



FEDERAL RESERVE

press release

For immediate release

October 19, 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 July 21, 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 July 21, 1970

1. Authority to effect transactions in System Account.

Preliminary estimates of the Commerce Department indicated that real GNP had edged up at an annual rate of 0.3 per cent in the second quarter, after declining at rates of 3.0 per cent in the first quarter and 0.9 per cent in the fourth quarter of 1969. Staff projections suggested that the rate of increase in real GNP would pick up somewhat in the third and fourth quarters, but that it would remain well below the economy's growth potential. Prices and wage rates generally were continuing to rise at a rapid pace, but it appeared that improvements in productivity were slowing the rise in costs, and some major price measures were showing moderating tendencies.

Available data for June offered a mixed picture of economic developments. Industrial production declined further, but less than in other recent months. Retail sales increased slightly, according to advance estimates, and private housing starts rose sharply. Although the unemployment rate declined to 4.7 from 5.0 per cent in May, continued weakness in the demand for labor was reflected in a further sizable reduction in nonfarm payroll employment.

Average wholesale prices of industrial commodities rose further from mid-May to mid-June, but advances were less widespread than earlier

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and prices of nonferrous metals and a number of other materials were under downward pressure. Prices of farm products and foods declined for the third consecutive month, after allowance for seasonal influences.

According to the Commerce Department figures, inventory accumulation increased somewhat in the second quarter after having declined substantially in the two preceding quarters. The rate of growth in consumer spending rose only a little, despite an unusually large advance in disposable income resulting from retroactive increases in Federal pay and social security benefits. Among other major categories of final purchases, Federal expenditures for goods and services declined and the rate of expansion in State and local government outlays slackened. Business spending for fixed investment remained about unchanged in the second quarter and--according to revised figures--in the first quarter also.

The projection of moderately faster growth in real GNP in the second half was based largely on expectations of a recovery in residential construction and more rapid advances in outlays by State and local governments. Expansion in consumer spending was expected to remain relatively strong. At the same time, it appeared likely that declines in defense outlays and, later in the year, in business fixed investment would hold down the over-all rate of growth.

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The surplus on U.S. foreign trade expanded further in May-- continuing the improvement that had been under way since mid-1969. Nevertheless, because of large outflows of private capital the overall balance of payments remained in heavy deficit in the second quarter on both the liquidity and the official settlements bases.

In foreign exchange markets, selling pressure on the Italian lira developed following the resignation of the Rumor Government on July 6. The mark remained in demand, reflecting chiefly the tight monetary conditions in Germany. Early in July the German Government announced proposed measures to increase fiscal restraint. This was followed by some easing of monetary policy, including a reduction in the discount rate of the German Federal Bank from 7-1/2 to 7 per cent effective July 16.

Pressures in domestic financial markets had abated in recent weeks from the peaks that had been reached in the latter part of June, after a major railroad corporation indicated that it was insolvent and unable to pay off maturing commercial paper. Uncertainties and strains persisted, however--particularly in the market for commercial paper, the outstanding volume of which contracted sharply following the indication of the railroad's insolvency. It appeared that a large proportion of the funds so freed were being rechanneled through the banking system; there had been sharp increases recently both in bank loans to businesses and finance companies and in the outstanding

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volume of large-denomination CD's of short maturity, for which Regulation Q rate ceilings had been suspended effective June 24. The massive readjustment under way was facilitated by Federal Reserve assurances to member banks that the discount window was available to assist them in meeting the needs of businesses unable to replace maturing commercial paper.

Since the previous meeting of the Committee average prices of common stocks had continued to fluctuate in a range somewhat above the lows of late May. Interest rates on long-term bonds had declined considerably on balance, despite a continuing heavy volume of new corporate offerings. The reductions in bond yields reflected the abatement of general pressures in financial markets, including some lessening of inflationary expectations and a growing belief that monetary policy would become more expansive.

In the corporate bond market the spread between yields on Aaa and Baa offerings had widened recently, however, suggesting that investors had become more concerned about credit risks in this market as well as in the market for commercial paper. There also were indications that the desire to reduce credit risks had enhanced the relative attractiveness of Treasury and Federal agency securities. For example, market rates on Treasury bills had declined in recent weeks--substantially, in the case of longer-term bills--even though the Treasury had auctioned \$2.5 billion of tax-anticipation bills due in March 1971 on July 2 and \$2.25 billion of such bills due in April 1971 on July 16.

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The Treasury was expected to announce in late July the terms on which it would refund securities maturing in mid-August, including \$5.6 billion held by the public. It was considered likely that the Treasury would also undertake some cash borrowing in August, perhaps in connection with the refunding.

System open market operations since the preceding meeting of the Committee had been directed mainly at maintaining money market conditions conducive to stability in financial markets generally, amid the churning occasioned by developments in the commercial paper market. Member bank borrowings rose sharply during the period--from an average of less than \$900 million in the statement week ending June 24 to nearly \$1.7 billion in the July 15 statement week. The increase was in large part a consequence of special discount window accommodation of banks lending to firms that were finding it difficult to roll over maturing commercial paper. For the most part the Federal funds rate remained in a 7 to 7-5/8 per cent range, somewhat below the range prevailing before the June 23 meeting, and for much of the period the open market operations found necessary were quite limited. However, the System undertook a large volume of repurchase agreements late in the period when reserve drains from market factors proved to be much heavier than anticipated and the Federal funds rate came under some upward pressure.

