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 June 18, 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 June 18, 1974

Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services would change little in the current quarter after declining at an annual rate of 6.3 per cent in the first quarter. There was some improvement in economic activity as the spring progressed. The second-quarter increase in the GNP implicit deflator, while still large, was not expected to be quite so large as in the first quarter. Staff projections continued to suggest that real economic activity would expand somewhat in the second half of the year--although by less than had appeared likely 4 weeks earlier--and that prices would increase at a less rapid pace than in the first half.

In May industrial production rose--for the second consecutive month--reflecting significant gains in output of business equipment and consumer goods. Employment in manufacturing changed little, but total employment in nonfarm establishments expanded substantially further. The unemployment rate rose from 5.0 to 5.2 per cent, however, as the civilian labor force increased

sharply after having changed little over the preceding 3 months. According to the advance report, the dollar volume of retail sales had expanded in May; although the May level was moderately above the first-quarter average, the gain appeared to be no greater than the increase in average retail prices.

Wholesale prices of farm and food products declined substantially in May for the third consecutive month. However, wholesale prices of industrial commodities continued upward at a rapid pace; as in earlier months of the year, large price increases were reported for most commodity groups. The index of average hourly earnings of production workers on nonfarm payrolls accelerated somewhat further in May, but the size of the advance was influenced by the initial effects of the increase in the minimum wage at the beginning of the month and by other special factors. In April the rise in the consumer price index had been less rapid than in the first 3 months of the year, as retail prices of foods, particularly meats, had declined.

The latest staff projections for the second half of 1974 suggested that the rise in consumption expenditures would slow somewhat more from the first-half pace than had been anticipated 4 weeks earlier. The projected rise had been scaled down because of the recent continued sluggishness of retail sales and because

it no longer seemed likely that the rate of growth in disposable income would be augmented by a downward adjustment of the withholding schedule for Federal income taxes. Less expansion in both business fixed investment and residential construction also was now in prospect. It was still expected that government purchases of goods and services would continue to grow at a fairly rapid rate.

In foreign exchange markets the depreciation of the dollar against leading foreign currencies, which had been substantial over the preceding 3-1/2 months, was arrested in mid-May. The dollar was buoyed first by a news report that the United States, Germany, and Switzerland were contemplating concerted intervention in the markets, and later by the release of figures indicating improvement in U.S. foreign trade in April. On the balance of payments basis, the trade deficit had narrowed substantially, despite a further large rise in the cost of petroleum imports; over all, the increase in imports had been small while the gain in exports had been large. In May U.S. international transactions were in approximate balance on the official settlements basis, after having been in substantial deficit in the preceding 2 months. The improvement appeared to reflect an abatement in net outflows of capital reported by banks.

Growth in loans and investments at U.S. commercial banks moderated in May from the high rates earlier in the year, reflecting in large part a slowing in busines loan growth. While over-all business credit demands remained relatively strong, expansion in short-term credit--measured by the combination of bank loans and of borrowing in the commercial paper market--receded from the extraordinary pace of the preceding month to about the rate of the first quarter. Moreover, prime corporate borrowers tended to shift to commercial paper issuance as interest rates on prime paper declined relative to the effective rate on bank loans. At the same time, issuers with nonprime ratings experienced some difficulty in rolling over maturing commercial paper and, consequently, drew more heavily on their credit lines at banks.

Growth in the narrowly defined money stock (M_1)[1/] moderated further in May, to an annual rate of about 5.2 per cent. Weekly data suggested that the rate of growth had increased somewhat in early June, however, and it appeared likely that growth over the second quarter would be close to the 7 per cent rate of the first quarter.[2/] Banks' net inflows of time and savings deposits other than large-denomination CD's slowed in May, after having picked

1/ Private demand deposits plus currency in circulation.
2/ Growth rates cited are 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.

up in April, and expansion in the more broadly defined money stock (M_2)[3/] also slackened, to an annual rate of 5.5 per cent. In order to help finance loan growth, banks again issued a substantial amount of large-denomination CD's and continued to increase their borrowings in the Euro-dollar market, with the result that expansion in the bank credit proxy[4/]--although well below the unprecedented rate of April--was still relatively rapid. In late May and early June the increase in outstanding large-denomination CD's and Euro-dollar borrowings abated.

