



FEDERAL RESERVE

press release

For immediate release

February 16, 1971

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached records of policy actions taken by the Federal Open Market Committee at its meetings on November 17 and December 15, 1970. These records will be published in the Board's Annual Report for 1970 and in the Federal Reserve Bulletin.

Attachments

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on December 15, 1970

Authority to effect transactions in System Account.

The information reviewed at this meeting suggested that real output of goods and services had declined in the fourth quarter of 1970, largely because of the strike in the automobile industry that had extended from mid-September until late November. A bulge in activity was in prospect for the first quarter of 1971, in connection with the resumption of higher production and sales of automobiles.

In November retail sales, industrial production, and nonfarm payroll employment continued to decline and the unemployment rate rose further--to 5.8 from 5.6 per cent in October. The weakness in economic activity appeared to extend to areas well beyond those affected by the strike. While the decline in total retail sales was attributable to another sharp reduction at automobile dealers, sales at other types of retail establishments increased relatively little. Within the manufacturing sector, the cutbacks that occurred in production and employment were centered in industries making business and defense equipment and various types of industrial materials, as well as automobile parts and supplies; automobile assemblies were maintained at the reduced October rate. In the nonmanufacturing sector payroll

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employment changed little. On the other hand, private housing starts rose further in October, the latest month for which data were available.

Major price measures had behaved in a diverse manner recently. Average wholesale prices of industrial commodities leveled off from mid-October to mid-November after rising sharply in the previous month. Prices of farm products and foods declined further, and the total wholesale price index edged down. In contrast, the consumer price index continued upward in October at the accelerated rate recorded in September.

Staff projections had been revised since the previous Committee meeting to indicate a decline in real GNP in the fourth quarter, rather than little change; and a rebound in the first quarter, in the aftermath of the strike, somewhat greater than had been anticipated earlier. The projections still suggested that the pace of expansion would moderate considerably in the second quarter and that the average rate of growth in real GNP over the three quarters ending in mid-1971 would be relatively low. It was noted that the projections made no allowance for any unusual accumulation of steel inventories as a precaution against a possible steel strike when current wage contracts expired on July 31.

The surplus on U.S. foreign trade declined slightly further in October; in September and October together it was smaller than in any other 2-month period in 1970. With respect to the over-all

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balance of payments, the deficit on the liquidity basis in October and November remained at about the third-quarter rate despite the shrinkage in the trade surplus. The official settlements deficit, on the other hand, continued very large as a result of further repayments of Euro-dollar borrowings by U.S. banks.

On November 30 the Board of Governors announced certain measures to moderate the pace of repayments of such Euro-dollar borrowings, including an increase from 10 to 20 per cent in the reserves required from member banks against Euro-dollar borrowings in excess of the amounts allowed as a "reserve-free" base. The higher requirement was intended to give banks an added inducement to preserve their reserve-free bases against possible future need. At the same time the Board announced that discount rates at five Federal Reserve Banks had been lowered to 5-1/2 per cent from the level of 5-3/4 per cent to which they had been reduced earlier in the month.

Since late November Euro-dollar interest rates had risen considerably and the dollar had strengthened against most major European currencies. These developments appeared to reflect the combined influence of year-end adjustments in the Euro-dollar market and the response of U.S. banks to the Board's actions to moderate Euro-dollar repayments. In addition, the strength of the dollar reflected declines in domestic interest rates in some European financial markets. Discount rates were reduced by the German Federal Bank, from 6-1/2 to 6 per cent, on December 3; and by the National Bank of Belgium, from 7 to 6-1/2 per cent, on December 10. In each

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country similar reductions of 1/2 percentage point had been made only recently--on October 22 in Belgium and on November 17 in Germany.

System open market operations since the November 17 meeting of the Committee had been directed at fostering some easing of money market conditions, for the purposes of promoting easier conditions in credit markets generally and of achieving expansion in the money stock at a moderate rate. A substantial volume of reserves was supplied during the interval, in part through purchases of intermediate- and long-term Treasury securities. The effective rate on Federal funds, which had been around 5-3/4 per cent shortly before the mid-November meeting, subsequently fluctuated for the most part in a range from 5-1/2 per cent down to about 5 per cent. Most recently, however, the funds rate had moved below that range on a number of days and had averaged about 5 per cent. In the 4 weeks ending December 9 member bank borrowings had averaged about \$375 million, approximately \$100 million below the average of the preceding 4 weeks.

Both short- and long-term market interest rates had declined substantially in recent weeks. With respect to short-term securities, the market rate on 3-month Treasury bills was 4.80 per cent on the day before this meeting, 50 basis points below its level 4 weeks earlier. In capital markets, where an extended rally had begun around the end of October, yields had fallen to their lowest levels in well over a year despite a continuing very heavy volume of new corporate and municipal offerings.

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Contributing to these declines in interest rates were the cumulating evidence of weakness in economic activity, a growing belief that demands for funds in capital markets might moderate after the turn of the year, and widespread market expectations that an expansionary monetary policy would be pursued. A reduction on November 23 in the prime lending rate of commercial banks from 7-1/4 to 7 per cent--the third cut in the prime rate since the end of the summer--helped to sustain the rally, as did the recent reduction in Federal Reserve Bank discount rates.

Yields on residential mortgages declined further in November in secondary markets for federally insured loans, and the ceiling rate on such loans was lowered by administrative action from 8-1/2 to 8 per cent, effective December 1. This was the first reduction in the ceiling rate in nearly a decade. According to preliminary indications, both the inflows of savings funds to nonbank thrift institutions and the volume of new mortgage commitments by those institutions had continued large in November.

