FEDERAL RESERVE

press release

For immediate release January 17, 1972

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 October 19, 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 October 19, 1971

Authority to effect transactions in System Account.

Information reviewed at this meeting indicated that the increase in real output of goods and services in the third quarter was of only modest proportions, in part because of reductions in steel inventories after the threat of a steel strike was eliminated by the August 1 agreement on a new labor contract. However, there were indications of a strengthening in economic activity following the mid-August announcement of the Government's new economic program. Staff projections suggested that real GNP would grow considerably faster in the current quarter and in the first half of 1972 than it had in the third quarter, and that the rise in prices would be appreciably slower.

In September retail sales expanded further, mainly because of the sharp rise in purchases of new domestic automobiles that had begun in mid-August. Retail sales were considerably higher in the third quarter as a whole than in the second quarter. Industrial production, after having declined in July and August, increased somewhat in September, chiefly as a result of partial recovery in output of steel. Total nonfarm payroll employment rose appreciably, in part because of widespread gains among manufacturing industries, and the unemployment rate edged down to 6.0 from 6.1 per cent in August despite a sizable increase in the civilian labor force. Although the number of private housing starts fell in September, the total for the third quarter was a record high.

Wholesale prices of industrial commodities declined slightly from mid-August to mid-September--the first monthly decrease in several years. The number of increases among classes of industrial commodities dropped sharply, reflecting the 90-day freeze, and prices of motor vehicles were reduced as the 1971 model-year came to an end. The rise in wage rates apparently also slowed significantly following imposition of the freeze. The general framework of the post-freeze stabilization program, including provision for a Price Commission and a Pay Board, was described in an address by the President on October 7 and in subsequent statements by administration officials.

The latest staff projections for the fourth quarter contemplated a larger increase in Federal expenditures than those prepared 4 weeks earlier, mainly because it was now assumed that the military pay raise associated with the development of a volunteer armed force would be effective in mid-November rather than on January 1. Expansion in residential construction outlays was expected to be substantial, although well below the unexpectedly large gain in the third quarter. For other sectors, projections were about the same as 4 weeks earlier. Thus, it was anticipated that the real volume of consumer spending would increase appreciably; that State and local government expenditures would continue to expand at a substantial rate; that business capital outlays would change little; and that inventory investment would rise.

The expectation that real GNP would continue to grow in the first half of 1972 at about the rapid rate anticipated for the fourth quarter was based in part on the assumption that tax measures along the lines of those recently approved by the House of Representatives would be enacted into law. It was expected that consumer expenditures would rise substantially further as a result of advances in disposable income that reflected cuts in personal income taxes as well as increases in employment; and it appeared likely that a renewed expansion in business outlays for plant and equipment would be stimulated by the upswing in production, along with the investment tax credit. Also, business inventory investment was projected to increase considerably in response to the rise in final sales and the need for the auto industry to replenish depleted stocks.

U.S. imports again exceeded exports by a substantial margin in August, and in July and August together the trade deficit remained at about the second-quarter rate. Contributing to the July-August deficit was an acceleration in imports in anticipation of the East Coast port strike, which began on October 1. Outflows of short-term capital in September were much smaller than the massive outflows in August.

In foreign exchange markets, rates for most major currencies had risen further against the dollar in recent weeks. Some foreign central banks acquired substantial amounts of dollars in September and early October in the process of limiting appreciation of their currencies.

Interest rates on market securities had declined in recent weeks to levels somewhat below those to which they had dropped immediately after announcement of the new economic program in mid-August. Among the factors contributing to the declines were the developments with respect to the post-freeze stabilization program and growing expectations of a more stimulative monetary policy in the light of recent slackening in the expansion of the monetary aggregates and moderate easing of money market conditions. Although the volume of new issues of corporate bonds rose substantially from August to September and that of State and local government issues also increased, it appeared that total offerings in those sectors would decline somewhat in October and November.

The market for Treasury bills was influenced not only by the easing of money market conditions but also by the continuing demands for bills on the part of foreign central banks. On the day before this meeting the market rate on 3-month bills was 4.45 per cent, about 25 basis points lower than 4 weeks earlier and 70 basis points lower than on August 13.

The Treasury was expected to announce on October 27 the terms on which it would refund securities maturing on November 15, including about $3.8 billion held by the public. Market participants expected the Treasury to pre-refund some issues and to offer some longer-term issues, making further use of the limited authority to sell bonds with a yield above 4-1/4 per cent.

Contract interest rates on conventional new-home mortgages, which had risen over the preceding 4 months, were unchanged in September. Yields in the more sensitive secondary market for federally insured mortgages edged down for the second consecutive month. Inflows of savings to nonbank thrift institutions increased in September, but for the third quarter as a whole they were well below the extraordinary rates in the first two quarters of the year.

