FEDERAL RESERVE

press release

For immediate release August 26, 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 May 28, 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 May 28, 1968

1. Authority to effect transactions in System Account.

Reports at this meeting indicated that over-all economic activity was continuing to advance rapidly and that inflationary pressures were persisting. It appeared likely that growth in real GNP in the second quarter would again be large. Beyond midyear, economic prospects depended in large part on the outcome of pending fiscal legislation, which provided for a 10 per cent surtax on individual and corporate incomes and for a $6 billion reduction from the Budget estimate in Federal expenditures for the fiscal year 1969. Such legislation, if enacted, was expected to contribute to a marked slowing of the pace of expansion in aggregate output and to a gradual lessening of inflationary pressures.

Estimates for the second quarter included a further sizable rise in consumer spending, although not so large as the extraordinary advance of the first quarter. Defense expenditures were expected to continue to increase at a substantial rate. A sharp rise in housing starts in April, although it reflected temporary influences in large part, now suggested a moderate increase in outlays for residential construction in the second quarter. It appeared that business outlays for fixed capital would change relatively little; but inventory accumulation, which had been at a very low rate in the first quarter, was expected to increase considerably.

In April nonfarm employment rose moderately further, and the unemployment rate again edged down, to 3.5 per cent from 3.6 per cent in March. The industrial production index was unchanged from a March level that had been revised upward. Retail sales were advancing in early May, following a decline in April that was attributable largely to widespread civil disorders.

Gold and foreign exchange markets had been unsettled in recent weeks; important contributing influences included shifts in prospects for fiscal action in the United States and political uncertainties in France. The price of gold in the private London market had risen sharply after mid-May from around $39.50 per ounce to a new high of $42.60 on May 21, but subsequently declined somewhat. The Treasury gold stock recently had been reduced further, as a number of small central banks had purchased gold from the United States. Sterling was under renewed pressure in foreign exchange markets, and quotations for the French franc were nominal in most markets as a result of the general strike and the closing of French banks.

With respect to the U.S. balance of payments, the deficit on the official settlements basis was reduced in April and May by an accelerated rise in liabilities of domestic banks to their branches abroad. Movements out of sterling and French francs had contributed significantly to the availability of funds in the Euro-dollar market. U.S. exports of goods expanded sharply in

April from the substantially reduced March level while imports increased slightly. For March and April together, however, the merchandise trade surplus was quite small.

In early May the Treasury marketed two new 6 per cent notes having maturities of 15 months and of 7 years for payment on May 15. The shorter-term note was offered for cash and attracted subscriptions mainly from commercial banks, which were allowed to make payment by credit to Treasury tax and loan accounts. The 7-year note was offered in exchange for securities maturing in mid-May, of which $3.9 billion were held by the public. After allowing for attrition of $1.3 billion in the exchange offering, the Treasury raised about $2.1 billion of new cash in these financings.

Interest rates had risen substantially on balance in all maturity areas since the preceding meeting of the Committee. Yield increases were especially pronounced after the mid-May announcement that there would be a further delay in congressional consideration of the pending fiscal legislation. Other influences included the tightening of monetary policy associated with the mid-April increase in the discount rate and the continuing large volume of new offerings in the corporate and municipal bond markets. During the week immediately preceding this meeting, some short-term market rates, particularly on Treasury bills, had declined from their peaks as renewed optimism concerning prospects for enactment of fiscal legislation emerged. The market rate on 3-month Treasury bills, at 5.67 per cent on the day before this meeting, was down 25 basis points from its May 21 high but was still 19 basis points above its level of 4 weeks earlier.

During April interest rates on residential mortgages had risen substantially and yields on both conventional new-home mortgages and on FHA-insured mortgages trading in the secondary market were at postwar highs. Early in May, as permitted by new legislation, maximum contract interest rates on Federally underwritten home mortgages were increased to 6-3/4 per cent. Net inflows of funds to nonbank depositary institutions had weakened considerably further in April from the reduced inflow of the first quarter.

System open market operations since the preceding meeting of the Committee had been directed at maintaining firm conditions in the money market while countering persistent tendencies toward excessive tightness. In view of the advanced level of market rates, System repurchase agreements were made at an interest rate of 5-3/4 per cent, one-quarter of a percentage point above the discount rate. The effective rate on Federal funds moved up further to a range around 6-1/8 to 6-3/8 per cent, compared with a range around 6 per cent in the latter part of April. Bank rates on new loans to Government securities dealers also advanced sharply. Member bank borrowings averaged $720 million and net borrowed reserves $380 million in the 4 weeks ending May 22, compared with averages of $690 million and $340 million, respectively, in April.

