FEDERAL RESERVE

press release

For immediate release August 3, 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 May 5, 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 May 5, 1970

1. Authority to effect transactions in System Account.

Preliminary estimates of the Commerce Department indicated that real GNP had declined at an annual rate of 1.6 per cent in the first quarter of 1970, after having edged down at a rate of 0.4 per cent in the preceding 3-month period. Staff projections suggested that real economic activity would change little in the second quarter and would resume growth at a moderate pace after midyear. Although prices and costs in general were continuing to rise rapidly, some components of major price indexes recently had shown moderating tendencies. Since early April there had been a sharp, sustained decline in prices of common stock.

In April the unemployment rate rose for the fourth consecutive month, to 4.8 per cent. Industrial production--which had edged up in March after 7 months of contraction--was tentatively estimated to have declined again, in part because of the effects of work stoppages in the trucking industry. In March new orders for durable goods had dropped appreciably, but private housing starts had risen sharply for the second consecutive month. Retail sales had changed little, according to preliminary estimates. However, incomplete weekly figures for April suggested that sales might have risen a little in that month.

The preliminary wholesale price index declined from mid-March to mid-April as a result of a reduction in prices of farm products and foods. Average prices of industrial commodities increased at about the same rate as in the previous month, which was somewhat less rapid than in most other recent months. The pace of advance in the seasonally adjusted consumer price index slowed somewhat further in March, although it remained substantial.

According to the Commerce Department estimates, the decline in real economic activity in the first quarter of 1970--as in the preceding quarter--reflected a reduction in inventory investment; in both quarters total final sales had advanced moderately. The staff projections suggested that inventory investment would fall a little further in the second quarter and would then rise somewhat after midyear. It appeared likely that consumer spending would be sustained in coming months by the second-quarter increases in Federal pay and in social security benefits, both of which were retroactive to the beginning of 1970, and by the elimination at midyear of the remaining 5 per cent income tax surcharge. Also, it was expected that residential construction activity would turn up in the second half. On the other hand, the projections for the final two quarters of the year allowed for a slowing of the rise in business spending on plant and equipment and for a resumption of the decline in Federal outlays on goods and services.

The surplus on U.S. foreign trade improved somewhat in the first quarter, as exports rose more than imports. However, the overall balance of payments was in considerable deficit on both the liquidity and the official settlements bases. The deficit on the latter basis was particularly large because of the substantial decline, beginning in mid-January, in outstanding Euro-dollar borrowings of U.S. banks through their branches abroad.

In foreign exchange markets most major foreign currencies had remained in strong demand during recent weeks. Effective April 15, the Bank of England reduced its discount rate from 7-1/2 to 7 per cent, the second half-point reduction since early March.

On April 29 the Treasury announced the terms on which it would refinance securities that matured in mid-May, including $4.9 billion held by the public. In exchange for the maturing securities, holders were offered the choice of two reopened issues--the 7-3/4 per cent notes of May 1973 (priced to yield 7.98 per cent) and the 8 per cent notes of February 1977 (priced at par). In addition, $3.5 billion of an 18-month, 7-3/4 per cent note (priced to yield 7.79 per cent) was offered to the public for cash. Subscription books were open on May 5--the day of this meeting--for the cash offering, and on May 4-6 for the exchange offering.

Conditions in financial markets had been unsettled in recent weeks, and interest rates on most types of market securities had advanced rapidly. In long-term debt markets yields on new corporate issues and on Treasury bonds now exceeded their late-1969 highs, and yields on municipal securities were close to those peaks. The market rate on 3-month Treasury bills had risen since the previous meeting of the Committee by about 50 basis points--to 6.90 per cent on the day before this meeting--and rates on 6-month and 1-year bills had moved up by about 90 and 95 basis points, respectively.

Among the factors contributing to these rate increases, and to the unsettlement in financial markets generally, were the concern about prospects for the Government's anti-inflationary program--stimulated in part by the Federal pay raise that followed the recent postal workers' strike--and the uncertainties resulting from the President's announcement on April 30 of U.S. military operations in Cambodia. The rate increases also reflected the continuing very heavy volume of offerings in capital markets; perhaps some increase in liquidity preferences; and the disappointment of earlier expectations of further easing of conditions in the money market. The bulk of the recent advances in Treasury bill rates occurred during the last 10 days of April, after it had become evident that the Federal Reserve was fostering somewhat firmer money market conditions and that seasonal demands for bills were falling short of dealers' prior expectations.

During the course of April the bank credit proxy (daily-average member bank deposits) declined somewhat and the money stock receded from the peak to which it had suddenly risen--in good part because of technical factors--at the end of March. The bulge in money proved to be even larger than had been estimated earlier and its erosion during April was not so rapid as had been anticipated. In terms of monthly average levels, both the money stock and the proxy series increased substantially from March to April. The money stock expanded at an annual rate tentatively estimated at 12.5 per cent; the proxy series, after adjustment for some further reduction in banks' use of funds from nondeposit sources, rose at an estimated 14 per cent rate.

