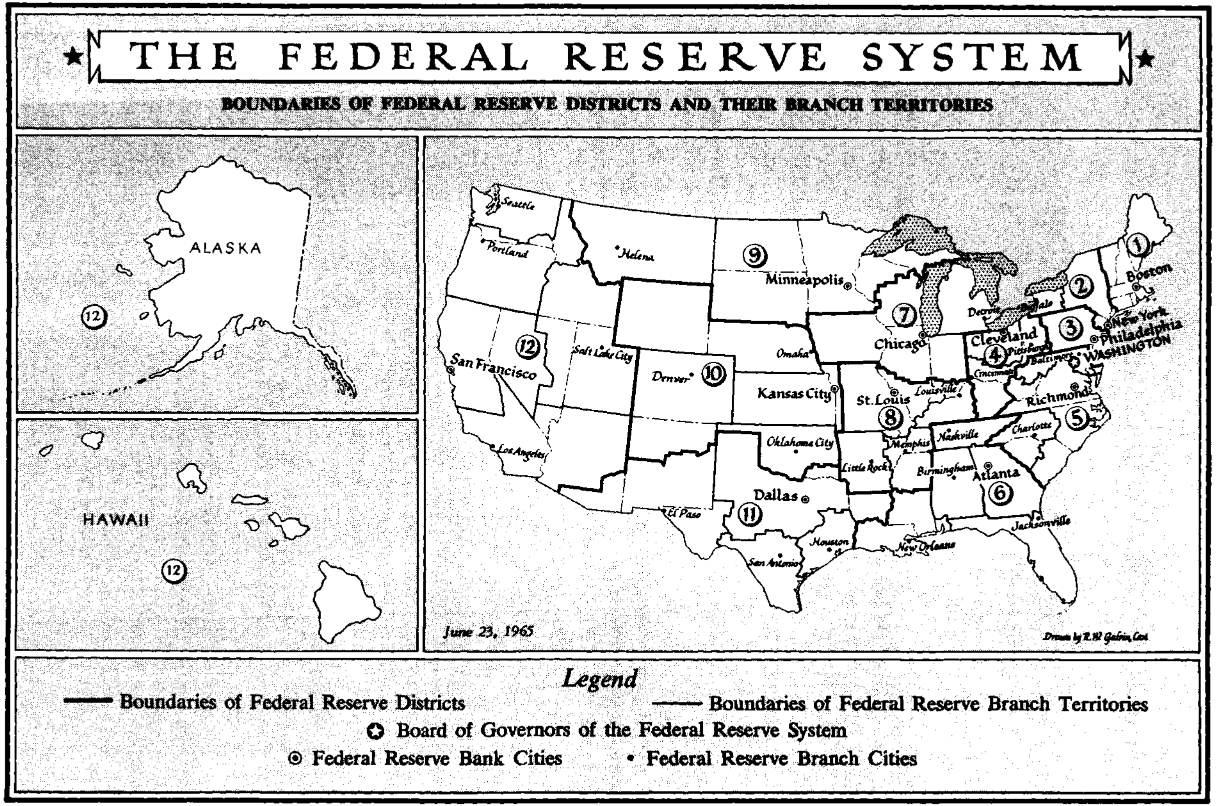
The small community of LaCrosse (population 750) is located in Mecklenburg County about 80 miles southwest of Richmond. LaCrosse Bank operates its single branch at South Hill (population 3,000), about 3 miles northwest of LaCrosse. The nearest office of Virginia Bank is at Boydton (population 450), also in Mecklenburg County, about 16 miles west of the LaCrosse–South Hill area. There is only a minor degree of competition between LaCrosse Bank and Virginia Bank, and there is nothing to indicate that they would become significant competitors if the transaction were not consummated. Virginia Bank is precluded by State law from branching into LaCrosse and South Hill except by merger.

The principal competition for LaCrosse Bank is provided by a bank headquartered in South Hill and by the Broadnax branch (4 miles east of LaCrosse) of a Lawrenceville bank. It does not appear that either of these banks would be adversely affected by the merger. The replacement of LaCrosse Bank by offices of Virginia Bank, with its larger lending limit and broader range of bank services, would afford added convenience for those businesses in the LaCrosse/South Hill area that presently deal with out-of-area banks and other financial institutions. Moreover, it is expected that the availability of full-scale banking services will have a favorable influence on the local economy.

[1] During 1966 the Board disapproved 1 merger, etc. However, under Section 18(c) of the Federal Deposit Insurance Act, only those transactions approved by the Board must be described in its ANNUAL REPORT to Congress.

[2] Each transaction was proposed to be effected under the charter of the first-named bank.

[3] The abbreviation "IPC" designates deposits of individuals, partnerships, and corporations.



NOTE.—For a complete description of each Federal Reserve district see *Description of Federal Reserve Districts—Territorial Composition of Each Head Office and Branch, Including Population and Land Area,* a pamphlet published in April 1966. This pamphlet is available upon request from the Division of Administrative Services, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

(December 31, 1966)

	Term expires
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J. L. ROBERTSON of Nebraska, *Vice Chairman*	January 31, 1978
CHAS. N. SHEPARDSON of Texas	January 31, 1968
GEORGE W. MITCHELL of Illinois	January 31, 1976
J. DEWEY DAANE of Virginia	January 31, 1974
SHERMAN J. MAISEL of California	January 31, 1972
ANDREW F. BRIMMER of Pennsylvania	January 31, 1980

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ROBERT SOLOMON, *Adviser to the Board*
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JOHN R. FARRELL, *Director*
M. B. DANIELS, *Assistant Director*
JOHN N. KILEY, JR., *Assistant Director*

DIVISION OF EXAMINATIONS
FREDERIC SOLOMON, *Director*
BRENTON C. LEAVITT, *Assistant Director*
JAMES C. SMITH, *Assistant Director*
LLOYD M. SCHAEFFER, *Chief Federal Reserve Examiner*
FREDERICK R. DAHL, *Assistant Director*
CHARLES C. WALCUTT, *Assistant Chief Federal Reserve Examiner*

DIVISION OF PERSONNEL ADMINISTRATION
EDWIN J. JOHNSON, *Director*
JOHN J. HART, *Assistant Director*

DIVISION OF ADMINISTRATIVE SERVICES
JOSEPH E. KELLEHER, *Director*
HARRY E. KERN, *Assistant Director*