Average interest rates on conventional new-home mortgages remained unchanged in June at about the levels that had prevailed

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since the beginning of the year. Net inflows of savings funds to nonbank thrift institutions were relatively strong during the month, and outflows immediately after midyear interest and dividend crediting were quite small. In view of such experience, it appeared likely that these institutions would step up the rate at which they were making new mortgage commitments.

Following the Board's action on Regulation Q in late June, major commercial banks acted quickly to raise their offering rates on large-denomination CD's of less than 90 days' maturity--generally into a range of 7-1/2 to 8 per cent, in contrast to the previous ceiling rates of 6-1/4 and 6-1/2 per cent for maturities of 30 to 59 and 60 to 89 days, respectively. The subsequent influx of funds was very large; in the 3 weeks ending July 15, large-denomination CD's outstanding at weekly reporting banks increased by about \$3 billion, the most rapid advance on record. Private demand deposits also expanded sharply in early July.

The latest staff analysis suggested that both the money stock and the bank credit proxy--daily-average member bank deposits--would rise considerably on the average from June to July. However, assuming that prevailing money market conditions were maintained, growth in the money stock was expected to slow sharply in the two succeeding months and to be at an annual rate of about 5 per cent over the third quarter.^{1/}

^{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.

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It appeared likely that the rate of expansion in large-denomination CD's would moderate after banks completed their initial adjustments to the Regulation Q action and were no longer faced with large loan demands from firms experiencing run-offs of outstanding commercial paper. However, the annual rate of growth in the proxy series over the third quarter was still expected to be high--about 14 per cent, after adjustment for an anticipated reduction in banks' use of funds from nondeposit sources.

The Committee decided that pressures in financial markets had abated sufficiently to warrant reducing the special emphasis recently given in open market operations to moderating such pressures, and increasing the emphasis placed on achieving the longer-run growth rates in the monetary aggregates that were considered appropriate to the underlying economic situation. At the same time, the Committee decided that account should be taken of the uncertainties and strains that did persist in financial markets, as well as of the "even keel" considerations associated with the forthcoming Treasury financing.

While there were some differences in the members' assessment of the economic outlook, they agreed that moderate growth in the monetary aggregates--including growth in the money stock at about a 5 per cent annual rate in the third quarter--would be desirable. A majority also concurred in the view that, if moderate deviations from that growth rate should develop, it would be preferable if they were in an upward direction.

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With respect to bank credit, it was noted that a relatively rapid rate of expansion in the third quarter need not be disturbing in light of the shift of credit flows from market to banking channels that was under way.

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 changed little in the second quarter after declining appreciably earlier in the year. Prices and wage rates generally are continuing to rise at a rapid pace. However, improvements in productivity appear to be slowing the rise in costs, and some major price measures are showing moderating tendencies. Since mid-June long-term interest rates have declined considerably, and prices of common stocks have fluctuated above their recent lows. Although conditions in financial markets have improved in recent weeks uncertainties persist, particularly in the commercial paper market where the volume of outstanding paper has contracted sharply. A large proportion of the funds so freed apparently was rechanneled through the banking system, as suggested by sharp increases in bank loans and in large-denomination CD's of short maturity--for which rate ceilings were suspended in late June. Consequently, in early July bank credit grew rapidly; there was also a sharp increase in the money supply. Over the second quarter as a whole both bank credit and money supply rose moderately. The over-all balance of payments remained in heavy deficit in the second 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, while taking account of persisting market uncertainties, liquidity strains, and the forthcoming Treasury financing, the Committee seeks to promote moderate growth in money and bank credit over the months ahead, allowing for a possible continued shift of credit flows from market to banking channels. System open

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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; provided, however, that operations shall be modified as needed to counter excessive pressures in financial markets should they develop.

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

Absent and not voting: Messrs. Hayes and Mitchell. (Mr. Treiber voted as Mr. Hayes' alternate.)

2. Authority to purchase securities directly from the Treasury.

Paragraph 2 of the Committee's continuing authority directive, as most recently amended on March 10, 1970, authorizes the Federal Reserve Bank of New York (and, under certain circumstances, other Reserve Banks) to purchase special short-term certificates of indebtedness directly from the Treasury, subject to certain conditions. This authorization is, in turn, based on a provision of Section 14(b) of the Federal Reserve Act authorizing the Federal Reserve Banks to buy and sell obligations of specified types "directly from or to the United States," subject to certain conditions.

It was noted at this meeting that the statutory authority in question had expired on June 30, 1970, and that paragraph 2 of the continuing authority directive had accordingly been in a state of de facto suspension since that date; and that the paragraph would remain in suspension until pending legislation, which would extend the authority until July 1, 1971, was enacted. (Such legislation was enacted on July 31, 1970.)