FEDERAL RESERVE

press release

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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 August 18, 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 August 18, 1970

Authority to effect transactions in System Account.

According to revised estimates of the Commerce Department, real GNP had edged up at an annual rate of 0.6 per cent in the second quarter of 1970--slightly more than preliminary estimates had indicated--after having declined appreciably in the first quarter. Prices and wage rates generally were continuing to rise at a rapid pace, but there were some indications that upward pressures on prices were moderating. Staff projections still suggested that growth in real GNP would pick up somewhat in the third and fourth quarters but would remain well below the economy's potential; also that the rate of price advance would slow as the year progressed.

In July industrial production increased slightly--about offsetting its decline in June--and was approximately 3 per cent below the peak that had been reached a year earlier. Retail sales also rose, according to advance estimates. On the other hand, the labor market continued to ease: nonfarm payroll employment dropped for the fourth successive month, and the unemployment rate moved back up to the 5 per cent level of May, after having declined in June to 4.7 per cent.

Average wholesale prices rose sharply from mid-June to mid-July, mainly because of an upsurge in prices of farm products and foods;

the increase for industrial commodities was somewhat below the average for the first half of the year. Although the consumer price index continued to rise at a rapid rate in June, after seasonal adjustment it advanced less over the second quarter as a whole than it had over the first. The increase in unit labor costs in the private nonfarm sector slowed substantially during the second quarter, largely because of improvements in productivity.

The staff's GNP projections for the second half assumed that there would not be an extended strike in the automobile industry when current wage contracts expired in mid-September. The expectation that over-all activity would expand somewhat further depended importantly on a fairly sharp recovery in residential construction activity and on some acceleration in expenditures of State and local governments. It was anticipated that consumer spending would continue to rise at about the average pace of the first half. On the other hand, business outlays on fixed investment were expected to turn down and defense spending to continue declining.

The surplus on U.S. foreign trade increased sharply further in June. Preliminary indications were that the over-all balance of payments, which had been in heavy deficit during the second quarter, had improved somewhat in July on the liquidity basis. On the other hand, it appeared that the official settlements deficit had remained heavy, reflecting substantial reductions in outstanding liabilities of U.S. banks to their foreign branches following the June 24 suspension of

Regulation Q ceilings on large-denomination CD's with maturities of less than 90 days.

In foreign exchange markets, demand had been heavy in recent weeks for the Canadian dollar, the exchange rate for which remained on a floating basis. There also were strong demands for the German mark and some other European currencies, especially the Dutch guilder. On August 12 the German Federal Bank, acting to offset the effects on bank liquidity of the large amounts of foreign exchange it had acquired, imposed high marginal reserve requirements on commercial banks.

In domestic securities markets demands for funds had remained heavy in recent weeks, and some uncertainties persisted, especially in the market for commercial paper, which had been most directly affected by the insolvency of a major railroad in the latter part of June. The volume of commercial paper outstanding had contracted further--although most recently it appeared to be stabilizing--and investors remained highly selective and cautious about investing in less than prime-grade issues in this market or in lower-grade securities in other markets. Long-term interest rates--which had declined considerably in late June and early July--subsequently showed mixed changes: municipal yields continued downward, but yields on Treasury and new corporate bonds edged up. Treasury bill rates also had been under some upward pressure in recent weeks. On the day before this meeting the market rate on 3-month bills, at 6.53 per cent, was about 15 basis points above its level of 4 weeks earlier.

In July interest rates on new-home mortgages remained close to the high levels that had prevailed since the beginning of the year. However, the availability of funds to the mortgage market appeared to be increasing as a result of continued heavy savings inflows to thrift institutions.

In late July the Treasury announced the terms on which it would refinance securities maturing in mid-August, including about $5.6 billion held by the public. Holders of the maturing issues were offered the choice of two new 7-3/4 per cent notes--a 3-1/2-year note priced at par and a 7-year note priced to yield 7.80 per cent. In addition, the Treasury indicated that it would sell for cash about $2.75 billion of a new 18-month, 7-1/2 per cent note (priced to yield 7.54 per cent). The volume of subscriptions received in the cash offering was very large, and the Treasury accepted somewhat more than originally planned. According to estimates at the time of this meeting, the financing yielded more than $2 billion of new cash after allowance had been made for attrition in the exchange offering.

On the day before this meeting, the Board of Governors had announced that it was amending Regulation D to apply regular time and demand deposit reserve requirements to funds obtained by member banks through the issuance of commercial paper by their affiliates, and at the same time to reduce from 6 to 5 per cent the reserves that member banks must hold against time deposits in excess of $5 million. The actions would become effective in the reserve computation period beginning October 1 and would be applicable to affected deposits and commercial paper outstanding in the week beginning September 17. It was expected that the net result for all member banks would be a reduction in required reserves of about $350 million.

Private demand deposits and the money stock expanded moderately on the average from June to July. The money stock rose at an annual rate of 4.1 per cent--considerably less than had been expected at the time of the preceding meeting of the Committee and almost the same as the 4.2 per cent rate of growth recorded over the second quarter.[1/] There was an unusually large increase in commercial bank time and savings deposits in July. As at nonbank thrift institutions, inflows of savings funds to banks were heavy, but the bulk of the rise in total time and savings deposits was attributable to the sharp expansion that had occurred in the outstanding volume of large-denomination CD's after the Board acted in late June to suspend rate ceilings on such CD's of 30 to 89 days' maturity. The rise in CD's outstanding appeared to be slowing somewhat in early August.

