FEDERAL RESERVE

press release

For immediate release September 27, 1971

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 June 29, 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 June 29, 1971

1. Authority to effect transactions in System Account.

Information reviewed at this meeting suggested that real output of goods and services was expanding moderately in the second quarter, after having risen sharply earlier in the year under the stimulus of the post-strike recovery in the automobile industry. Continued moderate gains in activity appeared to be in prospect for the rest of 1971.

Retail sales had declined in May, but according to weekly data they turned up in the first half of June. It appeared likely that the volume of retail sales in the second quarter as a whole would be appreciably above that of the first quarter. According to tentative estimates, industrial production was rising in June at a slower rate than in May. Conditions in labor markets remained slack; both the number of persons receiving unemployment insurance benefits and the number making initial claims for such benefits had increased further in recent weeks. In May private housing starts remained close to the advanced level that had been reached in the two preceding months.

Both consumer prices of goods and services and wholesale prices of industrial commodities increased sharply in May -- the latter for the second successive month -- after having risen at moderate rates earlier in the year. Wage rates continued to advance rapidly in most sectors of the economy.

The expectation that over-all economic activity would continue a gradual expansion in the second half of 1971 was based in part on the assumption that there would not be a strike in the steel industry when wage contracts expired at the end of July--or that if there were a strike, it would not be of long duration. The latest staff projections, like those of 3 weeks earlier, suggested that the rise in residential construction outlays would slow as the year progressed but would remain sizable, and that expenditures by State and local governments would continue to expand at a substantial rate. As before, it appeared that business fixed investment outlays would increase relatively little in the second half. And it was still anticipated that growth of consumer spending would be sustained in part by the recent increase in social security benefits, including retroactive payments made in late June; by a possible military pay raise; and by some decline in the personal saving rate.

The U.S. merchandise trade balance, which had shifted from a small surplus in the first quarter to a large deficit in April, remained in substantial deficit in May as a rise in exports was matched by a roughly equal rise in imports. The over-all balance of payments on the official settlements basis had been in surplus in recent weeks, in part because of some reversal of earlier speculative outflows of short-term capital from the United States. Funds moved out of Germany as the German Federal Bank bought a large amount of marks (sold dollars) at rising exchange rates for the mark; the rate currently was about 4.7 per cent above its par value, compared with 3.8 per cent in early June. The outflow from Germany depressed very short-term interest rates in the Euro-dollar market, and this decline in Euro-dollar rates apparently had been a factor contributing to the upturn in recent weeks in the liabilities of U.S. banks to their foreign branches. The exchange rate for the Dutch guilder had increased sharply when the German Federal Bank began to sell dollars, but later it declined to 1.6 per cent above par.

In connection with its sales of dollars in foreign exchange markets, the German Federal Bank not only sold U.S. Treasury bills but also redeemed a substantial volume of special nonmarketable U.S. Treasury securities it had acquired earlier. In part for this reason, the Treasury's cash balance was drawn down to a very low level prior to the mid-June tax date, and in the period June 8-16 the Treasury financed part of its cash needs temporarily through the sale of special certificates of indebtedness to the Federal Reserve Banks.[1/]

1/ The maximum volume of such certificates outstanding in the June 8-16 period was $610 million, on June 10.

To replenish its cash balance, on June 22 the Treasury auctioned \$2-1/4 billion of 16-month notes for payment on the day of this meeting, and on June 30 it was scheduled to auction for payment on July 6 \$1-3/4 billion of tax-anticipation bills due in September. Also, on the day before this meeting the Treasury announced that the German Federal Bank would acquire up to \$5 billion of special medium-term U.S. Treasury securities in an operation to be completed within the next few weeks, and that the Federal Bank had already acquired \$3 billion of the contemplated total. This acquisition was financed in part by the sale of \$1 billion of Treasury bills in the market, thus adding a like amount to the Treasury balance, and in part by the redemption of about \$2 billion of short-term special Treasury securities the Federal Bank had acquired earlier in the year.

Interest rates on most types of long- and short-term market securities had increased on balance since the June 8 meeting of the Committee. Contributing to the upward rate pressures were investor concern about the size of the Treasury's potential needs for cash and indications that the Federal Reserve was fostering firmer money market conditions in an effort to moderate the growth of the monetary aggregates. The market for State and local government bonds remained under pressure throughout the period, but conditions in the market for new corporate bonds--and to a lesser extent in that for long-term Treasury securities--improved somewhat after midmonth, mainly as a result of some indicated reduction in the forthcoming volume of new corporate issues.

In short-term markets, rates on Treasury bills were subject to additional pressures arising out of actual and anticipated sales of bills by foreign official accounts. The market rate on 3-month bills, at about 4.95 per cent on the day before this meeting, was roughly 50 basis points above its level of 3 weeks earlier. During June banks raised further their offering rates on large-denomination CD's, and early in the month several medium-sized banks increased their prime lending rate from 5-3/4 to 6 per cent. However, at the time of this meeting most banks were maintaining a 5-3/4 per cent prime rate.

Contract interest rates on conventional new-home mortgages edged up during May after trending down for nearly a year. In the more sensitive secondary market for federally insured mortgages, yields had turned up in late April and had reached a new high for 1971 in early June. Secondary-market yields later stabilized, apparently in part as a result of a special FNMA auction of purchase commitments on June 9, which was aimed at reducing inventories of mortgage companies and other institutions that originated loans for resale. Inflows of savings funds to nonbank thrift institutions remained large during the first half of June.

