FEDERAL RESERVE

press release

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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 21, 1974.

Such records are made available approximately 90 days after the date of each meeting of the Committee and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based on the information that was available to the Committee at the time of the meeting, rather than on data as they may have been revised since then.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on May 21, 1974

Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services was changing little in the current quarter, after having declined at an annual rate of 6.3 per cent in the first quarter, and that the increase in the GNP implicit deflator, which had accelerated to an annual rate of 11.5 per cent in the first quarter, was continuing at a rapid pace. Staff projections suggested that real economic activity would rise somewhat in the second half of the year and that prices would increase at a less rapid rate than in the first half.

In April industrial production expanded somewhat--after having receded over the preceding 4 months--mainly as a result of increases in output of automobiles and business equipment. Employment in manufacturing establishments also rose, following four consecutive months of decline, and total nonfarm payroll employment advanced moderately. The civilian labor force, which had changed little since January, declined in April, and the unemployment rate edged down from 5.1 to 5.0 per cent.

According to the advance report, retail sales expanded moderately further, reflecting in large part an increase in sales of domestic models of new automobiles.

Wholesale prices of farm and food products declined substantially in April, for the second consecutive month. However, wholesale prices of industrial commodities continued upward at a rapid pace; price increases, which were reported for most commodity groups, were particularly large for metals, woodpulp, paper products, chemicals, and some types of machinery. In March the consumer price index had risen almost as substantially as in the preceding month, although retail prices of meats had declined.

The index of average hourly earnings of production workers on nonfarm payrolls, which had risen more in February and March than earlier data for those months had indicated, advanced at a faster pace in April. In the first quarter, when real output and productivity declined, unit labor costs in the private nonfarm economy increased sharply.

The latest staff projections for the second half of 1974, like those of 5 weeks earlier, suggested that business fixed investment would increase further and that government purchases of goods and services would continue to grow at a fairly rapid rate. However, it was now expected that the expansion in real consumption expenditures would slow, reflecting mainly a slower rise in sales of new automobiles, and that the upturn in residential construction activity would be more moderate than had been anticipated 5 weeks earlier.

In foreign exchange markets the dollar depreciated further against leading foreign currencies in April and the first half of May. In mid-May, however, the dollar was buoyed by a speculative flurry based on a news report that the United States, Germany, and Switzerland were contemplating concerted intervention in the markets. The U.S. balance of payments, which had been in deficit in February and March, remained in deficit in April and early May. The U.S. foreign trade balance had shifted into sizable deficit in March, mainly because of increased costs of imports of petroleum and other industrial materials which reflected earlier increases in prices; for the first quarter as a whole the trade balance was still in surplus, but the amount was small and represented a substantial deterioration from the preceding quarter.

Growth in loans and investments at U.S. commercial banks remained strong in April, reflecting for the most part continuation of rapid expansion in business loans; loans to nonbank financial institutions and to foreign commercial banks also increased, and banks added to their holdings of both Treasury and other securities. As in March, effective rates on bank loans were favorable relative to rates in the commercial paper market, and businesses continued to concentrate their strong short-term credit demands at banks. Between mid-April and mid-May the prime rate applicable to large corporations was raised in six steps from 10 per cent to 11-1/2 per cent at most banks.

Growth in the narrowly defined money stock (M_1)[1/] slowed somewhat in April from the rapid pace of the preceding 2 months, but at an annual rate of about 8 per cent, it was slightly faster than over the first quarter as a whole. Banks' net inflows of time and savings deposits other than large-denomination CD's picked up slightly, and growth in the more broadly defined money stock (M_2)[2/] remained at about the moderate rate recorded in March. In order to help finance the growth in their loans, banks further stepped up the issuance of large-denomination CD's--to a record amount in April--and continued to increase borrowings

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1/ Private demand deposits plus currency in circulation.
2/ M_1 plus commercial bank time and savings deposits other than large-denomination CD's.

in the commercial paper and Euro-dollar markets. As a result, the bank credit proxy[3/] rose at an unprecedented rate.

