



FEDERAL RESERVE

press release

For immediate release

June 7, 1971

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 March 9, 1971.

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 March 9, 1971

1. Authority to effect transactions in System Account.

Revised official estimates indicated that real output of goods and services had declined at an annual rate of 3.9 per cent in the fourth quarter of 1970. It appeared that real GNP would rise substantially in the current quarter, largely as a result of the recovery of production in the automobile industry following settlement in late November of the strike at a major producer.

According to preliminary indications industrial production declined slightly in February, following 2 months of advance, as further increases in output of motor vehicles and steel were more than offset by continued reductions in output of business and defense equipment. Employment also declined in February, but because there was an even larger decline in the labor force the unemployment rate edged down to 5.8 from 6.0 per cent in January. Weekly data suggested that retail sales had risen in February at both automobile dealers and other types of stores. Apart from autos, however, it appeared that average retail sales in January and February were little changed from the fourth quarter. In January private housing starts fell sharply--reversing the unusually large increase of the previous month--but they remained at a high level.

Recent movements in major price indexes had been diverse. Average wholesale prices rose substantially from mid-January to

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mid-February, as a result of a marked increase in prices of farm products and foods; prices of industrial commodities rose less than in most other recent months. In January the advance in the consumer price index moderated from the sharp December increase. Meanwhile, wage rates continued to rise rapidly in most sectors of the economy.

Staff projections suggested that growth in real GNP would slow in the second quarter from its current high rate, mainly because the post-strike recovery in the automobile industry would no longer be providing unusual stimulus to consumer and business spending on autos and trucks. In addition, defense outlays were expected to decline. On the other hand, it seemed likely that residential construction expenditures and State and local government outlays would continue to rise at substantial rates, and that the stockpiling of steel in anticipation of a possible strike in that industry in August--which already was making an appreciable contribution to over-all business investment in inventories--would increase in importance. Also, it was expected that some strength would be imparted to consumer spending by payments late in the quarter of an anticipated increase in social security benefits retroactive to the beginning of the year.

The U.S. foreign trade surplus narrowed further in January, extending the trend begun in mid-1970. The chief factor in the deterioration was a sharp rise in the total value of imports. The over-all balance of payments in the January-February period continued very heavily in deficit on the official settlements basis. On the liquidity

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basis the deficit was at a rate much larger than in the second half of 1970, reflecting for the most part adverse capital flows stemming from the wide differentials between short-term interest rates in the United States and abroad.

Short-term interest rates in Britain had risen since the beginning of the year, and rates in Germany had fallen less than U.S. rates and Euro-dollar rates. Largely in consequence of interest rate differences, the dollar was at the floor against nearly all major currencies in the exchange markets in February. The Bank of Canada reduced its discount rate by 1/4 percentage point in mid-February and by a further 1/2 point, to 5-1/4 per cent, effective February 24. On February 26, the Export-Import Bank offered an additional \$1/2 billion of special securities to overseas branches of U.S. banks, for payment March 3.

In domestic financial markets short-term interest rates had continued to decline in recent weeks. For example, the market rate on 3-month Treasury bills, at 3.32 per cent on the day before this meeting, was 50 basis points below its level 4 weeks earlier. Discount rates at Federal Reserve Banks were reduced by another quarter of a percentage point, to 4-3/4 per cent, effective February 13 (February 19 for the New York Reserve Bank) and commercial banks lowered their prime lending rate again, from 6 to 5-3/4 per cent, effective February 16. Further declines also had been recorded recently in bank offering rates on large-denomination CD's and in rates on commercial and finance company paper.

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In contrast, yields on new issues of corporate and municipal bonds--which also had been declining earlier--turned up in early February and rose considerably over the course of the following weeks. These yield increases reflected the continuing very heavy calendar of new offerings--particularly of corporate bonds--and apparently also a growing belief among investors that long-term interest rates were at or near their cyclical lows. Yields rose only slightly on long-term Treasury bonds and they moved down on intermediate-term Treasury issues, in part because of sizable purchases of such securities by the Federal Reserve.

Interest rates on residential mortgages declined further in February in secondary markets for federally insured loans, and on February 18 the ceiling rate on such loans was reduced by administrative action from 7-1/2 to 7 per cent--the third half-point cut in 3 months. Deposit inflows at nonbank thrift institutions, which had reached extraordinarily high rates in January, continued large in the first half of February.

