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 July 18, 1967. Such records are made available approximately 90 days after the date of each meeting of the Committee and are also published in the monthly Federal Reserve Bulletin and in the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on July 18, 1967

1. Authority to effect transactions in System Account.

Real GNP rose modestly in the second quarter, according to preliminary Department of Commerce figures. Final expenditures expanded substantially further and the downdrag from inventory adjustments was considerably reduced. Staff projections continued to suggest that real GNP would grow at a faster rate in the third quarter, when it was expected that final sales would rise somewhat more rapidly and that the depressant influence of inventory adjustments would be reduced still more.

The private sector accounted for a much larger proportion of the expansion in final sales in the second quarter than in the first. Consumer spending contributed substantially to the expansion, with sales of automobiles especially strong. Residential construction activity increased significantly further but business outlays for fixed capital declined slightly. The rise in defense outlays was much smaller than in the first quarter, but State and local government purchases maintained their steady expansion.

Businesses accumulated inventories at a low rate in the second quarter, according to Commerce Department estimates, and the prospect appeared to be for some net liquidation in the third quarter. Industrial production again edged down in June. However, manufacturing employment advanced somewhat following 4 months of decline, and total nonfarm employment rose strongly. The unemployment rate increased to 4.0 per cent from 3.8 per cent in May, mainly because of an exceptionally large expansion in the labor force.

Prospects appeared favorable for another large increase in consumer spending in the third quarter, when rising employment was expected to result in a more rapid advance in wage incomes than in the spring quarter. Further gains in residential construction activity were suggested by a rise in building permits and a significant increase in lender mortgage commitments through May. Prospects for a modest advance in business spending for fixed capital were supported not only by the latest Commerce-SEC survey but also by recent increases in new orders for machinery and equipment. Little new information was available on prospective defense spending but the staff projection assumed that such spending would rise in the third quarter by about as much as it had in the second quarter.

The wholesale price index in June was officially estimated to have risen for the second consecutive month--reflecting a further increase in prices of farm products and foods. The average of industrial prices continued stable. In May the consumer price index rose again and was 2.7 per cent above a year earlier. Benefits provided in recently negotiated wage contracts suggested further upward pressure on unit labor costs in manufacturing in the months ahead.

Tentative estimates indicated that the balance of payments deficit on the "liquidity" basis of calculation was about as large in the second quarter as in the first, despite an increase in official foreign acquisitions of long-term deposits. An improvement in the trade surplus apparently was more than offset by a turn from inflow to outflow of U.S. short-term bank credit. The deficit on the "official reserve transactions" basis was much smaller in the second quarter than in the first, as repayments of borrowings by U.S. banks from their foreign branches tapered off. Abroad, economic activity remained sluggish in most industrial countries, but expansion continued in Italy and Japan.

System open market operations since the last meeting of the Committee had been directed toward maintaining about the same conditions in the money market as had prevailed during the preceding 4 weeks. A large volume of reserves was provided to meet seasonal needs, mainly through purchases of bills but partly through acquisitions of coupon securities.

Growth in nonborrowed reserves of member banks slowed further in June but total reserves increased moderately following the slight decline of May. Free reserves and member bank borrowings fluctuated over a wide range in the 4 weeks ending July 12, reflecting in large part seasonal patterns that regularly develop around the midyear bank statement date and the July 4 holiday. Free reserves averaged $295 million, little changed from the $285 million average of the preceding 4 weeks, and borrowings averaged about $165 million compared with about $70 million in the prior period. The Federal funds rate remained close to 4 per cent, and rates on bank loans to Government securities dealers also changed little.

Treasury bill rates rose sharply from late June to early July, and interest rates on other short-term market instruments also moved up generally, but less than did bill rates. The market rate on 3-month Treasury bills had reached a low for the year of 3.33 per cent on June 23; by July 5, the rate had advanced to a peak of 4.29 per cent. Subsequently the rate receded somewhat, but on the day before this meeting it was 4.17 per cent, almost 60 basis points higher than 4 weeks earlier. To some extent the rise reflected seasonal influences, but for the most part it was related to the large recent and prospective Treasury cash borrowing in the bill area.

Following an announcement on June 28, the Treasury auctioned $4 billion of March and April 1968 tax anticipation bills on July 5 at average issuing rates of 4.86 and 4.90 per cent, respectively, for payment July 11. The Treasury also indicated that it would raise an additional $2.2 billion of new money by adding $100 million to each of its regular weekly and monthly bill auctions. Virtually all of the tax anticipation bills, which carried 100 per cent tax-and-loan-account privileges, were acquired by commercial banks, and bank sales of the bills following the auction were relatively light. The Treasury was expected to announce in late July the terms on which it would refund coupon-bearing securities maturing in mid-August, of which the public held $3.6 billion.

