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 February 9, 1971.

Such records are made available approximately 90 days after the date of each meeting of the Committee and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based on the information that was available to the Committee at the time of the meeting, rather than on data as they may have been revised since then.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on February 9, 1971

1. Authority to effect transactions in System Account.

Preliminary estimates of the Commerce Department indicated that in the fourth quarter of 1970 real GNP had declined at an annual rate of 3.3 per cent. The decline was attributable largely to the strike in the automobile industry that had ended in late November. In the current quarter, according to staff projections, real GNP was rising again, primarily as a consequence of the resumption of higher automobile production. Wage rates were continuing to advance at a rapid pace in most sectors of the economy, and relatively large increases had recently been recorded in some major price measures.

Tentative estimates suggested that both retail sales and industrial production had advanced in January, mainly as a result of the ending of the auto strike. Nonfarm payroll employment increased moderately--also largely because of higher auto production--and the unemployment rate declined to 6.0 per cent, from the (upward revised) December rate of 6.2 per cent. Private housing starts had risen sharply further in December, the latest month for which data were available.

Average wholesale prices increased considerably from mid-December to mid-January as a result of a substantial advance in prices of farm products and foods and a small rise in prices of industrial commodities. The rate of increase in the consumer price index, which had slowed in November, stepped up again in December.

The staff's GNP projections had been reassessed in light of the Federal budget estimates for the 1971 and 1972 fiscal years that were presented by the administration in January, and in light of the probability that steel users would accumulate inventories of that metal as a hedge against a possible strike in the steel industry at the end of July, when current wage contracts will expire. Although modified in some respects, the projections still suggested that real GNP would rise markedly in the first quarter in the aftermath of the automobile strike, and that the pace of the advance would slow in the second quarter.

Resumption of a higher rate of automobile and truck purchases was expected to result in a sharp increase in consumer spending and some rise in business capital outlays in the first quarter, but it seemed likely that consumer spending would increase only moderately further in the second quarter and that business capital spending would level off. An accelerated pace of business inventory investment appeared to be in prospect for the second quarter, reflecting in part a step-up in the accumulation of steel stocks. In line with the new budget estimates, it was expected that defense spending would decline in both quarters, but that total Federal expenditures would rise considerably--largely because of increased transfer payments to individuals and grants to State and local governments. Outlays of State and local governments were projected to increase substantially, as were residential construction expenditures.

The surplus on U.S. foreign trade in the fourth quarter of 1970 was much smaller than it had been earlier in the year. The over-all balance of payments deficit on the liquidity basis was little changed from the third-quarter level. The official settlements deficit rose sharply, however, as U.S. banks reduced their Euro-dollar borrowings further under the stimulus of wide differentials between short-term interest rates in the United States and in the Euro-dollar market. These differentials had continued wide in recent weeks, when both U.S. and Euro-dollar interest rates declined; but the spread between those rates and the still higher rates in major European national markets had become larger. Movements of funds in response to interest rate differentials had tended to strengthen most major foreign currencies relative to the dollar and had contributed to further large reserve gains by a number of central banks.

Euro-dollar borrowings of U.S. banks increased seasonally in the first part of January when U.S. corporations were reversing year-end capital repatriations, but subsequently the decline in such borrowings resumed. On January 25 the Export-Import Bank sold $1 billion of special securities to foreign branches of U.S. banks and thereby helped to restrain the flow of funds to other countries.

Effective January 20, the Bank of Japan lowered its discount rate from 6 to 5-3/4 per cent, and on the same day the National Bank of Denmark reduced its discount rate from 9 to 8 per cent.

On January 20 the Treasury announced that in its mid-February financing it would offer two new securities--a 4-1/2-year, 5-7/8 per cent note and a 7-year, 6-1/4 per cent note--in exchange for nine outstanding issues, including three that would mature in mid-February or mid-March and three each that would mature in November 1971 and February 1972. This combination of a refunding and a prerefunding was highly successful. Of the $19.5 billion of eligible issues held by the public, about $11 billion were exchanged for the new notes; and less than 20 per cent of the issues maturing in February and March 1971 were redeemed for cash, despite the fact that the new securities offered did not include the customary short-term "anchor" issue.

Although the volume of current and prospective offerings of new corporate and municipal bonds had remained very heavy in recent weeks, long- as well as short-term interest rates had fallen considerably further since the January 12 meeting of the Committee. The rate declines reflected continuing reports of weakness in economic activity and other developments that tended to buttress market expectations of lower rates to come. The latter included two additional reductions in the prime lending rate of commercial banks--from 6-1/2 to 6-1/4 per cent on January 15 and then to

6 per cent on January 18; a further cut in Federal Reserve Bank discount rates, from 5-1/4 to 5 per cent, effective on various dates from January 19 through January 29; and the progressive easing of money market conditions that had occurred during the period. In short-term markets the rate on 3-month Treasury bills had fallen about 85 basis points in the last 4 weeks, to about 3.80 per cent on the day before this meeting.

Interest rates on residential mortgages continued downward in January in both primary and secondary markets. Inflows of savings funds to nonbank thrift institutions--which had been heavy in the fourth quarter of 1970--reached extraordinarily high levels during January as the yields available on competitive market instruments declined sharply further.

Commercial banks also experienced heavy inflows of consumer-type time and savings deposits in January. Growth in the volume of large-denomination CD's slowed appreciably as banks reduced their offering rates on such certificates, but the expansion in CD's was still rapid by historical standards. The volume of business loans outstanding (adjusted to include loans that had been sold to affiliates) increased moderately in January after 4 months of decline, and banks added considerably further to their holdings of securities.