At commercial banks the rate of growth in consumer-type time and savings deposits was exceptionally rapid in February, but the expansion in large-denomination CD's slowed somewhat further. The volume of business loans outstanding (including loans that had been sold to affiliates) increased substantially, following a moderate rise in January and declines in the four preceding months. Banks again made sizable additions to their holdings of securities.

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Total bank credit, as measured by the adjusted proxy series-- daily-average member bank deposits, adjusted to include funds from nondeposit sources--increased considerably further on the average in February. Sharp increases also were recorded for two key measures of the money stock-- M_1 , defined as private demand deposits plus currency in circulation, and M_2 , defined as M_1 plus commercial bank time deposits other than large-denomination CD's. For all of these aggregates the growth rates in February exceeded those expected at the time of the preceding meeting of the Committee. For both of the money stock series, however, earlier estimates of the increase in January had been revised downward somewhat, and for M_1 the February expansion followed a number of months in which growth had fallen well short of Committee expectations. The strength of the aggregates in February appeared to be related to the step-up in the growth of business loans at banks and, more generally, to the first-quarter bulge in economic activity in the aftermath of the auto strike.

System open market operations had been directed at achieving somewhat easier conditions in the money market shortly after the February 9 Committee meeting, when revised data for late January and tentative estimates for early February suggested that both M_1 and M_2 were growing less rapidly than desired. Subsequently, however, new data becoming available indicated that these aggregates were currently expanding at rates at or above those desired, and operations were directed at

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maintaining prevailing conditions. The Federal funds rate fluctuated rather widely during the period, but most recently it had averaged about 3-1/2 per cent, compared with the average of about 3-3/4 per cent that had prevailed shortly before the February 9 meeting. In recent weeks needs for reserves had been met to an important extent by System purchases of intermediate- and long-term Treasury securities.

Staff analysis suggested that, if prevailing money market conditions were maintained, both M_1 and M_2 would expand considerably less in March than they had in February, and that over the first quarter as a whole they would grow at annual rates of about 7 and 16 per cent, respectively. The adjusted bank credit proxy was projected to continue upward in March at a pace close to that of February, and to increase at about a 12 per cent annual rate over the first quarter. It was noted that, while the outlook for the monetary aggregates in the second quarter was highly uncertain at this juncture, present indications suggested that M_1 would grow more rapidly than in the first quarter if money market conditions remained unchanged, and that M_2 and the proxy series would grow a little less rapidly.

In the Committee's discussion considerable concern was expressed about the recent sharp increases in corporate and municipal bond yields, and the members agreed that it would be desirable to accommodate renewed declines in long-term interest rates generally. At the same time, there was widespread sentiment to the effect that further sizable declines in short-term interest rates would not serve a useful purpose. Indeed,

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in light of the expected growth rates in the monetary and credit aggregates and the recent large capital outflows, a number of members thought that some modest increase in short-term rates would be desirable if--as they considered likely--such a development would not be inconsistent with a downward drift in long-term rates. However, other members believed that any significant rise in short-term rates at this time would risk putting upward pressure on long-term rates.

The members also expressed diverse views about the emphasis that should be placed on the behavior of the monetary and credit aggregates in making open market operating decisions during coming weeks, and about the appropriate rates of growth in the aggregates over the months ahead. In the latter connection, some members expressed concern about the relatively high growth rates projected by the staff for the period through the second quarter on the assumption of unchanged money market conditions, and especially about the acceleration anticipated in M_1 . Others, however, stressed the uncertainties attached to the projections for the later months of the period covered and indicated that they were not disturbed by the near-term outlook for the aggregates--particularly in light of the shortfalls in M_1 experienced in other recent months.

At the conclusion of the discussion the Committee decided that open market operations at present should be directed at maintaining prevailing money market conditions while accommodating any downward movements in long-term interest rates. A proviso was added calling for

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modification of money market conditions if during coming weeks the monetary and credit aggregates appeared to be deviating widely from the growth paths consistent with the first-quarter rates of expansion cited above. Specifically, money market rates were to be increased somewhat if the aggregates were rising considerably faster than expected, but in light of recent declines in such rates they were to be shaded down only slightly if growth were markedly below expectations. The Committee also agreed that its objectives for interest rates would be served if, to the extent feasible, needs to supply reserves continued to be met by purchases of longer-term Treasury securities.

