FEDERAL RESERVE
press release

For immediate release April 8, 1968

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on January 9, 1968. Such records are made available approximately 90 days after the date of each meeting of the Committee and will be found in the Federal Reserve Bulletin and the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on January 9, 1968

1. Authority to effect transactions in System Account.

Economic activity was expanding vigorously as 1967 drew to a close, and prospects were for further rapid growth in early 1968. Prices were rising at a substantial rate; and with demands strong and costs increasing, inflationary pressures were expected to persist in the period ahead.

Industrial production was tentatively estimated to have increased sharply further in December to a level above the peak of a year earlier. Nonfarm employment also continued to expand rapidly; in December nearly 1 million more persons were employed than in August, before the strike in the automobile industry. The unemployment rate, which in November had declined to 3.9 per cent, fell in December to 3.7 per cent, the same as a year earlier. Housing starts rose further in November, but part of the increase may have reflected an acceleration of schedules by some builders, in reaction to increasing uncertainties about future mortgage market conditions.

Average prices of industrial commodities continued to rise in December, according to preliminary estimates. Since midyear, such prices had advanced at an annual rate of about 3 per cent. Moreover, wholesale prices of farm products, which had been declining earlier, turned up in December--raising the possibility that advances in retail prices of food might resume. The consumer price index increased considerably further in November despite a slight decline in food prices.

Real gross national product in 1967 as a whole was estimated to have been about 2.5 per cent greater than in 1966. Growth was at a considerably higher rate in the second half of the year, however, and further acceleration appeared likely in early 1968. Recent surveys indicating that consumers were cautious in their attitudes and buying intentions suggested that personal saving would continue in the first quarter at the unusually high rate prevailing throughout 1967. Nevertheless, in view of the prospect for a large rise in incomes, a substantial increase in consumer expenditures was anticipated. Business spending on plant and equipment was expected to expand sharply, and the rate of inventory accumulation--which now appeared to have advanced more in the fourth quarter than had been estimated earlier--was expected to continue rising. Some further increase in outlays for residential construction appeared probable, in light of the upward course of housing starts through November and advances in construction costs. On the other hand, defense outlays--growth in which had slackened in the second half of 1967--were expected to level off.

The U.S. balance of payments worsened sharply in the fourth quarter of 1967. On the "liquidity" basis of calculation the deficit increased markedly from the third quarter, and on the "official reserve transactions" basis the balance shifted to a large deficit from a surplus in the preceding quarter.[1/] For the year as a whole,

---

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 (sometimes referred to as the "official settlements" 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 ordinary capital flows.

the deficit on the liquidity basis was estimated at about $3.7 billion, compared with $1.4 billion in 1966; and the official settlements balance was in deficit by an estimated $3.4 billion, compared with a small surplus in 1966. Although detailed information on fourth-quarter payments was not yet available, it appeared that much of the deterioration was attributable to a reduction in the surplus on merchandise trade; in the October-November period exports declined and imports rose from their third-quarter rates. Special transactions--including the liquidation of official British holdings of U.S. securities--also contributed to the deficit on both bases in the fourth quarter. For 1967 as a whole, the liquidity deficit was substantially reduced by the net effect of special transactions.

On January 1, 1968, the President announced a new program which was, in his words, "designed to bring our balance of payments to--or close to--equilibrium in the year ahead." After stressing the need for a tax increase and other actions to "help stem the inflationary pressures which now threaten our economic prosperity and our trade surplus," the President outlined elements of a program through which an improvement of about $3 billion in the U.S. payments balance would be sought in 1968. The most important of these were a mandatory reduction in the flow of U.S. funds into direct investments abroad, particularly to continental Western Europe, and increased restrictions, under the Federal Reserve's foreign credit restraint program, on lending abroad by U.S. financial institutions. The program also included reduction of expenditures by American citizens for travel outside the Western Hemisphere, curtailment of Government expenditures overseas, and a variety of measures to increase U.S. exports and the trade surplus.

