



FEDERAL RESERVE

press release

For immediate release

May 11, 1970

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 February 10, 1970. Such records are made available approximately 90 days after the date of each meeting of the Committee and will be found in the Federal Reserve Bulletin and the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on February 10, 1970

Authority to effect transactions in System Account.

According to information reviewed at this meeting, over-all economic activity apparently was weakening further in early 1970 but prices and costs were continuing to rise rapidly. Staff projections suggested that real GNP, which had leveled off in the fourth quarter of 1969, would decline slightly in the first half of 1970 but would begin growing again in the second half. Some moderation in the rate of price advance was expected over the course of the year.

Industrial production was tentatively estimated to have declined in January for the sixth consecutive month. There were various indications that the demand for labor was continuing to ease: Total nonfarm employment was about unchanged in January at the level reached 3 months earlier, the average length of the workweek in manufacturing had declined sharply, and the over-all unemployment rate had risen to 3.9 per cent after 2 months at the (revised) level of 3.5 per cent. Retail sales estimates for November and December had been revised downward to levels below October, and weekly sales data for January suggested only a slight advance in that month. Private housing starts declined again in December, reaching their lowest level since June 1967, and the downtrend had apparently continued in January.

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Average wholesale prices continued to rise at a rapid pace from mid-December to mid-January; the increase was exceptionally sharp for farm products and foods. The consumer price index again advanced rapidly in December.

Federal budget estimates recently released by the administration showed small surpluses in both the 1970 and the 1971 fiscal years, despite the reduction of the income tax surcharge from 10 to 5 per cent on January 1, 1970, and its scheduled expiration on July 1. The budget document implied tight controls over expenditures; it suggested that Federal purchases of goods and services would decline over the course of the 1970 calendar year, with substantial cutbacks in defense expenditures. However, a sharp rise in transfer payments was in prospect for the second quarter, reflecting an increase in social security benefit payments--and a retroactive payment for the period since January 1--under legislation that had been enacted earlier.

The staff's GNP projections for the first half of 1970 suggested further reductions in business inventory accumulation and in residential construction outlays as well as in defense spending. Only moderate increases in consumer spending were projected--despite the reduction in the surtax in the first quarter and the anticipated increase in social security benefit payments in the second--because it appeared likely that smaller gains in employment and shorter workweeks would tend to slow the growth in personal income and that

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the personal saving rate would rise somewhat. It was expected, however, that business capital spending would increase substantially further in the first half.

The projections of resumed growth in real GNP in the second half of 1970 were based in part on expectations of a recovery in residential construction outlays, some step-up in spending by State and local governments, an end to the reduction in business inventory accumulation, and the elimination of the income tax surcharge at midyear. However, the rate of increase in real GNP was expected to be held to moderate proportions by continuing declines in defense spending and by a leveling off in business capital outlays.

The surplus in U.S. merchandise trade rose in December, as imports declined more than exports. For the fourth quarter as a whole the trade surplus was somewhat larger than in the preceding quarter. The over-all payments balance reverted to deficit in January on both the liquidity and official settlements bases, as a result of cessation (and partial reversal) of the exceptionally large year-end inflow of funds that had produced large surpluses in December and in the fourth quarter as a whole.

In foreign exchange markets sterling strengthened significantly after mid-January. The Italian lira was under considerable selling pressure throughout the month. Euro-dollar rates declined more than seasonally in January, in part because of reduced demands for Euro-dollars by U.S. banks.

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On January 28 the Treasury announced that, in exchange for bonds maturing on February 15 and March 15, it would offer three new notes having, respectively, maturities of 18 months, 3-1/2 years, and 7 years, and yields of 8-1/4, 8-1/8, and 8 per cent. The refunding was favorably received by the market, and according to preliminary estimates, only about 15 per cent of the \$5.6 billion of maturing securities held by the public were turned in for cash.

Interest rates on new corporate and municipal bonds and on outstanding Treasury securities of all maturities had fluctuated over a relatively wide range since the January 15 meeting of the Committee. The rate declines that had been under way earlier in the month continued for a time after mid-January, against the background of additional reports indicating weakness in the economy. Subsequently, however, yields turned up under the pressure of a mounting volume of new corporate and municipal issues and continued large-scale borrowing by Federal agencies. Then, around the month-end, yields moved sharply downward as market participants interpreted statements by various officials as suggesting that monetary restraint would be eased soon. On the day before this meeting the market rate on 3-month Treasury bills was 7.30 per cent, about 55 basis points below its mid-January level.