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, which declined in the fourth quarter of 1970, is rising in the current quarter primarily because of the resumption of higher automobile production. Although the unemployment rate has edged down recently, it remains high. Wage rates in most sectors are continuing to rise at a rapid pace. Movements in major price measures have been diverse; most recently, the rate of advance moderated for consumer prices and wholesale prices of industrial commodities, but wholesale prices of farm products and foods rose sharply. Bank credit increased considerably further in February, as business loans strengthened substantially and banks again made sizable additions to their holdings of securities. The money stock both narrowly and broadly defined expanded sharply in February. Short-term interest rates and mortgage rates have fallen further in recent weeks but yields on new issues of corporate and municipal bonds have risen considerably, in part as a result of the very heavy calendar of offerings. The overall balance of payments deficit in January and February was exceptionally large. Imports increased more rapidly than exports in January, and capital outflows have been stimulated

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by widened short-term interest rate differentials. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the resumption of sustainable economic growth, while encouraging an orderly reduction in the rate of inflation and the attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining prevailing money market conditions while accommodating any downward movements in long-term rates; provided that money market conditions shall be modified if it appears that the monetary and credit aggregates are deviating significantly from the growth paths expected.

Votes for this action: Messrs.
Burns, Hayes, Brimmer, Clay, Daane,
Kimbrel, Maisel, Mayo, Mitchell,
Morris, Robertson, and Sherrill.
Votes against this action: None.

2. Amendment to authorization for System foreign currency operations.

On recommendation of the Special Manager of the System Open Market Account the Committee amended paragraph 3 of the authorization for System foreign currency operations to authorize the purchase of currencies to be used for the liquidation of System swap commitments from the foreign central bank drawn on, at the same exchange rate as that employed in the drawing to be liquidated. Prior to this amendment, the paragraph had specified that unless otherwise expressly authorized by the Committee all transactions in foreign currencies undertaken under paragraph 1(A) of the authorization should be at prevailing market rates. As a result of this action, paragraph 3 read as follows:

3. Currencies to be used for liquidation of System swap commitments may be purchased from the foreign central bank

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drawn on, at the same exchange rate as that employed in the drawing to be liquidated. Apart from any such purchases at the rate of the drawing, all transactions in foreign currencies undertaken under paragraph 1(A) above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates and no attempt shall be made to establish rates that appear to be out of line with underlying market forces.

Votes for this action: Messrs.
Burns, Hayes, Brimmer, Clay, Daane,
Kimbrel, Maisel, Mayo, Mitchell,
Morris, Robertson, and Sherrill.
Votes against this action: None.

Discussions had been under way recently with certain central banks in the System's swap network regarding the possibility of using new procedures in connection with the liquidation of System swap drawings in cases in which it was necessary to obtain the foreign currency required for liquidation by purchasing it directly from the central bank drawn on. It had been noted that both parties were exposed to a risk of loss if such transactions could be made only at the rate prevailing in the foreign exchange market at the time of repayment, and that such risks could be avoided if it were understood in advance that the currency could be purchased from the foreign central bank at the same exchange rate as that employed in the drawing to be liquidated. The Committee concurred in the judgment of the Special Manager that it would be appropriate to enter into such understandings with foreign central banks at the time a System drawing was made if the foreign bank were agreeable. It was specified that such understandings should not preclude Federal Reserve repayment of swap

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drawings on or before maturity through purchase of the foreign currency required at market rates in the foreign exchange market or elsewhere.

3. Review of continuing authorizations.

This being the first meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1971, and their assumption of duties, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. The action taken with respect to the authorization for System foreign currency operations has been described in the preceding portion of the record for this date. Except for the change resulting from that action, the Committee reaffirmed the authorization, and also the foreign currency directive and the continuing authority directive with respect to domestic open market operations, in the form in which they were outstanding at the beginning of the year 1971.

Votes for these actions: Messrs.
Burns, Hayes, Brimmer, Clay, Daane,
Kimbrel, Maisel, Mayo, Mitchell, Morris,
Robertson, and Sherrill. Votes against
these actions: None.

In connection with the review of the continuing authority directive for domestic operations, the Committee took special note of paragraph 3, which authorized the Reserve Banks to engage in lending of U.S. Government securities held in the System Open Market Account under such instructions as the Committee might specify from time to time. That

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paragraph had been added to the directive on October 7, 1969, on the basis of a judgment by the Committee that in the existing circumstances such lending of securities was reasonably necessary to the effective conduct of open market operations and to the effectuation of open market policies, and on the understanding that the authorization would be reviewed periodically. At this meeting the Committee concurred in the judgment of the Manager of the System Open Market Account that the lending activity in question remained necessary and, accordingly, that the authorization should remain in effect subject to periodic review.