OFFICE OF THE CONTROLLER
JOHN KAKALEC, *Controller*

OFFICE OF DEFENSE PLANNING
INNIS D. HARRIS, *Coordinator*

DIVISION OF DATA PROCESSING
LAWRENCE H. BYRNE, JR., *Director*
LEE W. LANGHAM, *Assistant Director*
DAVID S. STAIGER, *Assistant Director*

FEDERAL OPEN MARKET COMMITTEE

(December 31, 1966)

MEMBERS

WM. McC. MARTIN, JR., *Chairman* (Board of Governors)
ALFRED HAYES, *Vice Chairman* (Elected by Federal Reserve Bank of New York)
KARL R. BOPP (Elected by Federal Reserve Banks of Boston, Philadelphia, and Richmond)
ANDREW F. BRIMMER (Board of Governors)
GEORGE H. CLAY (Elected by Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco)
J. DEWEY DAANE (Board of Governors)
W. BRADDOCK HICKMAN (Elected by Federal Reserve Banks of Cleveland and Chicago)
WATROUS H. IRONS (Elected by Federal Reserve Banks of Atlanta, St. Louis, and Dallas)
SHERMAN J. MAISEL (Board of Governors)
GEORGE W. MITCHELL (Board of Governors)
J. L. ROBERTSON (Board of Governors)
CHAS. N. SHEPARDSON (Board of Governors)

OFFICERS

ROBERT C. HOLLAND, *Secretary*

MERRITT SHERMAN, *Assistant Secretary*
KENNETH A. KENYON, *Assistant Secretary*
ARTHUR L. BROIDA, *Assistant Secretary*
CHARLES MOLONY, *Assistant Secretary*
HOWARD H. HACKLEY, *General Counsel*
DAVID B. HEXTER, *Assistant General Counsel*
DANIEL H. BRILL, *Economist*
DAVID P. EASTBURN, *Associate Economist*
GEORGE GARVY, *Associate Economist*
RALPH T. GREEN, *Associate Economist*
ALBERT R. KOCH, *Associate Economist*
MAURICE MANN, *Associate Economist*
J. CHARLES PARTEE, *Associate Economist*
ROBERT SOLOMON, *Associate Economist*
CLARENCE W. TOW, *Associate Economist*
RALPH A. YOUNG, *Associate Economist*

ALAN R. HOLMES, *Manager, System Open Market Account*
CHARLES A. COOMBS, *Special Manager, System Open Market Account*

During 1966 the Federal Open Market Committee met at intervals of three or four weeks as indicated in the Record of Policy Actions taken by the Committee (see pp. 111–201 of this Report).

FEDERAL ADVISORY COUNCIL

(December 31, 1966)

MEMBERS

District No. 1—John Simmen, President, Industrial National Bank of Rhode Island, Providence, Rhode Island.

District No. 2—William H. Moore, Chairman of the Board, Bankers Trust Company, New York, New York.

District No. 3—William L. Day, Chairman, The First Pennsylvania Banking and Trust Company, Philadelphia, Pennsylvania.

District No. 4—Leland A. Stoner, President, The Ohio National Bank of Columbus, Columbus, Ohio.

District No. 5—John F. Watlington, Jr., President, Wachovia Bank and Trust Company, Winston-Salem, North Carolina.

District No. 6—Sam M. Fleming, President, Third National Bank in Nashville, Nashville, Tennessee.

District No. 7—Henry T. Bodman, Chairman of the Board, National Bank of Detroit, Detroit, Michigan.

District No. 8—A. M. Brinkley, Jr., Chairman of the Board and Chief Executive Officer, Citizens Fidelity Bank and Trust Company, Louisville, Kentucky.

District No. 9—John A. Moorhead, President, Northwestern National Bank of Minneapolis, Minneapolis, Minnesota.

District No. 10—Roger D. Knight, Jr., Chairman of the Board, Denver United States National Bank, Denver, Colorado.

District No. 11—Robert H. Stewart, III, Chairman of the Board, First National Bank in Dallas, Dallas, Texas.

District No. 12—Ransom M. Cook, Chairman, Executive Committee, Wells Fargo Bank, San Francisco, California.

OFFICERS

JOHN A. MOORHEAD, *President*
RANSOM M. COOK, *Vice President*
HERBERT V. PROCHNOW, *Secretary*
WILLIAM J. KORSVIK, *Assistant Secretary*

EXECUTIVE COMMITTEE

JOHN A. MOORHEAD, *ex officio*
RANSOM M. COOK, *ex officio*
WILLIAM L. DAY
JOHN F. WATLINGTON, JR.
SAM M. FLEMING

Meetings of the Federal Advisory Council were held on February 14-15, June 20-21, September 19-20, and November 14-15, 1966. The Board of Governors met with the Council on February 15, June 21, September 20, and November 15. The Council is required by law to meet in Washington at least four times each year and is authorized by the Federal Reserve Act to consult with and advise the Board on all matters within the jurisdiction of the Board.

FEDERAL RESERVE BANKS and BRANCHES

(December 31, 1966)

CHAIRMEN AND DEPUTY CHAIRMEN OF BOARDS OF DIRECTORS

Federal Reserve Bank of—	Chairman and Federal Reserve Agent	Deputy Chairman
Boston	Erwin D. Canham	William Webster
New York	Everett N. Case	Kenneth H. Hannan
Philadelphia	Willis J. Winn	Bayard L. England
Cleveland	Joseph B. Hall	Logan T. Johnston
Richmond	Edwin Hyde	William H. Grier
Atlanta	Jack Tarver	Edwin I. Hatch
Chicago	Franklin J. Lunding	John W. Sheldon
St. Louis	Frederic M. Peirce	Smith D. Broadbent, Jr.
Minneapolis	Judson Bemis	Robert F. Leach
Kansas City	Homer A. Scott	Dolph Simons
Dallas	Carl J. Thomsen	Max Levine
San Francisco	Frederic S. Hirschler	John D. Fredericks

CONFERENCE OF CHAIRMEN

The Chairmen of the Federal Reserve Banks are organized into a Conference of Chairmen that meets from time to time to consider matters of common interest and to consult with and advise the Board of Governors. Such a meeting, attended also by Deputy Chairmen of the Reserve Banks, was held in Washington on December 1-2, 1966.