When it became apparent soon after the April 7 meeting that both money and bank credit were expanding more rapidly on the average than desired by the Committee, System open market operations were directed at achieving somewhat firmer conditions in the money market. Later, particularly when it appeared that the Treasury's cash financing might be in jeopardy, it was found necessary first to moderate developing tendencies toward undue firmness and then to calm market unsettlement. In total, during the six business days preceding this meeting the Federal Reserve purchased more than $1.7 billion of Treasury bills. In the process the System supplied reserves more readily than it might otherwise have done, although to a large extent these operations served to offset reserve drains resulting from other factors. The effective rate on Federal funds, which had fluctuated mostly in a range of 7-1/2 to 8 per cent in late March and early April, subsequently moved into an 8 to 8-1/2 per cent range. In the 3 weeks ending April 29, member bank borrowings averaged about $960 million, compared with an average in March of slightly under $900 million.

Staff analysis suggested that annual rates of growth of about 4 per cent for both the money stock and the adjusted bank credit proxy over the second quarter[1/] might be attained with money market conditions similar to or slightly firmer than those currently prevailing. The indicated growth rates--somewhat higher for the money stock and somewhat lower for the proxy series than those contemplated by the Committee at its previous meeting--took account of the likelihood that the public's demand for money now was greater than had been thought earlier and that, as a consequence of recent increases in short-term market interest rates, the pace of expansion in time and savings deposits would be considerably slower in May and June than previously anticipated. For May alone it was expected that the money stock would rise on the average, although much less than it had in April, and that the proxy series would decline.

The Committee agreed that growth in money and bank credit during the second quarter at about the 4 per cent annual rates indicated above would be appropriate to the underlying economic

---

1/ Calculated on the basis of the daily-average levels in March and June.

situation and outlook. At the same time, however, the members agreed that account should be taken of the current Treasury financing, and that operations directed at attaining the targets for the aggregates should be modified if necessary in light of "even keel" considerations. It was also agreed that operations should be modified to moderate unusual pressures in financial markets, should they develop.

In considering the language of the second paragraph of the current economic policy directive, the Committee decided that reference should be made to "bank reserves" as well as to "money market conditions" in the statement concerning open market operations. The purpose was to clarify the Committee's intention that information regarding deviations from the expected paths of various aggregative reserve measures was to be used as a supplement to--but not as a substitute for--data reflecting money market conditions in making decisions regarding possible System operations.

The following current economic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting indicates that real economic activity weakened further in the first quarter of 1970. Growth in personal income, however, is being stimulated in the second quarter by the enlargement of social security benefit payments and the Federal pay raise. Prices and costs generally are continuing to rise at a rapid pace, although some components of major price indexes recently have shown moderating tendencies. Most market interest rates have risen sharply in recent weeks as a result of heavy demands for funds, possible shifts in liquidity preferences, and the disappointment of earlier expectations regarding easing of credit market

conditions. Prices of common stocks have declined markedly since early April. Attitudes in financial markets generally are being affected by the expansion of military operations in Southeast Asia and by concern about the success of the Government's anti-inflationary program. Both bank credit and the money supply rose substantially from March to April on average, although during the course of April bank credit leveled off and the money supply receded sharply from the end-of-March bulge. The over-all balance of payments was in considerable deficit during the first quarter. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee desires 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 maintaining bank reserves and money market conditions consistent with that objective, taking account of the current Treasury financing; provided, however, that operations shall be modified as needed to moderate excessive pressures in financial markets, should they develop.

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

In dissenting from this action Mr. Francis expressed the view that under present economic circumstances the target for growth in the money stock during the second quarter should remain at the 3 per cent annual rate favored by the Committee as a whole at recent meetings. He noted that second-quarter growth at a 4 per cent annual rate would imply a rise from February--the recent monthly low for the money stock--to June at about a 6 per cent annual rate, which in his judgment would be excessive for the period in question.

2. Action with respect to continuing authority directive.

At this meeting the Committee suspended, for the period from the opening of business May 5, 1970, until the close of business May 26, 1970, the provision of paragraph 1(a) of the continuing authority directive limiting changes in System Account holdings of U.S. Government securities between meetings of the Committee to $2 billion.

> Votes for this action: Messrs. Burns, Hayes, Brimmer, Daane, Francis, Heflin, Hickman, Maisel, Mitchell, Robertson, Sherrill, and Swan. Votes against this action: None.

This action was taken on the recommendation of the System Account Manager, who advised that increased leeway for System purchases of Government securities might well be required during the period in question, in view of the unsettled conditions in markets for Government securities and of the uncertain prospects for the Treasury financing now in process.