FEDERAL RESERVE

press release

For immediate release

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The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached records of policy actions taken by the Federal Open Market Committee at its meetings on November 17 and December 15, 1970. These records will be published in the Board's Annual Report for 1970 and in the Federal Reserve Bulletin.

Attachments

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on November 17, 1970

Authority to effect transactions in System Account.

Information reviewed at this meeting suggested that real output of goods and services, which had risen at an annual rate of 1.4 per cent in the third quarter, was changing little in the current quarter. Part but not all of the weakness in over-all activity was attributable to a strike at a major automobile manufacturer, which had begun in mid-September and which apparently was now coming to an end. Although recent movements in major price measures had been erratic, the general tendency in these measures had been toward a slower rate of increase.

In October retail sales, industrial production, and nonfarm payroll employment all declined and the unemployment rate edged up to 5.6 from 5.5 per cent in September. Sales fell sharply at automobile dealers, but they increased at other types of retail establishments after having changed little since April. Production was cut back further in October in the motor vehicle and supplier industries and also in industries that make business and defense equipment and many types of industrial materials. Although payroll employment rose moderately in the nonmanufacturing sector, it declined in manufacturing even apart from the effects of the automobile shutdown.

Average wholesale prices of industrial commodities advanced sharply from mid-September to mid-October after some slowing in the third quarter. Wholesale prices of farm products and foods declined about as much in October as they had risen in the previous month. The consumer price index rose considerably in September, but over the third quarter as a whole it had increased less than in either of the two preceding quarters.

Wage rates were continuing to advance at a rapid pace; the increases provided by contract settlements concluded during the third quarter, while somewhat smaller than the second-quarter increases, were significantly larger than those of 1968 and 1969. However, output per manhour in the private nonfarm sector had risen considerably further in the third quarter, and the rate of advance in unit labor costs in the second and third quarters taken together was the lowest since mid-1967.

According to the latest staff projections--in which it was assumed that the automobile industry would be back in full production by early December--real GNP would remain about unchanged in the fourth quarter, partly because of the effects of the strike in curtailing business inventory investment and growth in consumer spending. It appeared likely that over-all economic activity would rebound sharply in the first quarter of 1971 in the aftermath of the strike; but that the pace of expansion would moderate considerably in the second quarter, when automobile output and sales were expected to fall back from their earlier post-strike surge.

Over the three quarters ending with the second quarter of 1971 the average rate of growth in real GNP was expected to be relatively low. The projections for that period contemplated further sizable advances in residential construction expenditures and State and local government outlays. However, it was anticipated that consumer expenditures would increase only moderately on balance, and that business capital investment and defense outlays would decline. The rate of advance in prices was still expected to slow, but by less than had appeared likely earlier.

The surplus on U.S. foreign trade declined further in September; for the third quarter as a whole the surplus was slightly below the high second-quarter rate. The over-all balance of payments on the liquidity basis improved markedly from the second to the third quarter, largely because of a reversal of flows involved in U.S. bank lending to foreigners and a renewal of foreign buying of U.S. stocks. The deficit on the official settlements basis remained near the high level of the second quarter as a result of substantial repayments of Euro-dollar borrowings by U.S. banks.

Preliminary estimates for October suggested that on both bases the over-all payments deficit was remaining at about the third-quarter rate. Repayments of Euro-dollar borrowings by U.S. banks appeared to be continuing at a fairly steady pace; although Euro-dollar interest rates had declined markedly during October, they were still considerably above comparable U.S. interest rates.

In the foreign exchange markets, most currencies had strengthened against the dollar recently. Abroad, discount rates were reduced by the National Bank of Belgium, from 7-1/2 to 7 per cent, on October 22; by the Bank of Japan, from 6-1/4 to 6 per cent, on October 28; and by the Bank of Canada, from 6-1/2 to 6 per cent, on November 12. These actions followed indications of easing of demand in the respective domestic economies. The German Federal Bank cut its discount rate from 7 to 6-1/2 per cent on the day of this meeting.