Mr. Hoadley, Chairman of the Federal Reserve Bank of Philadelphia, and Mr. Rebsamen, Chairman of the Federal Reserve Bank of St. Louis, who were elected Chairman and Vice Chairman of the Conference, respectively, in December 1965, resigned as Reserve Bank directors early in 1966, and thus terminated their association with the Conference. Mr. Tarver, Chairman of the Federal Reserve Bank of Atlanta, who was the other member of the Executive Committee, served as Chairman of the Conference until the close of the 1966 meeting.

On December 2, 1966, Mr. Hyde, Chairman of the Federal Reserve Bank of Richmond, was elected Chairman of the Conference and of the Executive Committee to serve for the succeeding year; Mr. Thomsen, Chairman of the Dallas Bank, was elected Vice Chairman of the Conference and a member of the Executive Committee; and Mr. Winn, Chairman of the Federal Reserve Bank of Philadelphia, was elected as the other member of the Executive Committee.

DIRECTORS

Class A and Class B directors are elected by the member banks of the district. Class C directors are appointed by the Board of Governors of the Federal Reserve System.

The Class A directors are chosen as representatives of member banks and, as a matter of practice, are active officers of member banks. The Class B directors may not, under the law, be officers, directors, or employees of banks. At the time of their election they must be actively engaged in their district in commerce, agriculture, or some other industrial pursuit.

The Class C directors may not, under the law, be officers, directors, employees, or stockholders of banks. They are appointed by the Board of Governors as representatives not of any particular group or interest, but of the public interest as a whole.

Federal Reserve Bank branches have either 5 or 7 directors, of whom a majority are appointed by the Board of Directors of the parent Federal Reserve Bank and the others are appointed by the Board of Governors of the Federal Reserve System.

DIRECTORS	District 1 — Boston	*Term expires Dec. 31*
Class A:		
Darius M. Kelley	President, The Orange National Bank, Orange, Mass.	1966
William I. Tucker	President, Vermont National Bank, Brattleboro, Vt.	1967
Lawrence H. Martin	President, The National Shawmut Bank of Boston, Mass.	1968
Class B:		
William R. Robbins	Vice President for Finance, United Aircraft Corporation, East Hartford, Conn.	1966
James R. Carter	President, Nashua Corporation, Nashua, N.H.	1967
W. Gordon Robertson	President, Bangor Punta Alegre Sugar Corporation, Bangor, Maine	1968
Class C:		
William Webster	Chairman and Chief Executive Officer, New England Electric System, Boston, Mass.	1966
Erwin D. Canham	Editor in Chief, The Christian Science Monitor, Boston, Mass.	1967
Charles W. Cole	President Emeritus, Amherst College, Mass.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 2 — New York**

		Term expires Dec. 31
Class A:		
Robert H. Fearon	President, The Oneida Valley National Bank of Oneida, N.Y.	1966
George A. Murphy	Chairman of the Board, Irving Trust Company, New York, N.Y.	1967
Robert G. Cowan	Chairman of the Board, National Newark and Essex Bank, Newark, N.J.	1968
Class B:		
Albert L. Nickerson	Chairman of the Board, Mobil Oil Corporation, New York, N.Y.	1966
Arthur K. Watson	Chairman of the Board, IBM World Trade Corporation, and Vice Chairman of the Board, International Business Machines Corporation, Armonk, N.Y.	1967
Milton C. Mumford	Chairman of the Board, Lever Brothers Company, New York, N.Y.	1968
Class C:		
Everett N. Case	President, Alfred P. Sloan Foundation, New York, N.Y.	1966
James M. Hester	President, New York University, New York, N.Y.	1967
Kenneth H. Hannan	Executive Vice President, Union Carbide Corporation, New York, N.Y.	1968

Buffalo Branch

Appointed by Federal Reserve Bank:		
Charles W. Millard, Jr.	Chairman of the Board, Manufacturers and Traders Trust Company, Buffalo, N.Y.	1966
J. Wallace Ely	President, Security Trust Company of Rochester, N.Y.	1967
John D. Hamilton	Chairman of the Board, Marine Midland Chautauqua National Bank, Jamestown, N.Y.	1967
Arthur S. Hamlin	President, The Canandaigua National Bank and Trust Company, Canandaigua, N.Y.	1968
Appointed by Board of Governors:		
Thomas E. LaMont	Farmer, Albion, Orleans County, N.Y.	1966
Robert S. Bennett	General Manager, Lackawanna Plant, Bethlehem Steel Corporation, Buffalo, N.Y.	1967
Maurice R. Forman	President, B. Forman Company, Rochester, N.Y.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont.

District 3 — Philadelphia

		Term expires Dec. 31
Class A:		
Charles R. Sharbaugh	Senior Vice President, United States National Bank, Ebensburg, Pa.	1966
Lloyd W. Kuhn	President, The Bendersville National Bank, Bendersville, Pa.	1967
Howard C. Petersen	Chairman of the Board, Fidelity-Philadelphia Trust Company, Philadelphia, Pa.	1968
Class B:		
Leonard P. Pool	Chairman of the Board, Air Products and Chemicals, Inc., Allentown, Pa.	1966
Philip H. Glatfelter, III	President, P. H. Glatfelter Company, Spring Grove, Pa.	1967
Ralph K. Gottshall	Chairman of the Board, Atlas Chemical Industries, Inc., Wilmington, Del.	1968
Class C:		
Bayard L. England	Chairman of the Board, Atlantic City Electric Company, Atlantic City, N.J.	1966
Willis J. Winn	Dean, Wharton School of Finance and Commerce, University of Pennsylvania, Philadelphia, Pa.	1967
D. Robert Yarnall, Jr.	President, Yarway Corporation, Philadelphia, Pa.	1968

District 4 — Cleveland

Class A:		
Richard R. Hollington	President, The Ohio Bank and Savings Company, Findlay, Ohio	1966
Seward D. Schooler	President, Coshocton National Bank, Coshocton, Ohio	1967
Everett D. Reese	Chairman of the Board, The City National Bank and Trust Company of Columbus, Ohio	1968
Class B:		
Edwin J. Thomas	Chairman of the Executive and Finance Committees, The Goodyear Tire and Rubber Company, Akron, Ohio	1966
David A. Meeker	Chairman of the Board and Chief Executive Officer, The Hobart Manufacturing Company, Troy, Ohio	1967
Walter K. Bailey	Chairman of the Board, The Warner and Swasey Company, Cleveland, Ohio	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont.	**District 4 — Cleveland — Cont.**	*Term expires Dec. 31*
Class C:		
Albert G. Clay	President, Clay Tobacco Company, Mt. Sterling, Ky.	1966
Joseph B. Hall	Director, former Chairman of the Board, The Kroger Co., Cincinnati, Ohio	1967
Logan T. Johnston	Chairman of the Board, Armco Steel Corporation, Middletown, Ohio	1968

