FEDERAL RESERVE

press release

For immediate release

April 12, 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 January 12, 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 January 12, 1971

Authority to effect transactions in System Account.

The information reviewed at this meeting suggested that real output of goods and services (real GNP) had declined in the fourth quarter of 1970, largely as a consequence of the strike in the automobile industry that ended in late November. The resumption of higher automobile production was expected to result in a bulge in economic activity in early 1971. The rate of advance in major price indexes appeared to have moderated recently, following substantial increases earlier in the fall.

In December the labor market eased further, and the unemployment rate rose to 6.0 from 5.8 per cent in November. Although both nonfarm payroll employment and industrial production increased, the advances appeared to be attributable to the ending of the auto strike. On the other hand, weekly data suggested that nonautomotive retail sales might have been relatively strong during December. In November private housing starts had risen considerably further, to the highest rate in nearly 2 years.

Average wholesale prices--which had declined from mid-October to mid-November--were about unchanged in the following month, when a further reduction in prices of farm products and foods about offset an increase in prices of industrial commodities. Over the fourth quarter as a whole wholesale prices rose much less than in the preceding quarters of 1970 as a result of declines in prices of farm products and foods. In November the rise in the consumer price index slowed appreciably from the accelerated rate of the two preceding months.

Staff projections suggested that real GNP would rise sharply in the first quarter in the aftermath of the auto strike, but that the pace of the advance would then slow. For both the first and second quarters the projections contemplated sizable increases in residential construction expenditures and in State and local government outlays. Prospects were for moderate increases in consumer spending, apart from the anticipated return to a higher rate of new car purchases early in the year. Neither defense spending nor business outlays on fixed investment were expected to contribute to expansion in GNP over the first half of the year. It was noted, however, that these projections did not make allowance for the probability that steel users would accumulate inventories of that metal as a hedge against a possible strike in the steel industry at the end of July, when current wage contracts will expire.

The deterioration in the U.S. foreign trade balance that had been under way since mid-1970 continued in November. In June and July merchandise exports had been substantially larger than imports, but the surplus had declined in each of the three succeeding months, and in November exports were slightly smaller than imports. With respect to the over-all balance of payments, tentative estimates for the fourth quarter suggested that on the "liquidity" basis[1/] the deficit had remained about as large as in the third quarter. The deficit on the "official reserve transactions" basis was very large, mainly as a result of heavy repayments of Euro-dollar borrowings by U.S. banks.

Interest rates in the Euro-dollar market rose considerably in the first half of December and then declined sharply after mid-month, reflecting seasonal forces to a large extent. Also contributing to the early-December rise in rates was more aggressive bidding by U.S. banks for Euro-dollars following the November 30 announcement by the Board of Governors of certain measures designed to moderate repayments of Euro-dollar borrowings by these banks. In general, exchange rates for major foreign currencies eased in early December while Euro-dollar interest rates were rising; then toward the end of the month they firmed as Euro-dollar rates declined. Effective January 9, the Bank of France reduced its discount rate from 7 to 6-1/2 per cent.

The Treasury was expected to announce on January 20 the terms on which it would refund securities maturing on February 15, including

1/ The balance on the "liquidity" basis is measured by changes in U.S. reserves and in liquid U.S. liabilities to all foreigners. The balance on the "official reserve transactions" basis (sometimes referred to as the "official settlements" basis) is measured by changes in U.S. reserves and in liquid and certain nonliquid liabilities to foreign official agencies, mainly monetary authorities. The latter balance differs from the former by (1) treating changes in liquid U.S. liabilities to foreigners other than official agencies (including liabilities to U.S. bank branches abroad) as ordinary capital flows, and (2) treating changes in certain nonliquid liabilities to foreign monetary authorities as financing items rather than ordinary capital flows.

about $5 billion held by the public. It appeared likely that the Treasury would decide at the same time to refund securities maturing in mid-March, and perhaps also to pre-refund certain issues maturing later in the year.

In capital markets the strong rally that had been under way since late October halted in mid-December, but only temporarily; yields rose on most types of long-term bonds during the closing weeks of the year, but they turned down again in early January. Short-term interest rates followed a similar pattern. For example, the market rate on 3-month Treasury bills reached a low of about 4.75 per cent shortly after mid-December, advanced to about 4.90 per cent near year-end, and then declined to about 4.65 per cent on the day before this meeting.

Various factors contributed to the upward pressures on interest rates in late December. These included the very heavy recent and prospective volume of corporate and municipal bond offerings, the possibility that the Treasury might pre-refund a sizable volume of securities in connection with its mid-February financing, and--in the Government securities sector--uncertainties that existed for a time about the availability of insurance against loss or theft. The renewed declines in market interest rates were stimulated by continuing reports of sluggishness in economic activity, by an easing of conditions in money markets, and by further reductions in the prime lending rate of commercial banks and in Federal Reserve discount rates. The prime rate was lowered to 6-3/4 per cent on December 22, 1970, and then to 6-1/2 per cent on January 6, 1971; and discount rates at 10 Federal Reserve Banks were reduced from 5-1/2 to 5-1/4 per cent effective January 8.

In December interest rates on residential mortgages declined further in both primary markets for conventional home loans and secondary markets for federally underwritten mortgages. Nonbank thrift institutions continued to experience very heavy inflows of savings funds during December, and the net outflows following year-end interest and dividend crediting were much smaller than usual.