Net deposit inflows at nonbank thrift institutions continued to be weak in May, as yields on market securities remained attractive to savers; growth in the measure of the money stock that includes such deposits (M_3)[5/] slowed. Contract interest rates on conventional mortgages and yields in the secondary market for Federally insured mortgages rose further from early May to early June.

System open market operations since the May 21 meeting had been guided by the Committee's decision to maintain about the prevailing restrictive money market conditions, provided that the monetary aggregates appeared to be growing at rates within the

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3/ M_1 plus commercial bank time and savings deposits other than large-denomination CD's.

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

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

specified ranges of tolerance, while taking account of developments in domestic and international financial markets. In the first 2 weeks following the meeting, the maintenance of taut money market conditions, with the Federal funds rate averaging close to the upper limit of the 11 to 11-1/2 per cent range established by the Committee, served to counter incipient market anticipations of an easing in System policy and of declining interest rates. At the same time, it appeared that the monetary aggregates would grow in the May-June period at rates within their specified ranges.

In the first 3 days of the statement week beginning June 6 the Federal funds rate averaged about 11.40 per cent. The System Account Manager advised that market psychology was delicately poised; expectations of declining interest rates had strengthened during the previous week, partly in conjunction with publicity concerning 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. The members of the Committee concurred in the Chairman's recommendation of 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. Subsequently, estimates of the 2-month growth rates for the monetary aggregates were revised upward to the neighborhood of those upper limits, and in the remaining days before this meeting the funds rate fluctuated around 11-3/4 per cent.

In the four statement weeks ending June 12, member bank borrowings averaged about $3,120 million, up from an average of about $1,925 million in the preceding 4 weeks. The magnitude of the increase was associated with the special problems experienced by the Franklin National Bank.

Short-term market interest rates fluctuated in a narrow range in the period between the Committee's meeting on May 21 and this meeting, as money market conditions remained taut. Wide yield spreads between high- and lower-quality securities persisted as financial markets continued uneasy. Treasury bill rates remained unusually low relative to other short-term rates, reflecting not only the shift in investor preference toward securities of higher quality, but also the persistence of substantial purchases of bills by foreign monetary authorities and strong demands for such securities by small investors. On the day before this meeting the market

rate on 3-month bills was 8.17 per cent, compared with 7.94 per cent on the day before the May meeting.

Yields on long-term securities also fluctuated in a narrow range in the inter-meeting period. The volume of public offerings of corporate bonds--which had declined in April, in part because some scheduled offerings were postponed or canceled--rose substantially in May, and a further increase was in prospect for June. Offerings of State and local government issues declined moderately in May, and little change was in prospect for June.

A staff analysis suggested that maintenance of prevailing money market conditions would be associated with some slowing 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 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 remain relatively slow.

The Committee concluded that the economic situation continued to call for moderate growth in monetary aggregates over the months ahead. As at the May 21 meeting, the members decided that greater emphasis than usual should be placed on money market conditions

during the period until the next meeting. 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 June-July period at rates within specified ranges of tolerance. Also, against the background of the substantial growth rates recorded earlier in the year, the members 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 if such rates were to develop under 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 11-1/4 per cent to as high as 12-1/4 per cent, if necessary, in the course of operations. For the June-July period the Committee adopted ranges of tolerance of 3-1/2 to 7-1/2 per cent and 5-1/2 to 8-1/2 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 growth in reserves available to support private nonbank deposits (RPD's) during the same period at an annual rate within a 10 to 13-1/2 per cent range.

The Committee 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 will be about the same in the current quarter as a whole as in the first quarter, but that there has been some improvement as the spring has progressed. The over-all rate of price rise, while very large, is not quite so rapid as in the first quarter. In May industrial production increased somewhat for the second consecutive month, and nonfarm employment expanded substantially further. The unemployment rate moved above 5 per cent, however, as the civilian labor force rose sharply. 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 accelerated somewhat further.
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> In May the depreciation of the dollar against leading foreign currencies was arrested. U.S. international transactions were in approximate balance on the official settlements basis, as bank-reported net outflows of capital apparently abated. The foreign trade deficit narrowed in April, despite a further large rise in the cost of petroleum imports.