Commercial bank credit, as measured by the bank credit proxy--daily-average member bank deposits--was estimated to have increased only a little in May following a small decline in April. Business loans, after a sharp rise in early April, had changed relatively little through early May while banks had continued to reduce their holdings of U.S. Government securities. The further advance in market interest rates acted to limit growth in commercial bank time and savings deposits, and in May, as in April, such deposits increased very little. Rates on large-denomination CD's generally moved up to the new Regulation Q ceilings, but the volume of outstanding CD's was little changed over the month. Rates on Euro-dollar deposits rose sharply as U.S. banks built up their Euro-dollar liabilities. The money supply continued to grow rapidly in May; private demand deposits expanded substantially as U.S. Government deposits declined.

The bank credit proxy was now projected to decline in June at an annual rate in the range of 1 to 4 per cent if prevailing money market conditions were maintained. Business demand for bank loans was expected to be strong in June, partly to finance tax payments. The money supply and private demand deposits were projected to increase at about the rapid April-May rate, and U.S. Government deposits were projected to decline sharply, assuming no large cash financing. Total time and savings deposits were anticipated to show virtually no growth and possibly to decline, as relatively high market interest rates were expected to continue to curtail growth in consumer-type time and savings deposits and to result in a sizable decline in outstanding CD's for which scheduled maturities were large in June.

The Committee agreed that a restrictive monetary policy was appropriate in view of the strength of domestic demands and persisting inflationary pressures, as well as of the deterioration in the U.S. foreign trade balance that was contributing to continuation of an unsatisfactory over-all payments position. At the same time, however, there was general agreement that a number of considerations militated against any additional tightening at present. An important consideration was the possibility that in the near future Congress would enact the pending fiscal-restraint legislation. Furthermore, a considerable degree of monetary restraint had already been achieved; the banking system was being subjected to increasing liquidity pressures; over-all expansion of bank credit appeared to have halted in April and May; and market rates of interest had advanced sharply to levels that could give rise to a substantial amount of disintermediation.

The Committee concluded that open market operations should be directed at maintaining about the prevailing firm conditions in the money market, but that operations should be modified if bank credit appeared to be deviating significantly from current projections or if unusual pressures should develop in financial markets. The following current economic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting indicates that the very rapid increase in over-all economic activity is being accompanied by persisting inflationary pressures. There has been little or no growth on average in bank credit and time and savings deposits over the past 2 months, although the money supply has expanded considerably as U.S. Government deposits have declined. In recent weeks both short- and long-term interest rates have risen sharply on balance from their earlier advanced levels, partly in reaction to shifting expectations with regard to the likelihood of fiscal restraint. There has been some revival of speculative activity in the private gold market and in foreign exchange markets. The U.S. foreign trade balance and over-all payments position continue to be a matter of serious concern. In this situation, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resistance of inflationary pressures and attainment of reasonable equilibrium in the country's balance of payments, while taking account of the potential for severe pressures in financial markets if fiscal restraint is not forthcoming.
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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 firm conditions in the money market; provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current projections or if unusual pressures should develop in financial markets.

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

2. Authority to purchase and sell foreign currencies.

The Committee amended paragraph 1B(3) of the authorization for System foreign currency operations to increase, from $250 million to $300 million, the limit on authorized System Account holdings of sterling purchased on a covered or guaranteed basis.

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

At its previous meeting the Committee had increased the limit in question from $200 million to $250 million. That action had been taken on grounds that it would be helpful in connection with discussions of specific arrangements, including a drawing by Britain on its $1.4 billion standby facility with the International Monetary Fund, for repayment by the Bank of England of outstanding drawings under its swap line with the Federal Reserve; and it had been understood that initial use of the enlarged authority would be subject to the approval of Chairman Martin in light of developments in those discussions. Today's action was taken on similar grounds and subject to the same understanding.

The Committee also amended paragraph 4 of the foreign currency directive, by adding the words "and to facilitate operations of the Stabilization Fund" to clause (iv). With this amendment, paragraph 4 of the directive read as follows:

> 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, and to facilitate operations of the Stabilization Fund; (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.

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

On November 14, 1967, at a time when an increase in System Account and Stabilization Fund holdings of sterling was under consideration, the Committee had amended paragraph 1C(1) of the authorization for System foreign currency operations to enable the System Account to "warehouse" part of the Stabilization Fund's holdings of sterling if the Fund's resources should prove inadequate to meet all demands upon them from time to time in the future. Since such "warehousing" operations--none of which had been undertaken to date--would involve forward transactions, the Committee concluded that it was desirable to make a conforming change in the list of purposes, given in paragraph 4 of the foreign currency directive, for which forward transactions were authorized.