FEDERAL RESERVE
press release

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The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on May 23, 1967. Such records are made available approximately 90 days after the date of each meeting of the Committee and will be found in the Federal Reserve Bulletin and the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

May 23, 1967

1. Authority to effect transactions in System Account.

The latest reports on recent economic developments were somewhat less favorable than earlier. Nevertheless, staff projections continued to suggest some rise in real GNP in the second quarter and a more rapid advance in the third.

Retail sales data for February had been revised downward, and figures for March revealed that the expansion in sales then had been smaller than had been indicated by the earlier advance estimate. The Commerce Department's estimate of GNP for the first quarter had been reduced somewhat, as a downward revision in consumer expenditures on nondurable goods was only partly offset by upward revisions in defense outlays and net exports. The new estimates indicated that real GNP had declined slightly in the first quarter rather than remaining stable.

In April total retail sales were about unchanged, according to the advance estimate, although sales of new automobiles rose moderately. Industrial production declined slightly, and employment in manufacturing fell further. On the other hand, housing starts in April--while moderately below the first-quarter average--were sufficiently high to suggest that the large rise in starts usual in the spring season was likely to occur this year.

The rate of business inventory accumulation, which had declined sharply in February, fell slightly further in March and for the first quarter as a whole it was only one-third the extraordinarily high rate of the fourth quarter of 1966. Staff projections now suggested the possibility of small net inventory liquidation in the second quarter and some further decumulation in the third. While inventory adjustments were retarding industrial activity currently, by the third quarter their depressant influence was expected to be considerably reduced.

Final sales had expanded substantially in the first quarter, with increases in outlays by Federal, State, and local governments accounting for an unusually high proportion--about half--of the rise in the total. It appeared likely that expansion in final sales would remain substantial in the second and third quarters, with defense expenditures continuing to exceed earlier estimates, State and local government outlays expanding sharply further, and consumer expenditures rising somewhat faster than earlier in the year. Prospects continued to favor expansion in residential construction but little change in fixed capital outlays by business.

Despite upward pressures on unit labor costs in manufacturing, average industrial prices had been stable since early in the year. Recent sharp reductions in prices of farm products and foods had resulted in a decline in the total wholesale price index and an appreciable slowing in the rate of increase in average consumer prices. The earlier marked expansion in output of livestock products had begun to taper off, however, and by summer or autumn supplies of many livestock products were expected to return to about their levels of a year earlier. As a result, it seemed likely that average wholesale prices of farm products and foods would stabilize or rise soon, and that retail food prices would advance more than seasonally by summer.

The deficit in the U.S. balance of payments in the first quarter was officially estimated at $540 million on the "liquidity" basis, compared with $450 million in the fourth quarter of 1966. A substantial increase in the merchandise trade surplus was more than offset by the combination of an unusually large rise in outflows of private U.S. capital into foreign securities and the absence of official debt prepayments in the first quarter. Tentative estimates suggested that the rate of deficit increased in April.

The deficit on the "official reserve transactions" basis had been enlarged in recent months as a result of repayments by U.S. banks of earlier borrowings through their foreign branches. In the first quarter the official settlements deficit was estimated at a record $1.8 billion, compared with a level close to zero in the fourth quarter of 1966, and it apparently continued very large in April. These high deficits had a substantial counterpart in the improved position of sterling.

On May 4 the Bank of England reduced its discount rate for the third time in 1967, to 5-1/2 per cent, and on May 11 the German Federal Bank made the fourth such reduction, to 3 per cent. The National Bank of Belgium also had recently lowered its discount rate further.

In the recently completed Treasury refunding, \$3.4 billion of publicly held securities maturing in May and June and \$1.3 billion of securities maturing in August were exchanged for \$2.0 billion and \$2.7 billion, respectively, of the new 15-month and 5-year notes. The redemptions of May and June maturities for cash were somewhat larger than had been generally expected, but the volume of August maturities exchanged for the 5-year note also was greater than anticipated.

System open market operations since the preceding meeting of the Committee had been directed at maintaining an "even keel" in the money market during the Treasury financing. At member banks average free reserves were somewhat larger in the first 3 weeks of May than in April, and borrowings were moderately smaller. Federal funds traded in a narrow range around the 4 per cent discount rate, about the same as in April, while interest rates on most types of short-term market instruments moved lower. Demands for Treasury bills remained strong and the rate on 3-month bills declined 25 basis points further, to 3.50 per cent. On the other hand, major banks raised their offering rates on large-denomination CD's, particularly on those of longer maturity.

Yields on long-term securities continued to rise, under the influence of heavy current and prospective offerings of new issues and--despite some dampening of the earlier marked optimism--investor confidence that economic expansion would become more vigorous later in the year. Treasury, corporate, and municipal bond yields reached new highs for 1967, and some long-term rates were approaching the peaks recorded in the summer of 1966.

The decline in mortgage yields slowed in April despite continuing large inflows of funds to depositary-type institutions, and in early May there were scattered reports of slight rises in secondary-market yields on Federally underwritten mortgages on homes. Although interest rates on mortgages had fallen considerably since turning down in November 1966, they were still high relative to the level from which their advance had started in the summer of 1965.