Cincinnati Branch

Appointed by Federal Reserve Bank:		
John W. Humphrey	President, The Philip Carey Manufacturing Company, Cincinnati, Ohio	1966
James B. Pugh	President, The Security Central National Bank of Portsmouth, Ohio	1966
Kroger Pettengill	President, The First National Bank of Cincinnati, Ohio	1967
Jacob H. Graves	President, The Second National Bank and Trust Company of Lexington, Ky.	1968
Appointed by Board of Governors:		
Walter C. Langsam	President, University of Cincinnati, Ohio	1966
Barney A. Tucker	President, Burley Belt Fertilizer Company, Lexington, Ky.	1967
R. Stanley Laing	President, The National Cash Register Company, Dayton, Ohio	1968

Pittsburgh Branch

Appointed by Federal Reserve Bank:		
Charles M. Beeghly	Chairman of the Board, Jones and Laughlin Steel Corporation, Pittsburgh, Pa.	1966
Joseph S. Armstrong	President, The Grove City National Bank, Grove City, Pa.	1966
Edwin H. Keep	President, First National Bank of Meadville, Pa.	1967
Robert C. Hazlett	President, Wheeling Dollar Savings and Trust Company, Wheeling, W. Va.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 4 — Cleveland — Cont.** *Term expires Dec. 31*

Pittsburgh Branch — Cont.

Appointed by Board of Governors:

		Term expires Dec. 31
Lawrence E. Walkley	President, Westinghouse Air Brake Company, Pittsburgh, Pa.	1966
Robert Dickey, III	President, Dravo Corporation, Pittsburgh, Pa.	1967
F. L. Byrom	President, Koppers Company, Inc., Pittsburgh, Pa.	1968

District 5 — Richmond

Class A:

Robert T. Marsh, Jr.	Honorary Chairman of the Board, First and Merchants National Bank, Richmond, Va.	1966
George Blanton, Jr.	President, First National Bank, Shelby, N. C.	1967
William A. Davis	President, The Peoples Bank of Mullens, W. Va.	1968

Class B:

Robert E. L. Johnson	Formerly Chairman of the Board, Woodward and Lothrop, Inc., Washington, D. C.	1966
Robert R. Coker	President, Coker's Pedigreed Seed Company, Hartsville, S. C.	1967
Charles D. Lyon	President, The Potomac Edison Company, Hagerstown, Md.	1968

Class C:

William H. Grier	President, Rock Hill Printing and Finishing Company, Rock Hill, S. C.	1966
Edwin Hyde	President, Miller and Rhoads, Inc., Richmond, Va.	1967
Wilson H. Elkins	President, University of Maryland, College Park, Md.	1968

Baltimore Branch

Appointed by Federal Reserve Bank:

John P. Sippel	President, The Citizens National Bank, Laurel, Md.	1966
Martin Piribek	Executive Vice President, The First National Bank of Morgantown, W. Va.	1967

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 5 — Richmond — Cont.** *Term expires Dec. 31*

Baltimore Branch — Cont.

Appointed by Federal Reserve Bank—Cont.

Adrian L. McCardell	President, First National Bank of Maryland, Baltimore, Md.	1967
Joseph B. Browne	President, Union Trust Company of Maryland, Baltimore, Md.	1968

Appointed by Board of Governors:

Arnold J. Kleff, Jr.	Manager, Baltimore Refinery, American Smelting & Refining Company, Baltimore, Md.	1966
Leonard C. Crewe, Jr.	Chairman of the Board, Maryland Specialty Wire, Inc., Cockeysville, Md.	1967
E. Wayne Corrin	President, Consolidated Gas Supply Corporation, Clarksburg, W. Va.	1968

Charlotte Branch

Appointed by Federal Reserve Bank:

W. W. McEachern	Chairman and Chief Executive Officer, The South Carolina National Bank, Greenville, S.C.	1966
Wallace W. Brawley	President, National Bank of Commerce of Spartanburg (organizing), Spartanburg, S.C.	1967
C. C. Cameron	Chairman of the Board, First Union National Bank of North Carolina, Charlotte, N.C.	1967
G. Harold Myrick	Executive Vice President and Trust Officer, First National Bank, Lincolnton, N.C.	1968

Appointed by Board of Governors:

James A. Morris	Dean, School of Business Administration, University of South Carolina, Columbia, S.C.	1966
William B. McGuire	President, Duke Power Company, Charlotte, N.C.	1967
John L. Fraley	Executive Vice President, Carolina Freight Carriers Corporation, Cherryville, N.C.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont.

District 6 — Atlanta

		Term expires Dec. 31
Class A:		
George S. Craft	Chairman of the Board, Trust Company of Georgia, Atlanta, Ga.	1966
D. C. Wadsworth, Sr.	President, The American National Bank, Gadsden, Ala.	1967
John W. Gay	President, The First National Bank, Scottsboro, Ala.	1968
Class B:		
W. Maxey Jarman	Chairman, Genesco, Inc., Nashville, Tenn.	1966
James H. Crow, Jr.	Vice President, The Chemstrand Corporation, Decatur, Ala.	1967
Harry T. Vaughn	President, United States Sugar Corporation, Clewiston, Fla.	1968
Class C:		
John A. Hunter	President, Louisiana State University, Baton Rouge, La.	1966
Jack Tarver	President, Atlanta Newspapers, Inc., Atlanta, Ga.	1967
Edwin I. Hatch	President, Georgia Power Company, Atlanta, Ga.	1968

