FEDERAL RESERVE

press release

For immediate release July 6, 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 April 6, 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 April 6, 1971

Authority to effect transactions in System Account.

Information reviewed at this meeting suggested that real output of goods and services had risen substantially in the first quarter primarily because of the post-strike recovery of production in the automobile industry, but that the unemployment rate had remained high. Growth in real GNP was expected to slow in the current quarter. While wage rates were continuing to rise at a rapid pace in most sectors of the economy, the rate of advance in some major price indexes seemed to have moderated recently.

In March nonfarm payroll employment was about unchanged, and the unemployment rate moved back up to 6.0 per cent after having dipped to 5.8 per cent in February. Incomplete data suggested that retail sales had risen moderately and that industrial production had remained near the February level. Apart from fluctuations related to the auto strike, it appeared that in the first quarter as a whole retail sales were about the same as in the fourth quarter of 1970 and that industrial production had declined somewhat further. On the other hand, private housing starts continued at the high January rate in February and may have increased further in March.

Wholesale prices of industrial commodities rose further from mid-February to mid-March, but the increase in that period--and over the first quarter as a whole--was at a rate below the average pace of 1970. The rate of advance in the consumer price index slowed in February for the second successive month.

Expansion in real GNP was expected to moderate in the second quarter mainly because consumer and business spending on motor vehicles would be increasing much less rapidly than it had in the first quarter in the aftermath of the auto strike. In addition, defense spending was expected to decline further. As before, however, the staff projections suggested that residential construction expenditures and State and local government outlays would continue to rise at substantial rates, and that business inventory investment would be augmented by continued stockpiling of steel in anticipation of a possible strike in that industry at the beginning of August.

The possibility of a steel strike lent a high degree of uncertainty to the economic outlook for the second half of 1971. However, the average growth rate in real GNP over the second half was projected to be somewhat higher than the rate now anticipated for the second quarter, on the assumption that the duration of any such strike would be limited to about 60 days. It was expected that expansion in consumer spending would be sustained in part by the recently enacted increase in social security benefits, under which payments retroactive to January 1 were scheduled to be made in late June; possibly by a military pay increase around midyear; and possibly by some decline in the personal saving rate in the third and fourth quarters. In line with the results of the latest Commerce-SEC survey of business spending plans, taken in February, growth in business fixed investment outlays was projected to increase moderately over the second half. Continued sizable gains appeared to be in prospect for State and local government outlays, but it seemed likely that residential construction expenditures would expand more slowly than earlier in the year.

The U.S. foreign trade surplus was very small in January and February. With respect to the over-all balance of payments, it seemed likely that in the first quarter as a whole the deficit on the liquidity basis was at a rate higher than in the first half of 1970 and much higher than in the second half of that year. The worsening reflected principally an increase in net capital outflows.

On the official settlements basis, the first-quarter deficit in the payments balance was exceptionally large. International flows of interest-sensitive funds continued heavy in March, and major European countries experienced very substantial reserve gains. Recently, several European central banks had lowered their discount rates; in particular, the German Federal Bank and the Bank of England had made reductions of a full percentage point on April 1. These actions tended to narrow the wide differentials between short-term interest rates in

Europe and the United States. Nevertheless, exchange market demands for German marks were very strong at the beginning of April, and there were indications of speculative and hedging activity. At the time of this meeting, however, the markets appeared to be quieting.

On April 1 the U.S. Treasury announced an offering of $1.5 billion of special securities to foreign branches of U.S. banks, for payment April 9. Like similar Export-Import Bank issues earlier in the year, this offering was intended to help restrain the flows of funds to other countries.

In domestic securities markets, the Treasury announced on March 16 that it would offer $5 billion of new bills in three segments: a $2 billion addition to the outstanding tax-anticipation bills that were to mature on April 22, to be auctioned on March 24; a strip of bills maturing from July 8 to September 16, totaling $2.2 billion, to be auctioned on March 31; and $200 million increments to four consecutive weekly offerings of 6-month bills, beginning with the March 22 offering. The Treasury was expected to announce on April 28 the terms on which it would refund notes maturing in mid-May, including $5.8 billion held by the public.