Gold holdings of the U.S. Treasury were reduced in December by the record monthly amount of about $900 million, mainly as a result of settlement of the U.S. share of sales made by the gold pool in London in November and December. Following the President's announcement of the new balance of payments program, foreign purchases of gold slackened abruptly. In foreign exchange markets the dollar strengthened against all continental European currencies, and the position of sterling improved somewhat.

System open market operations since the preceding meeting of the Committee had been directed at fostering slightly firmer conditions in the money market. An announcement by the Board of Governors on December 27 of an increase in reserve requirements against demand deposits, effective in mid-January, reinforced the belief of market participants that the System was moving toward greater monetary restraint.[2/] The Federal funds rate, which earlier had fluctuated around the 4-1/2 per cent discount rate established on November 20, increased somewhat to a range around 4-5/8 per cent. Average free reserves of member banks were estimated to have declined to about $80 million in the three statement weeks ending January 3, from slightly over $200 million in the first 2 weeks of December.

2/ Reserve requirements against demand deposits in excess of $5 million at each member bank were increased from 16-1/2 to 17 per cent for reserve city banks, effective with the reserve computation period beginning Jan. 11, 1968; and from 12 to 12-1/2 per cent for other member banks, effective with the computation period beginning Jan. 18, 1968.

Most short-term interest rates rose somewhat further in the latter half of December as money market conditions firmed, but longer-term yields remained stable or edged down. Various factors contributed to an improvement in the atmosphere in capital markets in this period; these included a seasonal lull in new private security issues, the absence of Treasury financing activity, and an apparent shift in investor expectations toward the view that longer-term rates were not likely to rise much further.

Both short- and long-term market interest rates declined following the announcement on January 1 of the new balance of payments program--which many investors interpreted as reducing the likelihood of greater monetary restraint in the near term--and the downtrend was reinforced by press reports suggesting that prospects for peace negotiations in Vietnam had improved. As a result, yields on new corporate bonds and on Treasury notes, bonds, and longer-term bills were now considerably below their levels at the time of the Committee's preceding meeting, and yields on municipal bonds were slightly lower. Most short-term yields, however, were higher on balance; the market rate on 3-month Treasury bills, at 5.02 per cent on the day before this meeting, was 12 basis points above its level 4 weeks earlier.

Interest rates on new-home mortgages rose further in November and apparently remained under upward pressure in December. Net inflows of funds to nonbank depositary institutions continued to moderate in late 1967, although the available information did not suggest that depositary institutions in general were facing substantial drains around the year-end interest- and dividend-crediting period. With inflows slackening, and with high yields on marketable bonds offering an attractive alternative form of investment, lenders in the aggregate were expanding their new mortgage commitments at a slower pace than they had earlier.

Growth in time and savings deposits at commercial banks also had continued to moderate recently. Such deposits expanded at an annual rate of 8.5 per cent in December--compared with rates of about 12 per cent in November and about 16 per cent over the year 1967. The moderation of growth was a result of substantial run-offs of large-denomination CD's and further slowing of the rise in other time and savings deposits. Private demand deposits declined slightly on average in December, and the money supply increased relatively little. With Government deposits contracting, the "bank credit proxy"--total member bank deposits[3/]--was about unchanged. Banks reduced their borrowings of Euro-dollars through foreign branches in December, with much of the decline apparently seasonal in nature.

3/ In recent years the Committee had been making 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. Because 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 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 member bank deposit series and the bank credit statistics are given in the note on p. 1460 of the October 1966 Bulletin.

Over the year 1967 the money supply and the bank credit proxy increased by about 6.5 and 11.5 per cent, respectively. As measured by end-of-month data on loans and investments, bank credit was estimated to have increased by about 11 per cent in 1967.

Business loans at commercial banks, which had been rising at a relatively slow pace in recent months, expanded sharply in December. Part of the acceleration reflected special factors, but part appeared to be related to the increasing pace of economic activity and to the smaller volume of capital market financing. With growth in their deposits limited, banks accommodated the larger demand for loans by selling a substantial volume of Government securities. Banks also reduced the rate at which they acquired State and local government issues.

