Increases in Discount Rates of the Federal Reserve Bank of New York and the Federal Reserve Bank of Chicago and Increases in Maximum Interest Rates on Time Deposits under Regulation Q

The following statement was released by the Board of Governors of the Federal Reserve System on December 6, 1965:

The Federal Reserve announced today two complementary actions to reinforce efforts to maintain price stability, and thus to foster balance in the economy's continued growth and strength in the dollar's international standing.

The actions, intended not to cut back on the present pace of credit flows but to dampen mounting demands on banks for still further credit extensions that might add to inflationary pressures, were as follows:

1. The Board of Governors in Washington approved actions by the directors of the Federal Reserve Banks of New York and Chicago increasing the discount rates of those banks from 4 to 4½ per cent, effective December 6, 1965. The discount rate is the interest rate charged member banks for borrowing from their District Reserve Banks.

2. Simultaneously, the Board increased the maximum rates that member banks are permitted to pay their depositors to 5½ per cent on all time deposits and certificates of deposit having a maturity of 30 days or more. This change is also effective Monday, December 6. Previously, the maximum rates payable were 4 per cent for time deposits and certificates of 30 to 89 days, and 4½ per cent on those of 90 days or more. No change was made in the rate payable on savings deposits (4 per cent).

The increase in the rates that member banks are permitted to pay their depositors is intended to enable the banks to attract and retain deposits of businesses and individuals and thus to make more effective use of savings funds already available in the economy to finance their loan expansion.

The increase in discount rates is intended to moderate additional bank reliance on short-term borrowings from the Federal Reserve to meet intensifying loan demands.

The action contemplates, however, the continued provision of additional reserves to the banking system, in amounts sufficient to meet seasonal pressures as well as the credit needs of an expanding economy without promoting inflationary excesses, primarily through the Federal Reserve's day-in and day-out purchases of Government securities in the open market.

The changes in discount rates and the maximum rates that banks may pay depositors were the first in either respect since November 24, 1964.

Since then, total borrowing by consumers, business, and state and local governments has risen sharply, and interest rates at all maturities from the shortest to the longest have been rising under demand pressures. In these circumstances, the Federal Reserve would be forced to increase bank reserves at an accelerated pace if all demands for borrowing money at present rates were to be satisfied.

With slack in manpower and productive capacity now reduced to narrow proportions, with the economy closer to full potential than at any time in nearly a decade, and with military demands on output and manpower increasing, it was felt that excessive additions to money and credit availabilities in an effort to hold present levels of interest rates would spill over into further price increases in goods and services. Such price rises would endanger the sustainable nature of the present business expansion. Moreover, increases in costs and prices would make it more difficult for American goods to compete in markets at home and abroad.

In addition, a pattern of interest rates that is accepted by borrowers and lenders as fully reflecting market forces should add assurance of a smooth flow of funds to all sectors of the economy. Discount rate increases in 1963 and 1964 did not stop business or credit growth, but helped to keep the economy within an expansion that was sustainable.

In sum, the actions taken should have the three-pronged impact of:

1. Backing up the Government's efforts to prevent inflationary excesses from damaging an economy now carrying the added burden of military operations in Vietnam;

2. Bolstering the Government's programs to overcome the persistent deficit in the United States balance of payments; and

3. Demonstrating anew United States determination to maintain the international strength of the dollar.

Governors Robertson, Mitchell, and Maisel dissented from the discount rate action on the ground that it was at least premature in the absence of more compelling evidence of inflationary dangers. Governor Robertson also dissented from the action to increase the maximum rates on time deposits.