Because of the strength in time and savings deposits, the bank credit proxy--daily-average member bank deposits--increased substantially from June to July; growth was at an annual rate of 18 per cent, after adjustment for some decline in banks' reliance on funds from nondeposit sources. Banks added considerably to their holdings of short-term Government securities, mainly by investment in tax-anticipation bills auctioned by the Treasury on July 2 and 16. They

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.

also expanded sharply their loans to finance companies, particularly in the early weeks of the month when some finance companies were encountering difficulty in rolling over maturing commercial paper.

System open market operations since the preceding meeting of the Committee had been directed at fostering money market conditions that were favorable to stable financial markets and that were consistent with a moderate rate of growth in the money stock. Money market conditions were permitted to ease somewhat during the period when it began to appear that the money stock was falling below a path consistent with growth over the third quarter at the 5 per cent annual rate favored by the Committee. Thus, the Federal funds rate fluctuated mostly in a range of 6-1/2 to 7 per cent, compared with a 7 to 7-5/8 per cent range in the preceding interval between meetings. Average member bank borrowings in the period remained quite high--about $1.2 billion--chiefly as a result of special accommodation at the discount window for banks lending to firms that were encountering difficulties in rolling over maturing commercial paper. However, during the period such borrowings declined somewhat as pressures in the commercial paper market moderated.

Staff analysis suggested that if prevailing money market conditions were maintained the money stock would grow at an annual rate of about 4 per cent over the third quarter and into the fourth; and that some further easing of money market conditions would be required if money were to grow at a 5 per cent rate. Within the third quarter it was expected that the growth rate of money would increase somewhat from July to August and then slacken moderately in September. The analysis suggested that a 5 per cent growth rate for the money stock over the third quarter would be associated with a 16.5 per cent rate of expansion in the adjusted credit proxy--reflecting a high but slowing rate of growth in time deposits.

In the Committee's discussion it was noted that expectations of continuing inflation had abated considerably in recent months, even though prices were still advancing at an undesirably rapid rate. It was the consensus of the Committee that monetary policy at present should be sufficiently stimulative to foster moderate growth in real economic activity, but not so stimulative as to risk a resurgence of inflationary expectations. Considerable stress was placed on the need to encourage an adequate flow of credit to the housing industry and to State and local governments if a satisfactory rate of growth in overall activity were to be achieved.

Against this background, the Committee decided that open market operations should be directed at promoting some easing of conditions in credit markets and growth in the money stock at a rate somewhat greater than that of the second quarter. In the latter connection most members continued to believe, as they had at the preceding meeting, that an appropriate target rate of growth for the money stock over the period ahead would be an annual rate of about 5 per cent; and should moderate deviations from that growth rate develop, they preferably should be in an upward rather than a downward direction.

As to bank credit, the Committee took note of the reintermediation process now under way and decided that the growth rate should be allowed to reflect any continued shift of credit flows from market to banking channels. It also directed that account be taken of possible liquidity problems, if they should emerge in the coming period, and of the effect of the Board's actions with respect to Regulation D.

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 edged up slightly in the second quarter after declining appreciably earlier in the year, may be expanding somewhat further. 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. Credit demands in securities markets have continued heavy, and interest rates have shown mixed changes since mid-July after declining considerably in preceding weeks. Some uncertainties persist in financial markets, particularly in connection with market instruments of less than prime grade. In July the money supply rose moderately on average and bank credit expanded substantially. Banks increased holdings of securities and loans to finance companies, some of which were experiencing difficulty in refinancing maturing commercial paper. Banks sharply expanded their outstanding large-denomination CD's of short maturity, for which rate ceilings had been suspended in late June, and both banks and nonbank thrift institutions experienced large net inflows of consumer-type time and savings funds. The over-all balance of payments remained in heavy deficit in the second quarter, despite a sizable increase in the export surplus. In July the official settlements deficit continued large, but there apparently was a marked shrinkage in the liquidity deficit. 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.
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> To implement this policy, the Committee seeks to promote some easing of conditions in credit markets and somewhat greater growth in money over the months ahead than occurred in the second quarter, while taking account of possible liquidity problems and allowing bank credit growth to reflect any continued shift of credit flows from market to banking channels. 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 effects of other monetary policy actions.

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

Messrs. Hayes, Brimmer, and Francis believed that it was appropriate for money to grow at a moderate rate at present. They dissented from this directive primarily because they were opposed to the promotion of "some easing of conditions in credit markets" as a specific objective of Committee policy at this time. In their judgment such easing was not presently required for the purpose of encouraging a satisfactory rate of expansion in economic activity, and it would involve an unduly large risk of rekindling inflationary expectations.

The views of the dissenting members regarding bank credit differed. Mr. Brimmer indicated that he was deeply troubled by the rapid recent and projected growth rates in bank credit, and that he favored fostering growth at only a modest rate. Mr. Hayes thought that a sizable increase in bank credit in the last month or two had been appropriate, in view of the shrinkage in commercial paper following the insolvency of a major railroad corporation. However, he observed that he would be troubled by continued rapid growth in bank credit now that the commercial paper market seemed to be stabilizing.

Mr. Francis expressed the view that bank credit was likely to be misleading as a proximate guide to policy because of the reintermediation in process, and that the Committee accordingly should focus on the growth rate in money.