Birmingham Branch

Appointed by Federal Reserve Bank:		
John A. Hand	President, The First National Bank of Birmingham, Ala.	1966
Rex J. Morthland	President, The Peoples Bank & Trust Company, Selma, Ala.	1967
C. Willard Nelson	President, State National Bank, Decatur, Ala.	1967
Major W. Espy, Sr.	Chairman and President, The Headland National Bank, Headland, Ala.	1968
Appointed by Board of Governors:		
Mays E. Montgomery	General Manager, Dixie Home Feeds Company, Athens, Ala.	1966
C. Caldwell Marks	Chairman of the Board, Owen-Richards Company, Inc., Birmingham, Ala.	1967
Eugene C. Gwaltney, Jr.	Vice President and General Superintendent, Russell Mills, Inc., Alexander City, Ala.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont.	**District 6 — Atlanta — Cont.**	*Term expires Dec. 31*
	Jacksonville Branch	
Appointed by Federal Reserve Bank:		
William H. Dial	President, The First National Bank at Orlando, Fla.	1966
William R. Barnett	Chairman, Barnett National Bank of Jacksonville, Fla.	1967
Dudley Cole	President, Florida First National Bank at Ocala, Fla.	1967
Andrew P. Ireland	President, The American National Bank, Winter Haven, Fla.	1968
Appointed by Board of Governors:		
J. Ollie Edmunds	President, Stetson University, DeLand, Fla.	1966
Douglas M. Pratt	President, National City Lines, Inc., Tampa, Fla.	1967
Castle W. Jordan	President, Ryder System, Inc., Miami, Fla.	1968
	Nashville Branch	
Appointed by Federal Reserve Bank:		
William F. Earthman, Jr.	President, Commerce Union Bank, Nashville, Tenn.	1966
S. N. Brown	President, Union National Bank, Fayetteville, Tenn.	1967
J. A. Hill	President, Hamilton National Bank, Morristown, Tenn.	1967
Moses E. Dorton	President, The First National Bank of Crossville, Tenn.	1968
Appointed by Board of Governors:		
James E. Ward	President, Baird-Ward Printing Company, Nashville, Tenn.	1966
Robert M. Williams	President, ARO, Inc., Arnold Engineering Development Center, Tullahoma, Tenn.	1967
Alexander Heard	Chancellor, Vanderbilt University, Nashville, Tenn.	1968
	New Orleans Branch	
Appointed by Federal Reserve Bank:		
L. Y. Foote	Chairman of the Board, First National Bank of Hattiesburg, Miss.	1966

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 6 — Atlanta — Cont.** *Term expires Dec. 31*

New Orleans Branch — Cont.

Appointed by Federal Reserve Bank—Cont.

		Term expires Dec. 31
Robert M. Hearin	President, First National Bank of Jackson, Miss.	1967
W. Richard White	President, First National Bank of Jefferson Parish, Gretna, La.	1967
Donald L. Delcambre	President, State National Bank, New Iberia, La.	1968

Appointed by Board of Governors:

George Benjamin Blair	General Manager, American Rice Growers Cooperative, Lake Charles, La.	1966
Kenneth R. Giddens	President, WKRG-TV, Inc., Mobile, Ala.	1967
Frank G. Smith, Jr.	Vice President, Mississippi Power and Light Co., Jackson, Miss.	1968

District 7 — Chicago

Class A:

Kenneth V. Zwiener	Chairman of the Board, Harris Trust and Savings Bank, Chicago, Ill.	1966
John H. Crocker	Chairman of the Board, The Citizens National Bank of Decatur, Ill.	1967
Harry W. Schaller	President, The Citizens First National Bank of Storm Lake, Iowa	1968

Class B:

G. F. Langenohl	Formerly Treasurer and Assistant Secretary, Allis-Chalmers Manufacturing Company, Milwaukee, Wis.	1966
William E. Rutz	Director, Giddings and Lewis Machine Tool Company, Fond du Lac, Wis.	1967
Joseph O. Waymire	Vice President and Treasurer, Eli Lilly and Company, Indianapolis, Ind.	1968

Class C:

John W. Sheldon	President, Chas. A. Stevens and Company, Chicago, Ill.	1966
Franklin J. Lunding	Chairman, Finance Committee, Jewel Companies, Inc., Chicago, Ill.	1967
Elvis J. Stahr	President, Indiana University, Bloomington, Ind.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 7 — Chicago — Cont.** *Term expires Dec. 31*

Detroit Branch

Appointed by Federal Reserve Bank:

Franklin H. Moore	President, The Commercial and Savings Bank, St. Clair, Mich.	1966
John H. French, Jr.	President, City National Bank of Detroit, Mich.	1966
Raymond T. Perring	Chairman of the Board, The Detroit Bank and Trust Company, Detroit, Mich.	1967
B. P. Sherwood, Jr.	President, Security First Bank & Trust Co., Grand Haven, Mich.	1968

Appointed by Board of Governors:

Max P. Heavenrich, Jr.	President and General Manager, Heavenrich Bros. & Company, Saginaw, Mich.	1966
James William Miller	President, Western Michigan University, Kalamazoo, Mich.	1967
Guy S. Peppiatt	Chairman of the Board, Federal-Mogul Corporation, Detroit, Mich.	1968

District 8 — St. Louis

Class A:

H. Lee Cooper	President, Ohio Valley National Bank of Henderson, Ky.	1966
Bradford Brett	President, The First National Bank of Mexico, Mo.	1967
Harry F. Harrington	Chairman of the Board, The Boatmen's National Bank of St. Louis, Mo.	1968

Class B:

Roland W. Richards	Senior Vice President, Laclede Steel Company, St. Louis, Mo.	1966
Mark Townsend	Chairman of the Board, Townsend Lumber Company, Inc., Stuttgart, Ark.	1967
Sherwood J. Smith	Vice President, Whirlpool Corporation, Evansville, Ind.	1968

Class C:

William King Self	President, Riverside Industries, Marks, Miss.	1966
Smith D. Broadbent, Jr.	Owner, Broadbent Hybrid Seed Co., Cadiz, Ky.	1967
Frederic M. Peirce	President, General American Life Insurance Company, St. Louis, Mo.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 8 — St. Louis — Cont.** *Term expires Dec. 31*

Little Rock Branch

Appointed by Federal Reserve Bank:

R. M. LaGrone, Jr.	President, The Citizens National Bank of Hope, Ark.	1966
Cecil W. Cupp	Chariman of the Board and Chief Executive Officer, Arkansas Bank and Trust Company, Hot Springs, Ark.	1966
Ross E. Anderson	Chairman of the Board, The Commercial National Bank of Little Rock, Ark.	1967
Louis E. Hurley	President, The Exchange Bank and Trust Company, El Dorado, Ark.	1968

Appointed by Board of Governors:

Frederick P. Blanks	Planter, Parkdale, Ark.	1966
Reeves E. Ritchie	President, Arkansas Power and Light Company, Little Rock, Ark.	1967
Carey V. Stabler	President, Little Rock University, Little Rock, Ark.	1968

Louisville Branch

Appointed by Federal Reserve Bank:

Ray A. Barrett	President, The State Bank of Salem, Ind.	1966
Wm. G. Deatherage	President, Planters Bank & Trust Co., Hopkinsville, Ky.	1966
J. E. Miller	Executive Vice President, Sellersburg State Bank, Sellersburg, Ind.	1967
John H. Hardwick	President, The Louisville Trust Company, Louisville, Ky.	1968

Appointed by Board of Governors:

Lisle Baker, Jr.	Executive Vice President & General Manager, The Courier-Journal & Louisville Times Company, Louisville, Ky.	1966
Richard T. Smith	Farmer, Madisonville, Ky.	1967
C. Hunter Green	Vice President and General Manager, Southern Bell Telephone and Telegraph Company, Louisville, Ky.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont.

District 8 — St. Louis — Cont.

Memphis Branch

		Term expires Dec. 31
Appointed by Federal Reserve Bank:		
Allen Morgan	President, The First National Bank of Memphis, Tenn.	1966
Con T. Welch	President, Citizens Bank, Savannah, Tenn.	1966
Leon C. Castling	President, First National Bank at Marianna, Ark.	1967
Wade W. Hollowell	President, The First National Bank of Greenville, Miss.	1968
Appointed by Board of Governors:		
Edward B. LeMaster	President, Edward LeMaster Company, Inc., Memphis, Tenn.	1966
James S. Williams	Assistant Vice President, American Greetings Corporation, Osceola, Ark.	1967
Sam Cooper	President, HumKo Products Division, National Dairy Products Corporation, Memphis, Tenn.	1968

District 9 — Minneapolis

		Term expires Dec. 31
Class A:		
Harold C. Refling	Executive Vice President, First National Bank in Bottineau, N. Dak.	1966
John F. Nash	President, The American National Bank of St. Paul, Minn.	1967
Curtis B. Mateer	Executive Vice President, The Pierre National Bank, Pierre, S. Dak.	1968
Class B:		
Ray C. Lange	President, Chippewa Canning Company, Inc., Chippewa Falls, Wis.	1966
Joyce A. Swan	Executive Vice President & Publisher, Minneapolis Star and Tribune, Minneapolis, Minn.	1967
John H. Toole	President, Toole and Easter Co., Missoula, Mont.	1968
Class C:		
Judson Bemis	President, Bemis Company, Inc., Minneapolis, Minn.	1966
Byron W. Reeve	President, Lake Shore, Inc., Iron Mountain, Mich.	1967
Robert F. Leach	Attorney, Oppenheimer, Hodgson, Brown, Wolff & Leach, St. Paul, Minn.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont.	District 9 — Minneapolis — Cont.	*Term expires Dec. 31*
	Helena Branch	
Appointed by Federal Reserve Bank:		
Charles H. Brocksmith	President, First Security Bank of Glasgow N. A., Glasgow, Mont.	1966
Glenn H. Larson	President, First State Bank of Thompson Falls, Mont.	1966
B. Meyer Harris	President, The Yellowstone Bank, Laurel, Mont.	1967
Appointed by Board of Governors:		
C. G. McClave	President and General Manager, Montana Flour Mills Co., Great Falls, Mont.	1966
Edwin G. Koch	President, Montana College of Mineral Science and Technology, Butte, Mont.	1967
	District 10 — Kansas City	
Class A:		
Eugene H. Adams	President, The First National Bank of Denver, Colo.	1966
Kenneth H. Peters	President, The First State Bank of Larned, Kans.	1967
Burton L. Lohmuller	Chairman of the Board, The First National Bank of Centralia, Kans.	1968
Class B:		
Fred W. Gilmore	President, Union Stock Yards Company of Omaha, Nebr.	1966
Robert A. Olson	President, Kansas City Power and Light Company, Kansas City, Mo.	1967
Stanley Learned	President, Phillips Petroleum Company, Bartlesville, Okla.	1968
Class C:		
Homer A. Scott	Vice President and District Manager, Peter Kiewit Sons' Company, Sheridan, Wyo.	1966
Dolph Simons	Editor and President, The Lawrence Daily Journal-World, Lawrence, Kans.	1967
Dean A. McGee	Chairman of the Board, Kerr-McGee Corporation, Oklahoma City, Okla.	1968
	Denver Branch	
Appointed by Federal Reserve Bank:		
J. P. Brandenburg	President, The First State Bank of Taos, N. Mex.	1966

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 10 — Kansas City — Cont.** *Term expires Dec. 31*

Denver Branch — Cont.

Appointed by Federal Reserve Bank—Cont.

Theodore D. Brown	President, The Security State Bank, Sterling, Colo.	1966
Armin B. Barney	Chairman of the Board, Colorado Springs National Bank, Colorado Springs, Colo.	1967

Appointed by Board of Governors:

R. A. Burghart	Ingle Land and Cattle Company, Colorado Springs, Colo.	1966
Cris Dobbins	President and Director, Ideal Cement Company, Denver, Colo.	1967

Oklahoma City Branch

Appointed by Federal Reserve Bank:

Guy L. Berry, Jr.	President, The American National Bank and Trust Company, Sapulpa, Okla.	1966
C. M. Crawford	President, First National Bank, Frederick, Okla.	1966
Howard J. Bozarth	President, City National Bank and Trust Company, Oklahoma City, Okla.	1967

Appointed by Board of Governors:

Otto C. Barby	Attorney and rancher, Beaver, Okla.	1966
C. W. Flint, Jr.	Chairman of the Board, Flint Steel Company, Tulsa, Okla.	1967

Omaha Branch

Appointed by Federal Reserve Bank:

W. B. Millard, Jr.	Chairman of the Board, Omaha National Bank, Omaha, Nebr.	1966
Henry D. Kosman	Chairman of the Board and President, Scottsbluff National Bank, Scottsbluff, Nebr.	1967
John W. Hay, Jr.	President, Rock Springs National Bank, Rock Springs, Wyo.	1967

Appointed by Board of Governors:

Clifford Morris Hardin	Chancellor, The University of Nebraska, Lincoln, Nebr.	1966
John T. Harris	Merchant and cattleman, McCook, Nebr.	1967

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont.