Net deposit inflows at nonbank thrift institutions slowed sharply in April, as yields on market securities became increasingly attractive to savers, and growth in the measure of the money stock that includes such deposits (M_3)[4/] slackened somewhat. Contract interest rates on conventional mortgages and yields in the secondary market for Federally insured mortgages rose sharply in April and early May.

On May 1 the Treasury announced that it would auction up to $4.05 billion of notes and bonds to refund the bulk of $5.6 billion of publicly held securities maturing on May 15; the remainder would be retired by drawing down cash balances. In an auction on May 7 the Treasury sold $1.75 billion of 4-1/4-year, 8-3/4 per cent notes at an average price to yield 8.73 per cent; and in auctions on May 8 it sold $2 billion of 25-1/2-month, 8-3/4 per cent notes at an average price to yield 8.73 per cent and $300 million of 25-year, 8-1/2 per cent bonds at a price to yield 8.23 per cent.

3/ Daily-average member bank deposits, adjusted to include funds from nondeposit sources.

4/ M_2 plus time and savings deposits at mutual savings banks and at savings and loan associations.

System open market operations since the April 15-16 meeting had been guided by the Committee's decision to seek bank reserve and money market conditions that would moderate growth in monetary aggregates over the months ahead, while taking account of the forthcoming Treasury financing and of international and domestic financial market developments. Soon after the meeting, available data suggested that in the April-May period the annual rates of growth in the monetary aggregates would be above the upper limits of the ranges of tolerance that had been specified by the Committee. Accordingly, System operations were directed toward tightening in bank reserve and money market conditions.

Largely because of unexpectedly strong money market pressures, the Federal funds rate rose to around 11 per cent on April 22 and 23--from around 10-1/4 per cent just before the April meeting--and in the statement week ending April 24 it seemed likely to average a little above the upper limit of 10-3/4 per cent set by the Committee. The System Account Manager reported that in order to bring the funds rate back within the range of tolerance he would have to expand reserve-supplying operations, thus stimulating further growth of the monetary aggregates. On April 24 the members of the Committee--

with the exception of Mr. Bucher--concurred in the Chairman's recommendation that, in view of those circumstances and against the background of the increase in Federal Reserve discount rates announced that day, the upper limit of the funds rate constraint be raised by 1/4 of a percentage point to 11 per cent.

In mid-May available data suggested that in the April-May period growth rates in M_1 and M_2 would be within their short-run ranges of tolerance while the growth rate in reserves available to support private nonbank deposits (RPD's) would be well above its specified range. The Federal funds rate remained above its 11 per cent upper limit, averaging 11.46 per cent in the most recent statement week, despite System efforts to achieve a lower rate. Major member banks apparently were bidding in the Federal funds market in order to avoid borrowing at the discount window; in addition, efforts to provide reserves were hampered by a technical market shortage of collateral for repurchase agreements. In any event, it would have been difficult to reduce the funds rate to 11 per cent without providing reserves through open market operations on a scale that would have risked market misinterpretation of the System's policy intent. On May 17 the members--with the exception of Mr. Holland--concurred in Chairman Burns' recommendation that the Committee take note of the difficulties faced by the System Account Manager in recent days and, in view of the likelihood that those conditions would persist over the next few days, that it change the ceiling guideline for the funds rate from 11 to 11-1/4 per cent.

On the day before this meeting, the Federal funds rate was 11-1/4 per cent. In the four statement weeks ending May 15, member bank borrowings averaged about $1,920 million, compared with an average of about $1,555 million in the preceding 4 weeks.

Private short-term market interest rates rose sharply further in the period between the Committee's meeting on April 15-16 and this meeting--in response to persistent strong business demands for credit and further tightening in money market conditions. In addition, yield spreads between high and lower quality securities widened, in part because of the uneasiness that developed in financial markets as a result of press reports of the special problems being experienced by Franklin National Bank and of rumors that some other financial institutions might be encountering liquidity and other difficulties.

Treasury bill rates also increased in late April and early May. Subsequently, however, they dropped in response to a number of influences, including substantial purchases of bills by foreign monetary authorities, strong demands by small investors who continued to be attracted by the high yield relative to interest rates available on time deposits, System purchases for its own account, and the apparent shift in investor preference toward securities of higher quality. On the day before this meeting, the market rate on 3-month bills was 7.94 per cent, down nearly a percentage point from levels reached in late April and early May, and about the same as at the time of the April meeting. Federal Reserve discount rates were raised from 7-1/2 to 8 per cent, effective at seven Reserve Banks on April 25; shortly thereafter, rates were raised at the remaining five Banks.