At commercial banks growth in business loans had slowed markedly since the mid-April tax date. The volume of large-denomination CD's outstanding declined over the same period. As a result of further growth in other types of time and savings deposits, however, the total of such deposits was continuing to expand rapidly; new staff projections suggested that from April to May time and savings deposits would rise almost as fast as they had from March to April. As before, the projections for May allowed for a sharp decline in Government deposits and sizable increases in private demand deposits and the money supply. For total member bank deposits--the bank credit proxy--the range of expected growth in May had been narrowed somewhat, to an annual rate between 3 and 4 per cent. In June, the proxy was projected to rise at an annual rate in the 4 to 7 per cent range if money market conditions were unchanged. Growth in time and savings deposits was expected to be maintained at its recent pace. Further sharp declines in Government deposits and sharp increases in private demand deposits and the money supply were anticipated.

In the course of the Committee's discussion it was noted that, while prospects favored resumption of economic expansion later in the year, the current situation was characterized by various cross currents and uncertainties. The Committee concluded that under these circumstances it would be desirable to maintain prevailing conditions in the money market.

A considerable amount of concern was expressed in the discussion about the recent marked increases in long-term interest rates. Some members noted that further rises might result in slowing the expected economic upturn, especially in the housing sector. The Committee concluded, although some reservations on the matter were voiced, that a constructive influence might be exercised by more extensive resort to purchases of longer-term Government securities in meeting part of the needs for bank reserves that were expected to arise in the next several weeks. In particular, it was believed that some purchases of coupon issues, if and when feasible in the course of reserve-supplying operations in the coming period, could serve to lighten somewhat the market supplies of Government securities in the maturity ranges in which such supplies were the heaviest. It was also noted that this substitution of purchases of coupon issues for bill purchases could be important for balance of payments reasons, as a means of reducing downward pressures on bill rates. The Committee members made clear that such purchases of coupon issues should not be directed at maintaining any particular level or maturity pattern of interest rates.

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 suggest that renewed economic expansion later in the year is in prospect. Output is still being retarded by adjustments of excessive inventories, but growth in final demands, particularly Government, continues strong. Average wholesale prices have declined recently, but unit labor costs in manufacturing have risen further. Bank credit expansion has slowed in recent weeks from its earlier rapid rate. Long-term interest rates have continued to rise under the influence of heavy securities market financing, but short-term yields have declined further. Some further reductions have been made in foreign central bank discount rates. The balance of payments deficit has remained substantial despite some improvement in the foreign trade surplus. In this situation, it is the Federal Open Market Committee's policy to foster money and credit conditions, including bank credit growth, conducive to renewed economic expansion, while recognizing the need for progress toward reasonable equilibrium in the country's balance of payments.
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> To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing conditions in the money market, while utilizing operations in coupon issues in supplying part of reserve needs.

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

In dissenting from this action, Mr. Francis expressed the view that monetary policy had been highly stimulative thus far in 1967, that fiscal policy was providing an increasing stimulus, and that the economy was responding relatively quickly. On the grounds that a marked increase in demands for goods and services was likely later in the year and that monetary policy actions had their main effects after some time lag, he thought some firming in the money market should be sought now to guard against the development later of excessive demands and associated inflationary pressures.

2. Ratification of amendments to authorization for System foreign currency operations.

At this meeting the Committee ratified actions taken by the members on May 12, 1967, amending paragraphs 1A and 2 of the authorization for System foreign currency operations, effective May 17, 1967. The first of these paragraphs was amended to add Danish kroner, Norwegian kroner, and Mexican pesos to the list of foreign currencies in which System operations were authorized. The second paragraph was amended to expand the list of foreign banks with which reciprocal currency (swap) arrangements were authorized to include the National Bank of Denmark and the Bank of Norway, with each of which standby arrangements of $100 million equivalent were authorized, and the Bank of Mexico, with which a standby arrangement of $130 million equivalent was authorized. Maximum periods of 12 months were specified for all three new swap arrangements. With these amendments, the affected paragraphs read as follows:

1A. 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
Danish kroner
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Mexican pesos
Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

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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)	Maximum period of arrangement (months)
Austrian National Bank	100	12
National Bank of Belgium	150	12
Bank of Canada	500	12
National Bank of Denmark	100	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

Foreign bank	Amount of arrangement (millions of dollars equivalent)	Maximum period of arrangement (months)
Bank of Mexico	130	12
Netherlands Bank	150	3
Bank of Norway	100	12
Bank of Sweden	100	12
Swiss National Bank	200	6
Bank for International Settlements		
System drawings in Swiss francs	200	6
System drawings in authorized European currencies other than Swiss francs	200	6

Votes for ratification of these actions: Messrs. Martin, Brimmer, Daane, Francis, Maisel, Mitchell, Robertson, Scanlon, Sherrill, Swan, Wayne, and Treiber. Votes against ratification of these actions: None.

The Committee had considered the possibility of expanding the System's network of swap arrangements to include the central banks of Denmark, Norway, and Mexico at a number of recent meetings, and it had authorized the Special Manager of the System Open Market Account to hold discussions with officials of those central banks looking toward the negotiation of arrangements between their banks and the Federal Reserve. Committee members had approved the amendments to the authorization indicated above following receipt of advice from the Special Manager that the discussions had been satisfactorily completed.