District 11 — Dallas

		Term expires Dec. 31
Class A:		
Murray Kyger	Chairman of the Board, The First National Bank of Fort Worth, Tex.	1966
J. Edd McLaughlin	President, Security State Bank and Trust Company, Ralls, Tex.	1967
Ralph A. Porter	President, The State National Bank of Denison, Tex.	1968
Class B:		
D. A. Hulcy	Chairman of the Board, Lone Star Gas Company, Dallas, Tex.	1966
H. B. Zachry	Chairman of the Board, H. B. Zachry Company, San Antonio, Tex.	1967
J. B. Perry, Jr.	President and General Manager, Perry Brothers, Inc., Lufkin, Tex.	1968
Class C:		
Max Levine	Retired Chairman of the Board, Foley's, Houston, Tex.	1966
Carl J. Thomsen	Senior Vice President, Texas Instruments, Inc., Dallas, Tex.	1967
Kenneth S. Pitzer	President, Rice University, Houston, Tex.	1968

El Paso Branch

Appointed by Federal Reserve Bank:		
Dick Rogers	President, First National Bank in Alpine, Tex.	1966
Robert W. Heyer	President, Southern Arizona Bank and Trust Company, Tucson, Ariz.	1966
Robert F. Lockhart	Vice President, The State National Bank of El Paso, Tex.	1967
Joe B. Sisler	President, The Clovis National Bank, Clovis, N. Mex.	1968
Appointed by Board of Governors:		
C. Robert McNally, Jr.	Rancher, Roswell, N. Mex.	1966
Gordon W. Foster	Director, Shop Rite Foods, Inc., El Paso, Tex.	1967
Joseph M. Ray	President, The University of Texas at El Paso, Tex.	1968

Houston Branch

Appointed by Federal Reserve Bank:		
John E. Gray	President, First Security National Bank of Beaumont, Tex.	1966

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont.

District 11 — Dallas — Cont.

Houston Branch — Cont.

		Term expires Dec. 31
Appointed by Federal Reserve Bank—Cont.		
J. A. Elkins, Jr.	Chairman of the Board, First City National Bank of Houston, Tex.	1966
A. G. McNeese, Jr.	President, Bank of the Southwest National Assn., Houston, Tex.	1967
Henry B. Clay	President, First Bank & Trust, Bryan, Tex.	1968
Appointed by Board of Governors:		
George T. Morse, Jr.	President and General Manager, Peden Iron & Steel Company, Houston, Tex.	1966
Edgar H. Hudgins	Ranching—Partner in Hudgins Division of J.D. Hudgins, Hungerford, Tex.	1967
D. B. Campbell	Former Works Manager, Sabine River Works, E. I. du Pont de Nemours & Company, Orange, Tex.	1968

San Antonio Branch

Appointed by Federal Reserve Bank:		
Forrest M. Smith	President, National Bank of Commerce of San Antonio, Tex.	1966
J. R. Thornton	Chairman of the Board and President, State Bank and Trust Company, San Marcos, Tex.	1966
Max A. Mandel	President, The Laredo National Bank, Laredo, Tex.	1967
James T. Denton, Jr.	President, Corpus Christi Bank & Trust, Corpus Christi, Tex.	1968
Appointed by Board of Governors:		
G. C. Hagelstein	President and General Manager, Union Stock Yards, San Antonio, Tex.	1966
Harold D. Herndon	Independent Oil Operator, San Antonio, Tex.	1967
Francis B. May	Chairman, Department of General Business, The University of Texas, Austin, Tex.	1968

District 12 — San Francisco

Class A:		
Carroll F. Byrd	Chairman of the Board and President, The First National Bank of Willows, Calif.	1966
Charles F. Frankland	Chairman of the Board and Chief Executive Officer, The Pacific National Bank of Seattle, Wash.	1967
Ralph V. Arnold	President, First National Bank and Trust Company, Ontario, Calif.	1968

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 12 — San Francisco — Cont.**

		Term expires Dec. 31
Class B:		
Joseph Rosenblatt	Honorary Chairman of the Board, The Eimco Corporation, Salt Lake City, Utah	1966
Marron Kendrick	President, Schlage Lock Company, San Francisco, Calif.	1967
Herbert D. Armstrong	Treasurer, Standard Oil Company of California, San Francisco, Calif.	1968
Class C:		
John D. Fredericks	Chairman of the Board and Chief Executive Officer, Pacific Clay Products, Los Angeles, Calif.	1966
Frederic S. Hirschler	Chairman of the Board and Chief Executive Officer, The Emporium Capwell Company, San Francisco, Calif.	1967
Bernard T. Rocca, Jr.	President, Pacific Vegetable Oil Corporation, San Francisco, Calif.	1968

Los Angeles Branch

Appointed by Federal Reserve Bank:		
Douglas Shively	President, Citizens State Bank of Santa Paula, Calif.	1966
Harry J. Volk	President, Union Bank, Los Angeles, Calif.	1966
Sherman Hazeltine	Chairman of the Board, Chief Executive Officer, First National Bank of Arizona, Phoenix, Ariz.	1967
Appointed by Board of Governors:		
S. Alfred Halgren	Vice President and Director, Carnation Company, Los Angeles, Calif.	1966
Arthur G. Coons	President Emeritus, Occidental College, Los Angeles, Calif.	1967

Portland Branch

Appointed by Federal Reserve Bank:		
E. M. Flohr	President, The First National Bank of Wallace, Idaho	1966
E. W. Firstenburg	Chairman of the Board and President, First Independent Bank, Vancouver, Wash.	1966
E. J. Kolar	Chairman of the Board and Chief Executive Officer, United States National Bank of Oregon, Portland, Ore.	1967

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

DIRECTORS—Cont. **District 12 — San Francisco — Cont.**

Portland Branch — Cont.