At commercial banks, business loans (adjusted to include loans that had been sold to affiliates) declined sharply in November for the third successive month. The recent weakness in loan demands reflected the effects of the automobile strike and the general sluggishness of economic activity, and also the use by corporations of some proceeds of capital market offerings to repay bank debt.

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Banks continued to acquire securities--particularly municipal issues-- at a rapid rate, and they were less aggressive than earlier in seeking funds through issues of large-denomination CD's. Although the rate of growth in total time and savings deposits remained substantial, it was somewhat below that of October and only about half the exceptionally high rate of the summer.

According to preliminary estimates, both the bank credit proxy-- daily-average member bank deposits--and the money stock increased somewhat more rapidly on the average in November than had been anticipated at the time of the previous meeting. After adjustment for a further reduction in bank reliance on funds from nondeposit sources, the proxy series expanded at an annual rate of about 8 per cent, compared with rates of about 1 per cent in October and 17 per cent over the third quarter.^{1/} Preliminary calculations for the money stock, based on the newly revised statistical series,^{2/} indicated that growth in November was at an annual rate of 4.5 per cent. While this was above the 1 per cent growth rate recorded in October, it was below the increases--at annual rates of about 6 per cent--now indicated for each of the first three quarters of the year.

^{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.

^{2/} The revised series, published by the Board of Governors on November 27, 1970, incorporated the usual annual revisions of seasonal factors and benchmark adjustments for nonmember bank data. It also reflected the use of newly collected information to correct downward biases resulting from the accounting procedures employed in connection with certain types of international transactions.

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It was noted that the outlook for the monetary aggregates was particularly uncertain at this time, both because of the difficulties of assessing the precise impact on financial markets of the surge in activity expected in the aftermath of the automobile strike and because of the churning in those markets that is typical of the period around the year-end. Staff analysis suggested that the money stock would tend to increase relatively rapidly in December and January, in part as a result of the expected bulge in economic activity. According to the analysis, if money market conditions were about the same as those most recently attained, over the fourth quarter the money stock and the adjusted bank credit proxy would expand at annual rates of about 5 and 9 per cent, respectively. For both aggregates somewhat faster growth was anticipated over the first quarter of 1971.

In light of the uncertainties affecting the weeks immediately ahead, a number of Committee members suggested that it would be appropriate, in making decisions on open market operations in this period, to give somewhat greater weight than previously to money market conditions relative to the weight given to reported statistics on the monetary aggregates. A few members expressed the view that such a shift in emphasis was desirable on more general grounds, apart from present uncertainties.

With respect to the monetary aggregates, some members drew attention to the significance of the behavior of aggregates other than

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the narrowly defined money stock--private demand deposits plus currency in circulation, the so-called "M₁." Reference was made in this connection both to bank credit and to money on various definitions that are broader than M₁.

There were some differences in the views expressed regarding the rates of expansion in money and bank credit that might be considered desirable or acceptable in the coming period. In the course of the discussion, and against the background of present expectations regarding growth rates in the fourth quarter, it was suggested that the monetary aggregates should expand in the weeks immediately ahead by at least the amounts that appeared to be consistent with the somewhat faster growth rates anticipated for the first quarter. The Committee agreed that money market conditions should be eased if it appeared that shortfalls from those growth paths were developing, but that otherwise operations should be directed at maintaining the conditions most recently attained.

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 has declined since the third quarter, largely as a consequence of the recent strike in the automobile industry, and that unemployment has increased. Resumption of higher automobile production is expected to result in a bulge in activity in early 1971. Wage rates generally are continuing to rise at a rapid pace, but gains in productivity appear to be slowing the increase in unit labor costs. Movements in major price measures have been diverse; most recently, wholesale prices have shown little change while consumer prices have advanced substantially. Market interest rates declined considerably further in the past few weeks, and Federal Reserve discount rates

were reduced by an additional one-quarter of a percentage point. Demands for funds in capital markets have continued heavy, but business loan demands at banks have been weak. Growth in the money supply was somewhat more rapid on average in November than in October, although it remained below the rate prevailing in the first three quarters of the year. Banks acquired a substantial volume of securities in November, and bank credit increased moderately after changing little in October. The foreign trade balance in September and October was smaller than in any other 2-month period this year. The over-all balance of payments deficit on the liquidity basis remained in October and November at about its third-quarter rate. The deficit on the official settlements basis was very large as banks continued to repay Euro-dollar liabilities. 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, System open market operations shall be conducted with a view to maintaining the recently attained money market conditions until the next meeting of the Committee, provided that the expected rates of growth in money and bank credit will at least be achieved.

Votes for this action: Messrs.
Burns, Hayes, Brimmer, Daane, Heflin,
Maisel, Mitchell, Robertson, Sherrill,
Swan, and Mayo. Vote against this
action: Mr. Francis. (Mr. Mayo voted
as alternate for the late Mr. Hickman.)

Mr. Francis dissented from this action both because he favored increasing, rather than reducing, the emphasis on M_1 relative to that on money market conditions in making System operating decisions, and because he favored maintaining growth in the money stock at the recently prevailing annual rate of 5 per cent. In the latter connection, he believed that continued growth in money at a 5 per cent rate was likely

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to assure steady progress toward moderating price increases, along with a gradually increasing pace of expansion in real output. In his judgment a faster growth rate for money would result in higher real output in 1971, but at a disproportionate cost in terms of prolonging inflation and perhaps intensifying it after 1971.