Interest rates on most types of short-term securities had risen on balance in recent weeks. For example, the market rate on 3-month Treasury bills, at about 3.70 per cent on the day before this meeting of the Committee, was approximately 40 basis points above its level at the time of the March 9 meeting. The upturn in short-term yields reflected in part the additions to the outstanding supply of bills resulting from the Treasury's new offerings and the somewhat firmer money market conditions that developed during the period.

In March public offerings of new corporate bonds--which had been very large in recent months--expanded to an unprecedented volume, and offerings of State and local government issues continued heavy. Nevertheless, yields on new corporate and municipal bonds declined sharply after early March, reversing the advance of preceding weeks; and yields on Treasury notes and bonds also moved lower. The capital market rally was apparently a consequence of reports suggesting that the economy was recovering less rapidly than many market participants had anticipated and, more generally, of a modification of earlier views that long-term interest rates had already passed their cyclical lows. Although bond yields subsequently advanced somewhat, they still were well below the levels of 4 weeks earlier at the time of this meeting.

Interest rates on conventional home mortgages continued to decline in February. Yields in secondary markets for federally insured mortgages, which also had declined further in February, remained about unchanged over the course of March. At nonbank thrift institutions, inflows of savings funds had reached extra-ordinarily high levels in January and February, when interest rates on competitive short-term market instruments were falling markedly. These inflows continued at an extremely rapid pace in March, according to incomplete data for that month.

Although many commercial banks reduced their offering rates on consumer-type time and savings deposits during March, inflows of such deposits remained heavy at banks also. However, large-denomination CD's expanded only moderately further. The volume of business loans outstanding (including loans that had been sold to affiliates) declined during the month, and on March 11 major banks again reduced their prime lending rates--some by 1/2 of a percentage point, to 5-1/4 per cent, but most by 1/4 of a point. On March 19 the 5-1/4 per cent prime rate became general. Banks continued to increase their holdings of securities at a substantial pace and to reduce their reliance on nondeposit sources of funds, including borrowings of Euro-dollars from their foreign branches.

Preliminary estimates indicated that there had been a substantial increase from February to March in total bank credit, as measured by the adjusted proxy series--daily-average member bank deposits adjusted to include funds from nondeposit sources. However, the increase was less than that expected at the time of the March 9 meeting of the Committee and also less than the rise recorded in the previous month. Like bank credit, both the narrow and broader measures of the money stock--M_1 and M_2--rose substantially on the average in March, although less sharply than in February. In contrast to bank credit, however, both 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) increased considerably more than had been anticipated. Annual rates of growth over the first quarter as a whole[1/] were estimated at about 11 per cent for the proxy series and about 8 and 17.5 per cent, respectively, for M_1 and M_2.

System open market operations since the preceding meeting of the Committee had been directed at achieving a slight firming of money market conditions, as incoming data indicated that M_1 and M_2 were growing considerably faster than expected. At the same time, efforts were made during the period to counter repetitive tendencies toward undue firmness that arose from market factors affecting reserves. The Federal funds rate, which had averaged about 3-1/2 per cent shortly before the March 9 meeting, subsequently fluctuated mostly around 3-3/4 per cent--although it rose to 4 per cent or above on a number of days in mid-March and again in late March and early April. As in other recent weeks, an important part of reserve needs was met by System purchases of intermediate- and long-term Treasury securities.

Staff analysis suggested that, if prevailing money market conditions were maintained, M_1 would continue to rise rapidly early in the second quarter and would grow somewhat faster over the quarter

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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.

as a whole than it had in the first quarter. The analysis also suggested that expansion in time and savings deposits other than large-denomination CD's would slow substantially in coming months, in part because of the spreading practice among banks of reducing rates offered on such deposits. As a result, it was expected that growth in M_2 would moderate in the second quarter from its exceptionally rapid first-quarter pace. In addition, it appeared likely that the volume of CD's outstanding would increase relatively little further over the quarter and that this development, along with slower expansion of other time deposits, would contribute to an expected moderation in the growth of the adjusted bank credit proxy.