Tentative estimates for June suggested that consumer-type time and savings deposits at commercial banks were continuing to expand at the relatively rapid rate of the two preceding months and that the volume of large-denomination CD's outstanding was rising somewhat from its average level in May. It appeared from data for weekly reporting banks that the sharp increase in business loans recorded in May was not continuing in June. Total bank credit, as measured by the adjusted proxy series--daily-average member bank deposits, adjusted to include funds from nondeposit sources--was tentatively estimated to have risen at an annual rate of about 7.5 per cent from May to June and about 7 per cent over the second quarter as a whole.[1/] Over the first quarter, the adjusted bank credit proxy had increased at a rate of approximately 11 per cent.

Both the narrow and the broader measures of the money stock--M_1 (private demand deposits plus currency in circulation) and M_2 (M_1 plus commercial bank time deposits other than large-denomination CD's)--appeared to be growing rapidly on the average in June, although not so rapidly as in May. For the second quarter as a whole, M_1 was currently estimated to have expanded at a rate of about 11.5 per cent, and M_2 at a 13 per cent rate.

System open market operations in the period since the June 8 meeting of the Committee had been directed at attaining somewhat firmer conditions in the money market in light of the continued rapid growth of the monetary aggregates. The Federal funds rate, which had been fluctuating around 4-3/4 per cent shortly before the preceding meeting, rose gradually over the period to the neighborhood of 5-1/8

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.

per cent. In the 3 weeks ending June 23 member bank borrowings averaged about $390 million, compared with about $330 million in the preceding 4 weeks.

Staff analysis suggested that, if conditions in the money market were similar to those that had prevailed on the average during the period since the previous meeting, M_1 would grow slightly less in the third quarter than it had in the second, and growth in M_2 also would slow somewhat. In contrast, the adjusted bank credit proxy was expected to expand more rapidly in the third quarter than it had in the second. According to the analysis, if money market conditions were somewhat firmer, it was likely that both M_1 and M_2 would expand at annual rates in the neighborhood of 9 per cent over the third quarter, but that growth in these aggregates would recede to quite modest proportions by the final quarter of the year.

In the Committee's discussion considerable concern was expressed about the rapid growth in the monetary aggregates, particularly in light of the persistence of inflationary pressures and expectations. At the same time, concern was expressed about the recent upward pressures on interest rates, in view of the dependence of the current economic recovery on continued expansion in such interest-sensitive sectors of the economy as residential construction.

While the members agreed that an unduly sharp firming of money market conditions should be avoided because of the risk of undesired repercussions on market interest rates, the Committee decided that open market operations in the coming period should be directed at achieving more moderate growth in monetary aggregates over the months ahead. As at the preceding meeting, it was agreed that account should be taken of developments in capital markets in the conduct of operations.

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 is expanding moderately in the current quarter and that the unemployment rate has remained high. Wage rates in most sectors are continuing to rise at a rapid pace. The rate of advance in both consumer prices and wholesale prices of industrial commodities has stepped up again recently after moderating earlier in the year. In June, according to tentative estimates, the money stock both narrowly and broadly defined is still growing rapidly on average, although less than in May; growth in the bank credit proxy remains below the first-quarter rate. Interest rates on most types of market securities have increased on balance in recent weeks. The market exchange rate for the German mark has advanced, and a substantial flow of funds from Germany to other markets has occurred in recent weeks. In consequence of a partial reversal of the earlier speculative outflows of short-term capital from the United States and of an increase in Euro-dollar borrowings of U.S. banks, there has been a surplus in the U.S. payments balance on the official settlements basis in this period. The U.S. merchandise trade balance, which had been in small surplus in the first quarter, was in deficit in April and May. 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, moderation of short-term capital outflows, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee seeks to achieve more moderate growth in monetary aggregates over the months ahead, taking account of developments in capital markets. System open market operations until the next meeting of the Committee shall be conducted with a view to achieving bank reserve and money market conditions consistent with those objectives.

Votes for this action: Messrs. Burns, Hayes, Brimmer, Clay, Daane, Maisel, Mayo, Mitchell, Morris, Robertson, Sherrill, and Coldwell. Votes against this action: None. Absent and not voting: Mr. Kimbrel. (Mr. Coldwell voted as his alternate.)

2. Amendment to continuing authority directive.

The Committee amended paragraph 2 of its continuing authority directive to the Federal Reserve Bank of New York with respect to domestic open market operations, to reduce the dollar limit on Federal Reserve Bank holdings of short-term certificates of indebtedness purchased directly from the Treasury from $2 billion to $1 billion.

Votes for this action: Messrs. Burns, Hayes, Brimmer, Clay, Daane, Maisel, Mayo, Mitchell, Morris, Robertson, Sherrill, and Coldwell. Votes against this action: None. Absent and not voting: Mr. Kimbrel. (Mr. Coldwell voted as his alternate.)

The dollar limit in question had been increased to $2 billion at the preceding meeting of the Committee, after the System Account Manager advised that an expected sharp decline in the Treasury's cash balance in the period before the mid-June tax payment date might necessitate temporary borrowing by the Treasury from the System in an amount exceeding the then-existing $1 billion limit. It had been anticipated at the time of that action that the $1 billion limit would be restored at today's meeting.