A record volume of publicly offered corporate bonds and a continuing large volume of municipal bonds were issued in June, and the calendar of offerings for July and August was heavy. Yields on long-term securities generally rose further in the second half of June and early July and then declined. Before turning down, yields on intermediate- and long-term Treasury bonds had reached new highs for the year, while those on new corporate issues in some cases had exceeded their highs of August 1966. Yields on municipal issues also reached new 1967 highs and then tended to level off in the first half of July. To some extent the recent improvement in the tone of longer-term securities markets reflected both enhanced expectations of a tax increase and diminished expectations of a large further build-up of troops in Vietnam. Yields on Treasury bonds apparently also were influenced by the low volume of dealer inventories and by System purchases of coupon issues. In markets for common stocks, trading was heavy and there appeared to have been an increase in speculative activity.

In June contract rates on conventional first mortgages on homes edged up for the second consecutive month, and secondary market yields on Federally-underwritten home mortgages fose further. The inflow of savings to nonbank depositary-type institutions was maintained in record volume.

At commercial banks, credit demands were heavy during the tax and dividend period in June, and business loans increased sharply during the month. Banks liquidated sizable amounts of Treasury securities and increased their holdings of municipal securities at a less rapid rate than in other recent months.

Bank offering rates on negotiable CD's rose further in June and the outstanding volume of these deposits increased moderately. Inflows of other time and savings deposits continued large and total time and savings deposits increased about as fast as in earlier months of the year. The money supply rose at a 13 per cent annual rate, almost as sharply as it had in May. Government deposits at banks declined somewhat less than in May, and daily-average member bank deposits--the bank credit proxy--increased at an annual rate of almost 9 per cent. In the 6 months through June, time deposits had risen at an annual rate of 17 per cent; the money supply, almost 7 per cent; and the bank credit proxy, 12 per cent.

Banks were expected to reduce their holdings of the new tax bills in July, and repayments of business loans appeared likely to result in liquidation of some private deposits. Nevertheless, the latest staff projections suggested that total bank credit, as measured by the proxy series, would rise from June to July at an annual rate in the 13 to 15 per cent range and the money supply at a rate in the 5 to 7 per cent range if money market conditions were unchanged. Government deposits were expected to increase following the declines of May and June, and time and savings deposits were projected to grow nearly as rapidly as they had in June.

In August, business loans of banks were expected to increase relatively little on balance, as a result of repayment of the tax-related borrowings of late June and early July and continued small needs for financing inventories. On the assumption that the Treasury would not raise new cash until early September, the rate of bank credit expansion was expected to be considerably slower in August than in July. For the 2 months together, the bank credit proxy was projected to grow at an annual rate in the 10 to 12 per cent range.

In the course of the Committee's discussion considerable concern was expressed about the recent high rates of growth of bank credit and the money supply, particularly in view of the prospects for more rapid economic expansion later in the year. It was generally agreed, however, that the Treasury's forthcoming financing militated against seeking a change in money market conditions at present. Moreover, even apart from the Treasury financing, most members felt that it would be premature to seek firmer money market conditions at a time when resumption of expansion in over-all economic activity was in a fairly early stage; and some also referred in this connection to the growing expectations that the Administration would press for measures of fiscal restraint. In addition, some members expressed concern about the possibility that any significant further increases in market interest rates might reduce the flows of funds into mortgages and slow the recovery under way in residential construction activity.

The Committee concluded that it would be appropriate at present to maintain about the prevailing conditions in the money market, although the members agreed that operations should be modified, insofar as permitted by "even keel" considerations associated with the Treasury financing, if there was a tendency for bank credit and the money supply to expand more than currently expected. It was noted that the growth rates in bank credit and money currently expected rested on particular assumptions regarding the pattern of forthcoming Treasury financing activity and were subject to revision if the actual pattern differed from that assumed.

Prior to the vote on the full text of the current economic policy directive to be issued at this meeting, a preliminary vote was taken on the question of whether a reference to operations in coupon issues for supplying part of reserve needs, such as had appeared in the second paragraph of the directives issued on May 23 and June 20, 1967, should be included in today's directive.

> Votes for including such a reference: Messrs. Brimmer, Maisel, and Mitchell. Votes against: Messrs. Hayes, Robertson, Scanlon, Sherrill, Swan, Wayne, and Patterson.