At commercial banks, business loans rose moderately in September following the very large increase that had occurred in August in connection with developments in foreign exchange markets. Other categories of loans--especially real estate, consumer, and security loans--expanded appreciably. Banks acquired sizable amounts of short-term municipal securities but reduced their holdings of U.S. Government obligations for the third consecutive month.

The narrowly defined money stock (private demand deposits plus currency in circulation, or M_1) declined in September, after having increased at a sharply reduced rate in August. Inflows of consumer-type time and savings deposits remained relatively small, and the broadly defined money stock (M_1 plus commercial bank time deposits other than large-denomination CD's, or M_2) increased only slightly. Over the third quarter M_1 and M_2 grew at annual rates of about 3 and 4.5 per cent, respectively, compared with rates of 11.5 and 12.5 per cent in the second quarter.[1/]

Against the background of strong over-all demands for loans, banks raised offering rates on large-denomination CD's early in September, and the volume of such certificates outstanding rose considerably during the month. Consequently, expansion in the bank credit proxy--daily-average member bank deposits, adjusted to include funds from nondeposit sources--remained relatively rapid in September. Over the third quarter the proxy series rose at a rate of 9 per cent compared with 6.5 per cent in the second quarter. Late in September some banks reduced offering rates on CD's.

System open market operations in the period since the September 21 meeting of the Committee had been directed at encouraging somewhat easier conditions in the money market, in light of the continuing tendency of the monetary aggregates to fall short of the expected paths. The Federal funds rate, which had been fluctuating around 5-1/2 per cent at the time of the September meeting, edged down to around 5-1/4 per cent. In the 4 weeks ending October 13 member bank borrowings averaged about $380 million, compared with $675 million in the preceding 4 weeks. In the latter part of September

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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.

the System purchased about $96 million of Federal agency securities. These were the first operations conducted pursuant to the Committee's action of August 24, 1971, authorizing outright operations in agency issues.

Staff analysis suggested that if prevailing money market condi- ions were maintained, growth in both M_1 and M_2 would remain relatively slow in October and November but would quicken over the course of the following several months. It was noted that the precise timing of the step-up in monetary growth rates was particularly difficult to anticipate because of the many prevailing uncertainties. However, the analysis suggested that over the fourth quarter M_1 and M_2 might expand at rates close to those recorded in the third, and that M_1 might increase more rapidly in the first quarter of 1972. Growth in the bank credit proxy was expected to slow in the fourth quarter as a result of a reduction in U.S. Government deposits from their recent unusually high levels.

It was noted in the Committee's discussion that the 90-day freeze on prices and wages had been effective thus far and that the announcement concerning the framework of the post-freeze stabilization program seemed to have been generally well received. However, the details of the program remained to be filled in, and there appeared to be wide- spread uncertainty about how the program would operate and how effective it might prove to be. As to economic activity, the Committee agreed that a strengthening was under way but some members voiced doubt that real GNP was rising as much in the current quarter as the staff projections suggested.

Against this background the Committee decided that open market operations in the period until the next meeting should be directed at achieving moderate growth in monetary and credit aggregates over the months ahead, taking account of the forthcoming Treasury financing. The members agreed that while some easing of money market conditions in the coming period might be indicated by unfolding developments with respect to the aggregates, a marked easing designed to stimulate faster growth in the near term would not be warranted, particularly in light of the very high rates of monetary expansion earlier in the year. The members also agreed that a continued downdrift in market interest rates would be constructive, but that aggressive efforts to stimulate rate declines would risk both a resurgence of inflationary expectations and the development of conditions that could culminate in rising rates.

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 output of goods and services expanded modestly in the third quarter and that unemployment remained substantial. However, there are indications of a strengthening in economic activity since the mid-August announcement of the Government's new economic program. The 90-day freeze has thus far effectively limited increases in prices and wages, and the general framework of the post-freeze stabilization program has been established. The narrowly defined money stock, which had

grown rapidly through July, increased much less in August and declined in September. The broadly defined money stock increased slightly in September as inflows of consumer-type time and savings deposits to banks continued at the moderate August rate. However, the volume of large-denomination CD's outstanding rose sharply, and the rate of expansion in the bank credit proxy remained relatively rapid. Market interest rates have declined in recent weeks and are appreciably below their mid-August levels. The U.S. foreign trade balance remained in heavy deficit in August. Outflows of short-term capital, which had been massive in August, were much smaller in September. In recent weeks the market exchange rates for some foreign currencies against the dollar rose further, while foreign official reserve holdings increased substantially. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions consistent with the aims of the new governmental program, including sustainable real economic growth and increased employment, abatement of inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee seeks to achieve moderate growth in monetary and credit aggregates over the months ahead. 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 that objective, taking account of the forthcoming Treasury financing.

Votes for this action: Messrs. Burns, Hayes, Brimmer, Clay, Kimbrel, Maisel, Mayo, Mitchell, Morris, Robertson, and Sherrill. Votes against this action: None.

Absent and not voting: Mr. Daane.