Growth in the narrowly defined money stock moderated in May, but apparently it accelerated in early June. Net inflows of consumer-type time deposits at banks slowed in May, and deposit experience at nonbank thrift institutions continued poor. Business credit demands remained large, although the expansion in short-term credit was below the extraordinary pace of April and was less concentrated at banks. In May banks increased their outstanding large-denomination CD's substantially further and continued to borrow in the Euro-dollar market; most recently, however, they have reduced their reliance on these sources of funds. Market interest rates have fluctuated in a narrow range in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resisting inflationary pressures, supporting a resumption of real economic growth, and achieving equilibrium in the country's balance of payments.

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to maintain about the prevailing restrictive money market conditions, provided that the monetary aggregates appear to be growing at rates within the specified ranges of tolerance.

Votes for this action:
Messrs. Burns, Black, Brimmer,
Bucher, Holland, Kimbrel, Mitchell,
Sheehan, Wallich, Winn, and Debs.
Vote against this action: Mr. Clay.

Absent and not voting: Mr. Hayes.
(Mr. Debs voted as alternate for Mr. Hayes.)

Mr. Clay dissented from this action because he thought that for too long the Committee had accepted rates of growth in the monetary aggregates that would result in a continuing and

growing inflation. He believed that the aggregates had not yet been brought under control and that the longer that situation persisted the more difficult it would be to achieve control and the greater would be the damage done to the economy by inflation.

Subsequent to this meeting, in the statement week ending July 3, the Federal funds rate was consistently above 13 per cent and averaged about 13-1/2 per cent, despite System efforts to bring the rate down into the 11-1/4 to 12-1/4 per cent range of tolerance that had been specified by the Committee. On July 5 the Committee held a telephone meeting to discuss the situation and to consider whether any Committee actions would be appropriate. Mr. Coldwell and Mr. Debs participated as alternates for Mr. Kimbrel and Mr. Hayes, respectively.

On the day of the telephone meeting, it appeared that in the June-July period growth in M_1 would be within its range of tolerance and that growth in M_2 would be at about the upper limit of its range. The Manager reported that in order to bring the funds rate back within its range of tolerance he would have had to expand reserve-supplying operations substantially. In his view, the high funds rate was a reflection of the great uncertainty prevailing in both domestic and foreign financial markets, compounded by the effects of market transactions related to the midyear statement

date for banks and by the July 4 holiday. The Committee concluded that there was no immediate need to press hard to bring the funds rate down within the specified range of tolerance, in view of the likelihood that the high level of the rate was primarily a consequence of technical factors that might well prove temporary.

Subsequent to the telephone meeting the volume of reserves provided was deemed sufficient to have reduced the Federal funds rate to about 12 per cent under normal circumstances. Member bank borrowing at the Reserve Banks was unexpectedly low, however, and the funds rate remained at an extremely high level; its average for the statement week ending July 10 was estimated at about 13-1/2 per cent. The Manager reported that it probably would be difficult to bring the weekly average rate down to the 12-1/4 per cent upper limit of the Committee's range of tolerance without providing nonborrowed reserves on a very large scale. It appeared that in the June-July period the growth rates of both M_1 and M_2 would be somewhat below the upper limits of their ranges of tolerance.

On July 10 Chairman Burns recommended that the Manager be instructed to act to reduce the funds rate, but not so aggressively as to risk unduly rapid growth in reserves and monetary aggregates. The Chairman recommended specifically that the Manager be instructed to undertake operations promptly with a view to reducing the average

funds rate to 13 per cent, on the understanding that the funds rate would be permitted to decline to the neighborhood of 12 per cent should money market factors work in that direction. All of the members concurred in this recommendation except Messrs. Bucher and Sheehan, who favored decisive action to reduce the Federal funds rate to the neighborhood of 12-1/4 per cent, and Mr. Winn, who opposed overt action to lower the funds rate, although he would not resist a decline produced by market forces.