On the day of this meeting the Treasury was offering $2.5 billion of tax-anticipation bills, for payment on January 15. Banks were expected to be the initial purchasers of practically all of the offering, for which they were permitted to make full payment by crediting Treasury tax and loan accounts. Largely as a consequence of such purchases, bank credit expansion was expected to resume in January; the proxy series was projected to rise at an annual rate in the range of 6 to 10 per cent if prevailing money market conditions were maintained. It appeared likely that growth in business loans would be slower than in December but still fairly rapid, and there was some prospect that in meeting loan demands banks would continue to limit their takings of municipal securities. Growth in time and savings deposits was expected to continue moderating in light of the high yields available to investors on competing market instruments. Little or no increase was anticipated in private demand deposits and the money supply, but Government deposits were projected to rise substantially.

Concern was expressed in the Committee's discussion about the inflationary environment and outlook, on both domestic grounds and in light of the recent contraction in the surplus on U.S. merchandise trade. The new balance of payments program was expected to result in a substantial reduction in the over-all deficit in 1968. It was observed, however, that the various elements of the program directed at improving the balance on specific types of international flows did not obviate the fundamental need for slowing the rise in domestic prices.

It was noted in the discussion that since mid-November the System had employed all three of the major instruments of monetary policy--discount rates, open market operations, and reserve requirements--in shifting toward a posture of somewhat greater restraint, that the effects of these policy actions were still unfolding, and that growth in bank credit and the money supply had slowed appreciably in recent months. It also was noted that forthcoming Presidential messages and further congressional hearings on an income tax surcharge would soon be providing new information on planned Federal expenditures and the prospects for a tax increase. Accordingly, the Committee decided to make no further change in policy at present. Reinforcing this decision was the possibility that higher interest rates resulting from a further firming of monetary policy at this time might have undesired effects on flows of funds to financial intermediaries.

The Committee agreed that it would be appropriate to maintain the somewhat firmer conditions in the money market that had developed as a result of recent System open market operations and the announced action with respect to reserve requirements. Some members noted in this connection that a slightly lower average level of marginal reserves might be required after the effective dates of the increase in reserve requirements in order to maintain prevailing money market conditions in other respects. The Committee also agreed that operations should be modified as needed to moderate any apparently significant deviations of bank credit from current expectations. The following current economic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting indicates that over-all economic activity has been expanding vigorously, with both industrial and consumer prices continuing to rise at a substantial rate, and that prospects are for further rapid growth and persisting inflationary pressures in the period ahead. The imbalance in U.S. international transactions worsened further in late 1967, but the new program announced by the President should result in a considerable reduction in the deficit this year. Following announcement of the program, foreign purchases of gold slackened abruptly and the dollar strengthened in foreign exchange markets.

Long-term bond yields have declined in recent weeks but some short-term interest rates have risen further. Bank credit has changed little on balance recently as banks have disposed of Government securities to accommodate strengthened loan demands. Growth in the money supply has slackened and flows into time and savings accounts at bank and nonbank financial intermediaries have continued to moderate. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures and progress toward reasonable equilibrium in the country's balance of payments.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the somewhat firmer conditions that have developed in the money market in recent weeks, partly as a result of the increase in reserve requirements announced to become effective in mid-January; provided, however, that operations shall be modified as needed to moderate any apparently significant deviations of bank credit from current expectations.

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

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

At this meeting the Committee ratified the action taken by members on December 14, 1967, amending paragraph 2 of the authorization for System foreign currency operations to change (1) the size of the swap arrangement with the Bank for International Settlements providing for System drawings in Swiss francs, and (2) the size of the arrangement with the Swiss National Bank, each from $250 million to $400 million equivalent, effective immediately. As indicated in the policy record for the meeting held on December 12, 1967, these increases supplemented the enlargements of the System's swap network that had been approved on November 27 and November 30.

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

Absent at this point in meeting and not voting: Messrs. Martin, Robertson, and Daane.