Yields on long-term securities also increased in the inter-meeting period, but by much less than those on private short-term instruments. Demands for the longer-term issues--especially from small investors--tended to increase as yields advanced. Moreover, the volume of public offerings of corporate bonds declined in April, in part because some scheduled offerings of new issues were postponed or canceled.

A substantial increase in the volume was in prospect for May. Offerings of State and local government issues expanded in April, and a moderate decline was in prospect for May.

A staff analysis suggested that maintenance of prevailing money market conditions at this time would be associated with a dampening in the rate of growth of the narrowly defined money stock over the months ahead, because the demand for money was likely to be restrained by the lagged effects of the sharp rise in short-term market rates of interest that had occurred over the past few months. According to the analysis, growth in consumer-type time and savings deposits at both banks and nonbank thrift institutions would continue to be curtailed-- because of high market interest rates relative to rates available on time deposits--and growth in broader measures of the money stock would slow further. Banks would continue to rely heavily on issuance of large-denomination CD's and borrowings in the Euro-dollar market to finance loan expansion, although it appeared likely that a tightening in banks' lending terms would moderate loan growth.

The Committee concluded that the economic situation continued to call for moderate growth in monetary aggregates over the months ahead. At the same time, the members decided that--in view of the sensitive state of financial markets and the considerable tightening in money market conditions that had occurred over recent months--greater emphasis than usual should be placed on money market conditions during the period until the next meeting, and accordingly, that the range specified for the Federal funds rate should be narrower than usual. In particular, they agreed that operations in the coming period should be directed toward maintaining about the prevailing restrictive money market conditions, provided that the monetary aggregates appeared to be growing over the May-June period at rates within specified ranges of tolerance. The members also agreed that the lower limits of the tolerance ranges specified for the monetary aggregates should be set at levels that would accommodate slower growth rates than expected at present in the event that such rates developed, given about the prevailing money market conditions.

Taking account of the staff analysis, the Committee decided that in the period until the next meeting the weekly average Federal funds rate might be permitted to vary in an orderly fashion from as low as 11 per cent to as high as 11-1/2 per cent, if necessary, in the course of operations. For the May-June period the Committee adopted ranges of tolerance of

3 to 7 per cent and 4-1/2 to 7-1/2 per cent for the annual rates of growth in M_1 and M_2, respectively. The members agreed that rates of growth within those ranges would be likely to involve RPD growth during the same period at an annual rate within a 13 to 20 per cent range.

The members also agreed that, in the conduct of operations, account should be taken of developments in domestic and international financial markets. It was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives and constraints.

The following domestic 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--which had declined appreciably in the first quarter--is likely to change little in the current quarter and that price increases are continuing exceptionally large. In April industrial production and manufacturing employment expanded somewhat, after having declined for 4 months. The unemployment rate edged down to 5 per cent, as the civilian labor force declined. Wholesale prices of farm and food products declined substantially further, but increases among industrial commodities again were widespread and extraordinarily large. The advance in wage rates has accelerated somewhat in recent months, and unit labor costs have been rising at a fast pace.

In the first 3 days of the statement week beginning June 6 the Federal funds rate averaged about 11.40 per cent, close to the 11-1/2 per cent upper limit established by the Committee. The System Account Manager advised that market psychology was delicately poised; expectations of declining interest rates had strengthened during the past week, partly in conjunction with publicity attendant on reductions in the prime rate by a number of banks. Although those expectations had been dampened by System operations, the Manager reported that it would be useful to have some additional leeway with respect to the funds rate if necessary to counteract a resurgence of such expectations. Against that background, Chairman Burns recommended on June 10 that the upper limit of the funds rate constraint be raised to 11-3/4 per cent, on the understanding that the Manager would use the additional leeway if market interest rates came under downward pressure or if the monetary aggregates for the May-June period appeared to be testing the upper limits of their tolerance ranges. The members concurred in the Chairman's recommendation.