The Committee decided that open market operations at present should be directed at attaining temporarily some minor firming of money market conditions. Some members favored this course primarily for the purpose of achieving less rapid growth in the monetary aggregates than the staff analysis indicated might eventuate in the second quarter under unchanged money market conditions. Others placed main emphasis on the objective of contributing, at least marginally, to a narrowing of the differentials between short-term interest rates in this country and abroad, in the interest of moderating capital outflows. In the former connection, the Committee indicated that it would like to see more moderate expansion in the monetary aggregates in the second quarter than had occurred in the first. As a step in that direction it was felt that growth in M_1 in April at a slower rate than in March and more in line with the first-quarter rate would be desirable, and various members expressed a desire for further slowing in M_1 as the quarter progressed. It was recognized that the aggregates were likely to increase at faster rates in April than over the second quarter as a whole. The Committee agreed that money market conditions should be modified somewhat if the monetary and credit aggregates appeared to be deviating substantially from the growth paths desired.

The Committee also decided that needs for reserves should continue to be met to the extent feasible by purchases of long-term Treasury securities, in the interest of promoting accommodative conditions in long-term credit markets. It was noted that later in April even-keel considerations related to the forthcoming Treasury refunding would begin to place constraints on operations in coupon issues, as well as on operations directed at modifying money market conditions.

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 rose substantially in the first quarter primarily because of the resumption of higher automobile production, but that the unemployment rate remained high. More moderate growth in real GNP appears to be in prospect for the current quarter. Wage rates in most sectors are continuing to rise at a rapid pace. The rate of advance in consumer prices and in wholesale prices of industrial commodities appears to have moderated recently.

In March bank credit and the money stock both narrowly and broadly defined again expanded substantially, although the increases were less sharp than in February. Inflows of consumer-type time and savings funds to banks and nonbank thrift institutions reached unusually high levels in the first quarter as interest rates on competitive short-term market instruments declined considerably further. In recent weeks, however, key short-term interest rates have moved up somewhat on balance. Yields on new issues of corporate and municipal bonds declined during much of March despite a continuing heavy calendar of offerings, but most recently long-term market yields have also risen somewhat. The over-all balance of payments deficit in the first quarter was exceptionally large. The trade surplus for the first two months was very small, and capital outflows have been stimulated by wide short-term interest rate differentials. Despite recent reductions in the discount rates of several European central banks, these differentials remain wide. 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, moderation of short-term capital outflows, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of the Treasury financing the terms of which are to be announced late in the month, System open market operations until the next meeting of the Committee shall be conducted with a view to attaining temporarily some minor firming in money market conditions, while continuing to meet some part of reserve needs through purchases of coupon issues in the interest of promoting accommodative conditions in long-term credit markets; provided that money market conditions shall be modified if it appears that the monetary and credit aggregates are deviating significantly from the growth paths desired.

Votes for this action: Messrs. Burns, Brimmer, Clay, Daane, Maisel, Mayo, Morris, Robertson, and Sherrill. Votes against this action: Messrs. Hayes and Kimbrel.

Absent and not voting: Mr. Mitchell.

In dissenting, Messrs. Hayes and Kimbrel noted that they favored more firming of money market conditions than contemplated under this directive, although not so much firming as to cause serious repercussions in bond markets. Mr. Hayes thought the directive gave inadequate recognition to the need for moving toward somewhat higher short-term interest rates in light of the international financial situation, and he also expressed concern about the risk of excessive growth in the money stock. Mr. Kimbrel believed that higher short-term interest rates would be desirable mainly to hold growth in the monetary and credit aggregates to a moderate pace in order to avoid a rekindling of inflationary expectations.