FEDERAL RESERVE

press release

For immediate release August 24, 1970

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 26, 1970. 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 26, 1970

Authority to effect transactions in System Account.

Revised Commerce Department estimates indicated that real GNP had declined in the first quarter of 1970 at an annual rate of 3.0 per cent, rather than at the 1.6 per cent rate estimated earlier. Staff projections still suggested that real GNP would remain about unchanged in the second quarter, and that it would begin to grow again in the second half of the year. Prices and costs were generally continuing to rise at a rapid pace, but recently there had been some indications of moderating tendencies. Common stock prices had dropped sharply and continuously since early April, with the composite index of stocks listed on the New York Exchange down about one-fourth over that interval.

In April industrial production declined by about as much as it had risen in March and was approximately 2.5 per cent below its July 1969 peak. Employment in manufacturing was down substantially from March. Total nonfarm payroll employment also declined, in part because of strikes, and the over-all unemployment rate rose to 4.8 from 4.4 per cent in March. Private housing starts fell substantially after 2 months of strong advance. Retail sales increased in April, according to preliminary estimates, and weekly figures suggested that sales in early May were holding at about the April level.

Average wholesale prices were now estimated to have remained unchanged from mid-March to mid-April, as a sharp decline in prices of farm products and foods offset a further advance in prices of industrial commodities. The consumer price index rose considerably further in April.

The downward revision in the official GNP figures for the first quarter was attributable mainly to new information indicating that business inventory investment had declined more than previously estimated. As before, the staff projections suggested that inventory investment would fall only a little further in the second quarter, and that it would rise somewhat over the second half of the year--contributing to the resumption of growth in real GNP anticipated then. It was still expected that consumer spending would be sustained by the second-quarter increases in Federal pay and social security benefits and by the elimination at midyear of the income tax surcharge; also that residential construction outlays would turn up in the second half. However, it now appeared probable that the growth in business spending on new plant and equipment would taper off somewhat more over the course of the year than had been anticipated earlier. Largely for this reason, the staff projection of the rise in real GNP in the second half had been reduced somewhat.

The surplus on U.S. merchandise trade, which had improved somewhat in the first quarter, continued in April at about the first-quarter rate. According to tentative estimates, the over-all balance of payments remained in considerable deficit in April and early May.

In foreign exchange markets demands for most major foreign currencies had continued strong in recent weeks. Demands for the Canadian dollar, which were particularly heavy, moderated only briefly after the Bank of Canada reduced its discount rate from 8 to 7-1/2 per cent on May 12; and rumors of a possible upward adjustment in the exchange rate for that currency began to circulate.

Conditions in domestic financial markets had remained highly unsettled in recent weeks amid mounting concern about a possible liquidity crisis. Interest rates on long-term Treasury, corporate, and municipal securities had risen further to new record highs, in part because of a continuing heavy volume of offerings in capital markets and perhaps some increase in liquidity preferences. In short-term markets, rates on Treasury bills had fluctuated over a relatively wide range since early May but had changed little on balance; the 3-month bill rate, at about 7 per cent on the day before this meeting, was 10 basis points above its level of 3 weeks earlier. Attitudes in financial markets generally were being influenced by uncertainties arising from U.S. military operations in Cambodia and their domestic aftermath, including new uncertainties about the prospects for the Government's anti-inflationary program.

In late April and early May, when it appeared that the disturbed conditions in securities markets were jeopardizing the Treasury's May financing, the System supplied reserves through open market operations more readily than it might otherwise have done. The outcome of the two-part financing remained in doubt until the financing had been completed. As it turned out, subscriptions to the cash offering of 18-month notes--for which books were open May 5, the day of the preceding meeting of the Committee--totaled only slightly more than the $3.5 billion offered. Consequently, these subscriptions were allotted in full, in contrast to the usual partial allotments. However, in the exchange offering--in which holders of securities maturing in mid-May were offered notes of May 1973 or of February 1977--redemptions for cash were much smaller than had been expected. As a result, in the financing as a whole the Treasury raised about $2 billion of new money, considerably more than it had anticipated. For the exchange offering, subscription books were open on May 4-6; and for both parts of the financing, the settlement date was May 15.