At both commercial banks and nonbank thrift institutions, outflows of savings funds--which had been unusually heavy following

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year-end interest and dividend crediting--continued at a significant rate throughout January. On January 20 the Board of Governors of the Federal Reserve System announced moderate increases in maximum interest rates payable by member banks on time and savings deposits.^{1/} At about the same time the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board announced increases in maximum rates payable by the banks and savings and loan associations over which they have regulatory authority. Thus far these actions had had little observable effect on flows of time and savings funds.

Private demand deposits and the money stock declined over the course of January, following a sharp and sudden rise at the year-end, and

^{1/} By amendment to Regulation Q effective Jan. 21, 1970, the Board of Governors increased from 4 to 4-1/2 per cent the maximum rate payable on passbook savings and on 30- to 89-day "consumer-type" time deposits--those of less than \$100,000--of multiple maturity. Maximum rates were increased from 5 per cent to 5-1/2 and 5-3/4 per cent, respectively, for 1-year and 2-year single-maturity consumer-type deposits; for other consumer-type deposits (that is, multiple maturities of 90 days and over and single maturities of less than 1 year) the previous maximum of 5 per cent was retained. In addition, the following changes were made in maximum rates payable on time deposits of \$100,000 or more:

<u>Maturity</u>	<u>New maximum</u> (per cent)	<u>Previous maximum</u>
30-59 days	6-1/4	5-1/2
60-89 days	6-1/2	5-3/4
90-179 days	6-3/4	6
180 days to 1 year	7	6-1/4
1 year or more	7-1/2	6-1/4

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by early February they were below their average December levels. However, the erosion of the year-end bulge in these series was slower than expected, and from December to January on the average the money stock increased at an annual rate of 9 per cent. Meanwhile, total time and savings deposits contracted sharply--at an estimated annual rate of 12.5 per cent--because of the large outflow of consumer-type deposits.

Reflecting diverse movements among deposit categories, the bank credit proxy--daily-average member bank deposits--declined from December to January at an annual rate estimated at about 3.5 per cent. A sharp increase in funds obtained through sales of commercial paper by bank affiliates was nearly offset by a decline in the average level of Euro-dollar borrowings through foreign branches. After taking into account the net change in funds from these "nondeposit" sources, the adjusted bank credit proxy was estimated to have declined at an annual rate of about 3 per cent from December to January. In the fourth quarter of 1969 the money stock and the adjusted proxy series had increased at annual rates of about 1.5 and 2 per cent, respectively.

Along with the amendment to Regulation Q, on January 20 the Board of Governors published for comment a proposed rule applying reserve requirements to certain types of bank-related commercial paper. It was noted that the proposed action was of a type explicitly

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authorized by legislation enacted December 23, 1969. Earlier--on October 29, 1969--the Board had announced that it was considering applying interest rate ceilings to certain bank-related commercial paper, but action on that proposal subsequently was withheld while consideration was being given to the application of reserve requirements to the same type of paper.

System open market operations since the preceding meeting of the Committee had been directed at maintaining firm conditions in the money market, with operations subject to modification if it appeared that the Committee's objective of modest growth in the money stock and bank credit over the first quarter was not being achieved. In fact, not only had the average levels of two aggregates moved in opposite directions from December to January--the money stock rising and the bank credit proxy declining--but also, during the period since the previous meeting, the projections for the first quarter had been revised upward for the money stock and downward for the proxy series. In the 4 weeks ending February 4, the Federal funds rate averaged slightly more than 9 per cent and member bank borrowings about \$1 billion, both relatively close to their averages in the preceding 4 weeks. Average net borrowed reserves increased somewhat as excess reserves declined from the seasonal high they had reached at the year-end.