On October 22 the Treasury announced the terms on which it would refund securities maturing in mid-November, including $6 billion held by the public. Holders of the maturing obligations were offered the choice of a new 7-1/4 per cent, 3-1/2-year note priced at par or a reopened 7-1/2 per cent, 5-3/4-year note priced to yield 7.39 per cent. The offering was very well received by the market; redemptions for cash were smaller than had been expected and the notes traded at substantial premiums on a "when-issued" basis. Near the end of October, when it announced the results of the refunding, the Treasury also announced that on November 5 it would auction $2 billion of a 6-3/4 per cent, 18-month note, employing methods similar to those normally used in Treasury bill auctions. This financing also was highly successful; the average issuing rate in the auction was 6.21 per cent, well below expectations.

Short-term interest rates had declined substantially further since the October 20 meeting of the Committee. For example, the market rate on 3-month Treasury bills, at 5.30 per cent on the day before this meeting, was about 65 basis points below its level 4 weeks earlier and lower than at any time in the preceding 2 years. The recent rate declines reflected a reduction in demands for short-term credit as a result of the prolonged strike in the automobile industry and the general sluggishness in the economy; the reinvestment in short-term securities of the proceeds of the continuing heavy volume of capital market issues; and widespread expectations among investors of imminent reductions in Federal Reserve discount rates and the prime lending rate of commercial banks. On November 11 and succeeding days Federal Reserve Bank discount rates were reduced to 5-3/4 per cent from the 6 per cent level that had been in effect since early April 1969. On November 12 the prime lending rate--which had been cut from 8 to 7-1/2 per cent in the latter part of September--was lowered to 7-1/4 per cent.

In October some further easing of conditions in markets for residential mortgages was reflected in an additional slight decline in secondary market yields on federally insured loans. Inflows of savings funds to nonbank thrift institutions were again substantial, and it appeared that the volume of mortgage loans and of new commitments for such loans--both of which had increased considerably in the third quarter--had continued large.

At commercial banks the rate of growth in total time and savings deposits from September to October was below the very high third-quarter rate, although the expansion remained substantial for both consumer-type deposits and large-denomination CD's. The money stock changed little from September to October--declining slightly according to the published statistical series, and rising slightly after a tentative allowance was made for the biases resulting from the accounting procedures employed in connection with certain types of international transactions. On both bases the money stock had increased only slightly in September, but over the third quarter as a whole it had grown at an annual rate of about 5 per cent.[1/]

The lack of significant growth in the money stock in October contrasted with expectations at the time of the preceding Committee meeting of expansion in that month at about a 4.5 per cent rate. The shortfall appeared to be associated with the weakness in demands for short-term credit; business loans at banks (adjusted to include loans that had been sold to affiliates) declined even more sharply in October than in the preceding month. Growth in the bank credit proxy--daily-average member bank deposits--also fell considerably short of expectations. After adjustment for a further marked reduction in bank reliance on funds obtained from nondeposit sources, the proxy series increased at an annual rate of less than 1 per cent,

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.

compared with growth rates of about 10 per cent in September and more than 17 per cent in the third quarter as a whole.

System open market operations had been directed at achieving a slight easing of money market conditions early in the period following the October 20 meeting of the Committee, when current estimates indicated that the monetary aggregates were growing at rates moderately below those desired. Somewhat greater easing had been sought later in the period, when revised data indicated that the shortfall in the aggregates was greater than had been thought earlier and when conditions associated with the Treasury financings were such that "even keel" considerations offered less of a constraint on operations. Most recently, the Federal funds rate had been fluctuating in a range around 5-3/4 per cent, compared with the range above 6 per cent that had prevailed shortly before the October 20 meeting. In the 4 weeks ending November 11 member bank borrowings averaged about $475 million, down slightly from the average in the preceding 5 weeks.

Staff analysis suggested that, in light of the current weakness in demands for money and credit, attainment of even a 4 per cent annual rate of growth for money over the fourth quarter probably would necessitate some easing of prevailing money market conditions. The analysis suggested, however, that if subsequently there were no further substantial change in money market conditions, money growth would step up in the first quarter of 1971, when demands for money and credit were expected to strengthen temporarily in connection with the bulge in GNP anticipated in the aftermath of the auto strike. It appeared that growth in the money stock at an annual rate of 4 per cent in the fourth quarter might be associated with expansion in the adjusted bank credit proxy at a rate of about 4.5 per cent.