System open market operations since the May 5 meeting had been conditioned by "even keel" considerations during the final stages of the financing and, more generally, by the desirability of calming market unsettlement. Operations also were influenced by the fact that in May both the money stock and bank credit appeared to be running significantly above levels consistent with the Committee's target growth rates for the second quarter. However, in view of the very sensitive state of the securities markets, no effort was made to attain the degree of firmness in money market conditions that might have been required to restore the monetary aggregates to the targeted growth path. Since the May 5 meeting the Federal funds rate had fluctuated mostly in a range of 7-7/8 to 8-1/8 per cent, compared with a range of 8 to 8-1/2 per cent in late April and early May. Member bank borrowings averaged about $920 million in the 3 weeks ending May 20, a little below the $960 million average of the preceding 3 weeks.

Both the money stock and the bank credit proxy--daily-average member bank deposits--increased substantially from March to April. The money stock expanded at an annual rate now estimated at about 10.5 per cent; the proxy series, after adjustment for some reduction in banks' use of funds from nondeposit sources, grew at a rate of about 13.5 per cent. According to tentative estimates for May, the money stock was rising considerably more on the average than had been expected earlier, and the adjusted bank credit proxy was declining much less than had been anticipated.

Staff analysis suggested that if prevailing money market conditions were maintained the money stock would increase slightly further from May to June and the adjusted bank credit proxy would rise more rapidly, although not so fast as in the previous month. The analysis implied that, if these expectations were realized and if current estimates for May were correct, both aggregates would increase at annual rates of about 7 per cent over the second quarter.[1/] It appeared that somewhat firmer money market conditions than those currently prevailing would be required if the second-quarter growth rates of about 4 per cent--which the Committee earlier had concluded would be appropriate to the underlying economic situation--were to be attained. Looking forward to the third quarter, the analysis suggested that a 4 per cent growth rate in the money stock probably would be associated with more rapid growth in the adjusted proxy series--perhaps at a 7 per cent rate--partly because the Treasury was expected to raise a large volume of new money in July and August.

In its discussion of open market policy, the Committee considered the implications both of the uncertainties and the strains that were unsettling financial markets at present and of the underlying economic situation and outlook. The members agreed that moderate growth in money and bank credit remained the appropriate longer-run objective of policy. They concluded, however, that it was necessary at present to give priority to the objective of moderating pressures on financial markets, recognizing that that might temporarily entail higher growth rates in the monetary aggregates than were considered appropriate for the longer run.

1/ Calculated on the basis of the daily-average level in the last month of the quarter relative to that in the last month of the preceding quarter.

The following current economic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting indicates that real economic activity declined more than previously estimated in the first quarter of 1970, but little further change is projected in the second quarter. Prices and costs generally are continuing to rise at a rapid pace, although some components of major price indexes recently have shown moderating tendencies. Since early May most long-term interest rates have remained under upward pressure, partly as a result of continued heavy demands for funds and possible shifts in liquidity preferences, and prices of common stocks have declined further. Attitudes in financial markets generally are being affected by the widespread uncertainties arising from recent international and domestic events, including doubts about the success of the Government's anti-inflationary program. Both bank credit and the money supply rose substantially from March to April on average; in May bank credit appears to be changing little while the money supply appears to be expanding rapidly. The over-all balance of payments continued in considerable deficit in April and early May. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.
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> To implement this policy, in view of current market uncertainties and liquidity strains, open market operations until the next meeting of the Committee shall be conducted with a view to moderating pressures on financial markets, while, to the extent compatible therewith, maintaining bank reserves and money market conditions consistent with the Committee's longer-run objectives of moderate growth in money and bank credit.

Votes for this action: Messrs. Burns, Hayes, Brimmer, Daane, Francis, Hickman, Maisel, Mitchell, Robertson, Sherrill, Swan, and Morris. Votes against this action: None.

Absent and not voting: Mr. Heflin. (Mr. Morris voted as his alternate.)