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The latest staff projections suggested that, if prevailing money market conditions were maintained, the average level of the money stock would decline from January to February and would rise by a roughly equal amount from February to March; and that over the first quarter as a whole the money stock would expand at an annual rate of 3 to 4 per cent. The adjusted bank credit proxy, on the other hand, was projected to decline over the quarter at an annual rate of 2 to 4 per cent. This projection reflected an expectation that time and savings deposits--particularly consumer-type deposits--would continue to contract for a time, although there was some prospect that the decline would end in late February or early March as the quarterly interest-crediting period approached. It also seemed possible that by March large-denomination CD's--particularly those of longer maturity--might become at least marginally competitive with other market securities.

An alternative set of projections suggested that the money stock would grow slightly more rapidly over the first quarter--at an annual rate of 4 to 5 per cent--if money market conditions were eased somewhat at present. It was anticipated that with such a change time and savings deposits would be stronger than otherwise in March; and that the adjusted bank credit proxy might advance sufficiently in that month to result in no net decline, or perhaps a slight rise, over the first quarter as a whole. It was noted that any easing of

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money market conditions would be expected to have a greater stimulative effect on bank credit in the second quarter than in the first.

The Committee concluded that, in light of the latest economic developments and the current business outlook, it was appropriate to move gradually toward somewhat less restraint at this time. In particular, the Committee decided that money market conditions should be shaded in the direction of less firmness, beginning immediately, with a view to encouraging moderate growth in money and bank credit over the months ahead. It was agreed that the shift toward less firm money market conditions should be implemented cautiously, with close attention to successive estimates of growth rates in the monetary and credit aggregates; and that operations should be modified promptly if those aggregates appeared to be deviating significantly from a pattern of moderate growth.

Some members expressed the view that the longer any relaxation of prevailing money market firmness was postponed the greater the likelihood that developments in the economy would necessitate an unduly large and abrupt move toward monetary ease later on. At the same time, some members noted that caution was needed to avoid creating an exaggerated impression of the amount of relaxation contemplated, since widespread misunderstanding on that score could stimulate a new surge of inflationary expectations.

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It was also agreed that in the conduct of open market operations account should be taken of the current Treasury refunding and of any regulatory action by the Board of Governors with respect to bank-related commercial paper. 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 economic activity, which leveled off in the fourth quarter of 1969, may be weakening further in early 1970. Prices and costs, however, are continuing to rise at a rapid pace. Long-term market interest rates recently have fluctuated under the competing influences of heavy demands for funds and shifts in investor attitudes regarding the outlook for monetary policy. Bank credit declined in January but the money supply increased substantially on average; both had risen slightly in the fourth quarter. Flows of time and savings funds at banks and nonbank thrift institutions have remained generally weak since year-end, and they apparently have been affected little thus far by the recent increases in maximum rates payable for such funds. The U.S. foreign trade balance improved somewhat in December, as imports fell off. The over-all balance of payments has been in substantial deficit 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 the orderly reduction of inflationary pressures, with a view to encouraging sustainable economic growth and attaining reasonable equilibrium in the country's balance of payments.

To implement this policy, while taking account of the current Treasury refunding, possible bank regulatory changes and the Committee's desire to see moderate growth in money and bank credit over the months ahead, System open market operations until the next meeting of the Committee shall be conducted with a view to moving gradually toward somewhat less firm conditions in the money market; provided, however, that operations shall be modified promptly to resist any tendency for money and bank credit to deviate significantly from a moderate growth pattern.

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Votes for this action: Messrs. Burns, Bopp, Clay, Daane, Maisel, Mitchell, Robertson, Scanlon, and Sherrill. Votes against this action: Messrs. Hayes, Brimmer, and Coldwell.

The members who dissented from the policy directive did so primarily because they felt that any overt move toward less firm money market conditions was premature at this time and could strengthen market expectations of substantial easing. While recognizing some areas of weakness in the economy, they were impressed by the strength of inflationary expectations, the continuing increases in prices and wages, business plans for a large volume of capital spending, and the prospectively large balance of payments deficit. They were also concerned about the prospects for adequate fiscal restraint, even though the budget called for a small surplus. They agreed with the majority of the Committee that some growth in the monetary and credit aggregates was called for, but in their view this objective could have been covered adequately by a directive similar to the one the Committee had adopted at its January meeting. Thus, they preferred not to relax restraint at this time because of the risk of encouraging resurgent growth in over-all demand before inflationary pressures and expectations had been adequately dampened.