The narrowly defined money stock--private demand deposits plus currency in circulation, or M_1--increased less on the average in January than had been expected at the time of the preceding meeting of the Committee, and considerably less than it had grown in December. However, M_2--defined as M_1 plus commercial bank time deposits other than large-denomination CD's--expanded substantially further, as did the adjusted bank credit proxy--daily-average member bank deposits, adjusted to include funds from nondeposit sources.

System open market operations following the January 12 meeting of the Committee had been directed initially at achieving somewhat easier conditions in the money market. Further easing was sought later in the period, as data that became available in late January and early February offered increasing evidence that growth in M_1 was falling short of Committee expectations. The effective rate on Federal funds moved irregularly lower during the period; most recently it had fluctuated around 3-3/4 per cent, compared with a range around 4-1/2 per cent shortly before the January meeting.

Staff analysis suggested that both M_1 and M_2 would grow significantly faster in February and March than they had in January as a consequence of the expected bulge in economic activity, and that the adjusted credit proxy would continue upward at a substantial pace. According to the analysis, if prevailing money market conditions were maintained M_1 would expand at an annual rate of about 6 per cent over the first quarter as a whole.[1/] This rate would be roughly the same

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.

as the average for the first three quarters of 1970 and higher than the 3.4 per cent rate recorded in the fourth quarter. For M_2 and the adjusted credit proxy, the analysis suggested growth over the first quarter at rates of about 15 to 16 per cent and 10 to 11 per cent, respectively.

The Committee agreed that in light of the economic situation and outlook it would be desirable to accommodate further declines in long-term interest rates at this time. Views differed, however, with respect to the appropriate objectives for conditions in the money and short-term credit markets and for growth rates in the monetary and credit aggregates. A number of members advocated some further easing of money market conditions in an effort to achieve growth rates in M_1 over coming months that would tend to compensate for the recent shortfalls. Other members indicated that they would prefer to maintain prevailing money market conditions during coming weeks, at least in the absence of developments militating strongly in favor of further easing. Among the considerations stressed by these members were the rapid recent and prospective growth rates in monetary and credit aggregates other than M_1 and the undesirable consequences for international capital flows of further sizable declines in short-term interest rates in the United States. There also was some sentiment for placing less emphasis on short-run fluctuations in M_1 in the period ahead.

At the conclusion of the discussion the Committee decided that open market operations in the coming period should be directed at maintaining the prevailing conditions in the money market unless there were indications of shortfalls in M_1 and M_2 from the growth paths expected on that basis--in which case, money market conditions were promptly to be eased somewhat further. The Committee also agreed that its objectives for interest rates would be facilitated if, to the extent feasible, needs to supply reserves were met by purchases of longer-term Treasury securities.

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, which declined in the fourth quarter of 1970, is rising in the current quarter primarily because of the resumption of higher automobile production. The unemployment rate remained high in January. Wage rates in most sectors are continuing to rise at a rapid pace, and recent increases in some major price measures have been relatively large. Interest rates have fallen considerably further in recent weeks despite continued heavy demands for funds in capital markets, and differentials between interest rates in the United States and those in major foreign countries have widened further. Federal Reserve discount rates were reduced by an additional one-quarter of a percentage point to 5 per cent. Bank credit increased considerably further in January, as business loan demands strengthened somewhat and banks made substantial further additions to their holdings of securities. The money stock narrowly defined grew modestly in January following a stronger December rise, but money more broadly defined expanded sharply further as a result of continued rapid growth in consumer-type time and savings deposits. The over-all balance of payments deficit in the fourth quarter was about as large as in the third quarter on the liquidity basis; on the official settlements basis the deficit increased further from the very high third-quarter level as banks continued to repay Euro-dollar liabilities. More recently, the issuance of a special Export-Import Bank security to foreign branches of U.S. banks helped to moderate the flow of dollars to foreign central banks. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial

> conditions conducive to the resumption of sustainable economic growth, while encouraging an orderly reduction in the rate of inflation and the attainment of reasonable equilibrium in the country's balance of payments.
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> To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining prevailing money market conditions while accommodating additional downward movements in long-term rates; provided that money market conditions shall promptly be eased somewhat further if it appears that the monetary aggregates are falling short of the growth path desired.

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

Absent and not voting: Mr. Robertson. (Mr. Mayo voted as alternative for the late Mr. Hickman.)

Mr. Francis dissented from this action for reasons similar to those underlying his dissents from the directives adopted at the two preceding meetings. Briefly, he favored placing less emphasis on money market conditions in implementing policy, and he thought that expansion in M_1 at an annual rate of about 5 per cent would be best suited to the needs of the economy.

2. Ratification of an action with respect to continuing authority directive.

The Committee ratified an action taken by members on January 22, 1971, suspending a provision of paragraph 1(A) of the continuing authority directive (the provision limiting exchanges with the Treasury of securities held in the System Open Market Account to maturing issues) to the extent of enabling the Account Manager to prerefund $4 billion of System Account holdings of the 7-3/4 per cent note of November 1971 in the current Treasury financing. This action had been taken on recommendation of the Manager, for the purpose of reducing the System's concentrated holdings of this issue. As the Manager had indicated, more than $7.2 billion of this issue was held in the System Account, out of a total outstanding volume of about $10.7 billion.

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

(Mr. Mayo voted as alternate for the late Mr. Hickman.)