The Committee agreed that, in light of the current and prospective economic situation, some easing of conditions in credit markets and moderate growth in money remained appropriate as objectives of monetary policy. Concern was expressed about the shortfalls from expected growth rates for the monetary aggregates that had been experienced in October, and the members decided that an easing of money market conditions would be desirable at present for the purpose of stimulating more substantial growth in the aggregates.

As at other recent meetings, there were some differences of view with respect to the emphasis that should be placed on the growth rate of money relative to other indicators of policy, and with respect to the specific growth rate for money that should be sought. The Committee decided that it would be undesirable to "whipsaw" money and credit market conditions to the extent that might be required to attain a 5 per cent money growth rate in the fourth and first quarters individually. In particular, the Committee agreed that a 4 per cent growth rate in the fourth quarter would be acceptable if the results of operating experience over coming weeks bore out the indication of the staff analysis that attainment of a 5 per cent rate would require a sharp easing of money market conditions. This judgment was reached in light of the expectation that money growth would pick up in the first quarter if there were no further substantial change in money market conditions. At the same time, it was noted that the policy objectives for the first quarter and subsequent periods would, of course, be considered by the Committee at future meetings.

During the discussion the Committee considered the degree to which money market conditions should be eased in coming weeks in pursuing the longer-run objectives for the monetary aggregates, in light of the possibility that a marked easing might substantially accelerate the currently large outflows of short-term capital from the United States. The Committee decided that, if it was found in the course of operations that easing sufficient to reduce the Federal funds rate to around 5 per cent was still not producing an adequate response in terms of growth rates in the aggregates, members' views regarding appropriate further operations should be ascertained. It was noted in this connection that the Board of Governors was prepared to consider measures to moderate the pace of repayments of Euro-dollar borrowings by U.S. banks if those repayments threatened to exceed tolerable limits.

The Committee also considered a proposal for making somewhat more use than was customary at this time of the year of open market purchases of longer-term Treasury securities in meeting reserve needs. Most members thought that a moderate volume of such purchases, if practicable, could serve a constructive purpose.

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

> The information reviewed at this meeting suggests that real output of goods and services is changing little in the current quarter and that unemployment has increased. Part but not all of the weakness in over-all activity is attributable to the strike in the automobile industry which apparently is now coming to an end. Wage rates generally are continuing to rise at a rapid pace, but gains in productivity appear to be slowing the increase in unit labor costs. Recent movements in major price measures have been erratic but the general pace of advance in these measures has tended to slow. Most interest rates declined considerably in the past few weeks, and Federal Reserve discount rates were reduced by one-quarter of a percentage point in the week of November 9. Demands for funds in capital markets have continued heavy, but business loan demands at banks have weakened. The money supply changed little on average in October for the second consecutive month; bank credit also was about unchanged, following a slowing of growth in September. The balance of payments deficit on the liquidity basis was at a lower rate in the third quarter and in October than the very high second-quarter rate, but the deficit on the official settlements basis remained high as banks repaid Euro-dollar liabilities. 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, the Committee seeks to promote some easing of conditions in credit markets and

moderate growth in money and attendant bank credit expansion over the months ahead, with allowance for temporary shifts in money and credit demands related to the auto strike. System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining bank reserves and money market conditions consistent with those objectives.

Votes for this action: Messrs. Burns, Hayes, Brimmer, Daane, Francis, Heflin, Hickman, Mitchell, Robertson, Sherrill, and Swan. Vote against this action: Mr. Maisel.

Mr. Maisel dissented from this action because he believed that the objectives for growth in money and credit favored by the majority were unsatisfactory. He favored seeking a growth rate for money in the fourth quarter at least as high as the rate that had prevailed on the average in the first three quarters of the year. Indeed, he thought the information developed at this and prior meetings on the state of the economy and its prospects should have led the Committee to reconsider and change the policies it had previously pursued. The monetary conditions sought under this directive would, he believed, increase the probabilities that output and employment would continue on a path that was too far below the economy's potential. In his judgment the gap between actual and potential output and the consequent lost production, income, and jobs would be greater than could be justified on the basis of the needs of the economy, demand pressures on prices, or the balance of payments.