The majority favored omitting the reference in question for a number of reasons, including the imminent Treasury refunding, the small volume of net reserve needs projected for the interval up to the next meeting of the Committee, the substantial decrease in the market availability of coupon issues, and the recently more settled conditions in longer-term securities markets. It was stressed by members of the majority that operations in coupon issues from time to time were a normal part of open market operations, and that omission of the reference to them from the directive did not preclude such operations under appropriate circumstances.

Members of the minority noted that the heavy calendar of prospective corporate issues could result in renewed upward pressures on long-term yields, with possibly adverse effects on mortgage markets. They expressed the view that recent operations in coupon issues had had some moderating effect on long-term rates by affecting both market supplies and expectations of market participants, and that such operations could continue to serve a constructive purpose in dealing selectively with capital market pressures. Mr. Maisel thought that there remained a broad demand for liquidity in the economy, and that helping to meet that demand by purchases of coupon issues represented an appropriate System portfolio policy.

Mr. Brimmer observed that appropriate circumstances for coupon operations might not arise in the coming period, and along with Messrs. Maisel and Mitchell he agreed that omission of the reference from the directive would not preclude them if the need arose. Nevertheless, these members felt that the reference should be retained in the present directive to clarify the Committee's intent.

The Committee then voted to issue the following current economic policy directive to the Federal Reserve Bank of New York:

The economic and financial developments reviewed at this meeting indicate that economic activity has been rising modestly and that prospects are for further expansion. Output is still being retarded by adjustments of excessive inventories, but growth in final demands continues strong, reflecting some strengthening in consumer expenditures for durable goods and housing, and also further increases in Government outlays. The over-all indexes of both wholesale and retail prices have risen further, although wholesale prices of industrial commodities have remained stable. Bank credit expansion has been large in recent weeks. Most short- and long-term interest rates, after reaching advanced levels under the influence of heavy public and private securities market financing, have declined somewhat recently. 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 continuing economic expansion, while recognizing the need for reasonable price stability for both domestic and balance of payments purposes.

To implement this policy, while taking account of forthcoming Treasury financing activity, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining about the prevailing conditions in the money market; but operations shall be modified insofar as the Treasury financing permits to moderate any apparent tendency for bank credit and money to expand more than currently expected.

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

2. Amendments to authorization for System foreign currency operations.

At this meeting the Committee ratified an action taken by members on June 29, 1967, effective June 30, 1967, amending paragraph 2 of the Committee's authorization for System foreign currency operations to change the maximum period authorized for the reciprocal currency (swap) arrangement with the Netherlands Bank from 3 to 6 months.

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

Subsequently in the course of the meeting the Committee amended paragraph 2 of the authorization in certain other respects. In the text of the paragraph the phrase "for periods up to a maximum of 12 months" was added following the direction to the Federal Reserve Bank of New York to maintain swap arrangements with indicated foreign banks; and the column in the table contained in the paragraph that specified a maximum maturity for each of the existing arrangements--12 months in 10 cases and 3 or 6 months in the others--was deleted. These changes, which were in line with the Committee's interest in moving toward 12-month maturities for swap arrangements where agreeable with the foreign bank concerned, eliminated the necessity for amending the authorization each time the maturity of an arrangement was changed.

In addition, the paragraph was amended to reflect approval of increases (a) from $200 million to $250 million in the swap arrangement with the Swiss National Bank, (b) from $200 million to $250 million in the arrangement with the Bank for International Settlements covering System drawings in Swiss francs, and (c) from

$200 million to $300 million in the arrangement with the Bank for International Settlements covering System drawings in authorized European currencies other than Swiss francs. These increases were considered desirable to provide broader margins of safety to deal with unforeseeable contingencies.

Votes for these actions: Messrs. Hayes, Brimmer, Maisel, Mitchell, Robertson, Scanlon, Sherrill, Swan, Wayne, and Patterson. Votes against these actions: None.

Reflecting these amendments, paragraph 2 of the authorization for System foreign currency operations 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 for periods up to a maximum of 12 months 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)
Austrian National Bank	100
National Bank of Belgium	150
Bank of Canada	500
National Bank of Denmark	100
Bank of England	1,350
Bank of France	100
German Federal Bank	400
Bank of Italy	600
Bank of Japan	450
Bank of Mexico	130
Netherlands Bank	150
Bank of Norway	100
Bank of Sweden	100
Swiss National Bank	250
Bank for International Settlements	
System drawings in Swiss francs	250
System drawings in authorized European currencies other than Swiss francs	300