		Term expires Dec. 31
Appointed by Board of Governors:		
Robert F. Dwyer	Lumberman, Portland, Ore.	1966
Graham J. Barbey	President, Barbey Packing Corporation, Astoria, Ore.	1967

Salt Lake City Branch

		Term expires Dec. 31
Appointed by Federal Reserve Bank:		
Alan B. Blood	Executive Vice President, Barnes Banking Company, Kaysville, Utah	1966
Newell B. Dayton	Chairman of the Board, Tracy-Collins Bank & Trust Company, Salt Lake City, Utah	1966
William E. Irvin	President, The Idaho First National Bank, Boise, Idaho	1967
Appointed by Board of Governors:		
Peter E. Marble	Rancher, Deeth, Nev.	1966
Royden G. Derrick	President and General Manager, Western Steel Co., Salt Lake City, Utah	1967

Seattle Branch

		Term expires Dec. 31
Appointed by Federal Reserve Bank:		
M. F. Hastings	President, The First National Bank of Ferndale, Wash.	1966
Chas. H. Parks	Spokane and Eastern Advisory Board, Seattle-First National Bank, Spokane, Wash.	1966
Maxwell Carlson	President, The National Bank of Commerce of Seattle, Wash.	1967
Appointed by Board of Governors:		
Robert D. O'Brien	Chairman of the Board and Chief Executive Officer, Pacific Car and Foundry Company, Seattle, Wash.	1966
William McGregor	Vice President, McGregor Land and Livestock Company, Hooper, Wash.	1967

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

PRESIDENTS and VICE PRESIDENTS

Federal Reserve Bank or branch	President First Vice President	Vice Presidents	
Boston	George H. Ellis E. O. Latham	D. Harry Angney R. W. Eisenmenger Charles E. Turner Parker B. Willis	Ansgar R. Berge Luther M. Hoyle, Jr. G. Gordon Watts
New York	Alfred Hayes William F. Treiber	Harold A. Bilby John J. Clarke Felix T. Davis Alan R. Holmes Fred W. Piderit, Jr. T. M. Timlen, Jr.	William H. Braun, Jr. Charles A. Coombs Marcus A. Harris Robert G. Link Walter H. Rozell, Jr. Thomas O. Waage
Buffalo		Angus A. MacInnes, Jr.	
Philadelphia	Karl R. Bopp Robert N. Hilkert	Hugh Barrie Norman G. Dash David C. Melnicoff Harry W. Roeder Richard G. Wilgus	Joseph R. Campbell David P. Eastburn G. William Metz J. V. Vergari
Cleveland	W. Braddock Hickman Walter H. MacDonald	George E. Booth, Jr. Roger R. Clouse Elmer F. Fricek Harry W. Huning Maurice Mann	Paul Breidenbach Phillip B. Didham John J. Hoy Fred S. Kelly Clifford G. Miller
Cincinnati		Fred O. Kiel	
Pittsburgh		Clyde E. Harrell	
Richmond	Edward A. Wayne Aubrey N. Heflin	Robert P. Black W. S. Farmer John L. Nosker B. U. Ratchford Joseph F. Viverette	J. G. Dickerson, Jr. Upton S. Martin James Parthemos R. E. Sanders, Jr.
Baltimore		D. F. Hagner	
Charlotte		E. F. MacDonald	

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

PRESIDENTS and VICE PRESIDENTS—Cont.

Federal Reserve Bank or branch	President First Vice President	Vice Presidents	
Atlanta	Harold T. Patterson	Harry Brandt	J. E. McCorvey
	Monroe Kimbrel	Brown R. Rawlings	Richard A. Sanders
		R. M. Stephenson	Charles T. Taylor
Birmingham		Edward C. Rainey	
Jacksonville		Thomas A. Lanford	
Nashville		Robert E. Moody, Jr.	
New Orleans		Morgan L. Shaw	
Chicago	Charles J. Scanlon	Ernest T. Baughman	A. M. Gustavson
	Hugh J. Helmer	Paul C. Hodge	L. H. Jones
		Richard A. Moffatt	H. J. Newman
		Leland M. Ross	Harry S. Schultz
		Bruce L. Smyth	Jack P. Thompson
Detroit		Russel A. Swaney	
St. Louis	Darryl R. Francis	Leonall C. Andersen	Marvin L. Bennett
	Dale M. Lewis	Woodrow W. Gilmore	Homer Jones
		Stephen Koptis	Howard H. Weigel
		Joseph C. Wotawa	Orville O. Wyrick
Little Rock		John F. Breen	
Louisville		Donald L. Henry	
Memphis		John W. Menges	
Minneapolis	Hugh D. Galusha, Jr.	W. C. Bronner	F. J. Cramer
	M. H. Strothman, Jr.	Kyle K. Fossum	R. K. Grobel
		C. W. Groth	Howard L. Knous
		Franklin L. Parsons	
Helena		Clement A. Van Nice	
Kansas City	George H. Clay	Wilbur T. Billington	Raymond J. Doll
	John T. Boysen	J. R. Euans	Carl F. Griswold, Jr.
		M. L. Mothersead	George D. Royer, Jr.
		R. E. Thomas	Clarence W. Tow
Denver		John W. Snider	
Oklahoma City		Howard W. Pritz	
Omaha		George C. Rankin	

FEDERAL RESERVE BANKS and BRANCHES, Dec. 31, 1966—Cont.

PRESIDENTS and VICE PRESIDENTS—Cont.

Federal Reserve Bank or branch	President First Vice President	Vice Presidents	
Dallas	Watrous H. Irons Philip E. Coldwell	Roy E. Bohne Ralph T. Green James A. Parker W. M. Pritchett	James L. Cauthen G. R. Murff T. W. Plant Thomas R. Sullivan
El Paso		Fredric W. Reed	
Houston		J. Lee Cook	
San Antonio		Carl H. Moore	
San Francisco	Eliot J. Swan H. Edward Hemmings	J. L. Barbonchielli D. M. Davenport E. J. Martens W. F. Scott	J. Howard Craven Irwin L. Jennings A. B. Merritt
Los Angeles		P. W. Cavan	
Portland		William M. Brown	
Salt Lake City		Arthur L. Price	
Seattle		Erwin R. Barglebaugh	

CONFERENCE OF PRESIDENTS

The Presidents of the Federal Reserve Banks are organized into a Conference of Presidents that meets from time to time to consider matters of common interest and to consult with and advise the Board of Governors. Mr. Wayne, President of the Federal Reserve Bank of Richmond, and Mr. Swan, President of the Federal Reserve Bank of San Francisco, were elected Chairman of the Conference and Vice Chairman, respectively, in March 1966, and served in those capacities during the remainder of 1966.

Mr. W. T. Cunningham, Jr., of the Federal Reserve Bank of Richmond and Mr. Donald V. Masten of the Federal Reserve Bank of San Francisco were appointed Secretary of the Conference and Assistant Secretary, respectively, in March 1966, and served during the remainder of the year.

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