At commercial banks substantial increases were recorded in December in both consumer-type time and savings deposits and large-denomination certificates of deposit (CD's). The volume of business loans outstanding (adjusted to include loans that had been sold to affiliates) declined for the fourth successive month. However, banks continued to acquire securities at a rapid rate, and total bank credit--as measured by the "adjusted bank credit proxy"[2/]--rose sharply from November to December.

2/ The series called the "adjusted bank credit proxy" consists of daily-average figures on total member bank deposits subject to reserve requirements, plus Euro-dollar borrowings, bank-related commercial paper, and certain other nondeposit items. In recent years the Committee has been making use of this series as the best available measure, although indirect, of developing movements in bank credit. Because the series can be compiled with a very short lag, it can be kept more nearly current than available bank loan and investment data. Moreover, daily-average figures for a calendar month are much less subject to the influence of single-date fluctuations than are the available month-end data on total bank credit, which represent estimates of loans and investments at all commercial banks on one day--the last Wednesday--of each month. For monthly statistics, see the series entitled "Total member bank deposits plus nondeposit items" in the statistical section of the Federal Reserve BULLETIN (on page A-17 of the January 1971 issue).

Various measures of the money stock also expanded considerably on the average in December--including "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. However, growth in M_1 was smaller both in December and over the fourth quarter as a whole than had been expected at the time of the previous meeting of the Committee. After having expanded at an annual rate of approximately 6 per cent during the first three quarters of 1970, M_1 increased over the fourth quarter at a rate of about 3.5 per cent.[3/] Fourth-quarter growth rates for M_2 and the adjusted bank credit proxy were about 9 and 8 per cent, respectively.

System open market operations following the mid-December meeting of the Committee had been directed initially at maintaining the money market conditions that had recently been attained. Subsequently, however, when it became clear that M_1 was expanding at rates below earlier expectations, easier money market conditions were sought. Operations were complicated by the market churning that is typical of the period around a year-end, and conditions fluctuated relatively widely from day to day. Most recently, however, Federal funds had traded at an effective rate of about 4-1/2 per cent, compared with the rates around 5 per cent that had prevailed shortly before the preceding meeting. During the interval the System supplied a substantial volume of reserves, partly through purchases of longer-term Treasury securities.

3/ 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.

Staff analysis suggested that the bulge in economic activity anticipated for the first quarter would tend to produce more rapid growth in money and bank credit than had been recorded in the fourth quarter. According to the analysis, however, some further easing of money market conditions probably would be required if M_1 were to expand sufficiently over the first quarter--at an annual rate of about 7.5 per cent--to compensate for the shortfall in the fourth quarter from the expected growth rate.

The Committee agreed that it would be desirable at this time to promote accommodative conditions in credit markets and moderate expansion in monetary and credit aggregates. In the discussion divergent views were expressed about the degree to which open market operations during the period immediately ahead should be directed toward attaining specific objectives for various monetary and credit aggregates. A number of members favored seeking growth rates in the first quarter high enough to make up for the fourth-quarter shortfall in M_1. Others, while not necessarily opposed to such growth rates, noted that their concern about the shortfall was mitigated by the recent relatively high rates of expansion in M_2 and the bank credit proxy, or by the fact that they did not attach great importance in any event to short-run fluctuations in the growth rate of a single monetary aggregate.

At the conclusion of the discussion the Committee agreed that the attainment of its objectives for both credit conditions and the monetary and credit aggregates would be facilitated by some moderate easing of money market conditions; and that such easing should be accomplished soon, partly because it would become necessary to take account of the forthcoming Treasury financing later in the month. The members also agreed that money market conditions should be eased somewhat further if it appeared that the aggregates were expanding at rates below those consistent with making up the fourth-quarter shortfall in M_1.

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 declined in the fourth quarter of 1970, largely as a consequence of the recent strike in the automobile industry. Unemployment increased further in December. The resumption of higher automobile production is expected to result in a bulge in activity in early 1971. 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. The rise in both wholesale and consumer prices appears to have moderated recently, following substantial increases earlier in the fall. Most market interest rates turned down again in recent days, and Federal Reserve discount rates were reduced by an additional one-quarter of a percentage point. Demands for funds in capital markets have continued heavy, but business loan demands at banks remain weak. Although growth in the money supply accelerated in December, over the fourth quarter as a whole it was at a rate below that prevailing in the preceding three quarters. Banks made substantial further additions to their holdings of securities in December, and bank credit increased sharply. The foreign trade surplus has declined markedly in recent months. The over-all balance of payments deficit on the liquidity basis in the fourth quarter was apparently about as large as in the third quarter. The deficit on the official settlements basis was very large as banks continued to repay 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 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, the Committee seeks to promote accommodative conditions in credit markets and moderate expansion in monetary and credit aggregates. 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, taking account of the forthcoming Treasury financing.

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

Absent and not voting: Messrs. Hayes and Sherrill. (Mr. Treiber voted as alternate for Mr. Hayes, and Mr. Mayo voted as alternate for the late Mr. Hickman.)

Mr. Francis dissented from this action for reasons similar to those underlying his dissent from the directive adopted at the December meeting. In his judgment, if growth in M_1 were maintained over coming months at an average annual rate of approximately 5 per cent--about the average prevailing over the second half of 1970--the longer-run performance of production and prices would be better than if money were to expand at some faster rate. In addition, he favored reducing the emphasis given to money market conditions in implementing open market policy.