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 records of policy actions taken by the Federal Open Market Committee at its meetings on November 19-20 and December 17-18, 1973. As in the past, the record for the December meeting of the Committee has been released along with the record for the November meeting rather than in accordance with the usual schedule of approximately 90 days after the meeting in order to complete the published record for the year in advance of the Chairman's testimony at the Congressional hearings on the Economic Report of the President and the Annual Report of the Council of Economic Advisers.

These records will be published in the Board's Annual Report for 1973 and in the Federal Reserve Bulletin. 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 meetings, rather than on data as they may have been revised since then.

Attachments

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on December 17-18, 1973[1/]

1. Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services, which had been at an annual rate of about 3.5 per cent in the third quarter, was slowing appreciably in the current quarter. Staff projections suggested that economic activity would weaken further in the first half of 1974 and that prices would rise appreciably, in part because of curtailment in oil supplies.

In November industrial production expanded slightly. Increases in output in September and October were considerably less than had been reported previously, however, and growth over the 3-month period was well below the pace of advance earlier in the year. The value of new residential construction activity declined further in November. Total nonfarm payroll employment continued to rise, reflecting gains in manufacturing as well as in trade, services, and State and local government. However, the unemployment rate--which had declined to 4.5 per cent in October--moved back up to 4.7 per cent, about

1/ This meeting was held over a 2-day period beginning on the afternoon of December 17, 1973, in order to enable the Committee to consider certain procedural matters without infringing on the time available for its deliberations on current monetary policy.

the rate that had prevailed since June. Retail sales were unchanged in November, according to the advance report; sales of new automobiles remained at the reduced level of October.

Wholesale prices of industrial commodities continued to rise sharply in November, reflecting extraordinarily large increases in prices of gasoline and other petroleum products and also sizable advances among metals, machinery, textiles, chemicals, and paper products. Wholesale prices of farm and food products declined for the third consecutive month, largely as a result of decreases in prices of cattle, poultry, grains, fats and oils, and cotton. In October the rate of increase in the consumer price index accelerated, after having slowed in September, as costs of fuels, health services, and homeownership rose appreciably.

Staff projections of growth in real GNP in the first half of 1974 suggested that the shortfall in supplies of petroleum products then envisioned would have its greatest impact on expenditures for automobiles and various other travel-related goods and services; as a result, the slower rate of growth in consumption expenditures that had been developing in the current quarter was likely to persist in the first half of 1974. It was also anticipated that the decline in residential construction would be larger than had appeared likely 4 weeks earlier--because of the adverse effects of the oil shortage on building in the more remote suburban areas and on construction of vacation homes--and that the expansion in business fixed investment would be somewhat less vigorous. State and local government purchases of goods and services were still expected to grow at a substantial rate.

In most other industrial countries, the prospect of a sustained cut in oil supplies threatened even greater economic disruptions than in the United States. From mid-November to mid-December, major foreign currencies depreciated significantly further against the dollar, and a number of foreign monetary authorities continued to intervene in the exchange markets, selling dollars to prevent their currencies from depreciating even more. The U.S. merchandise trade balance, which had been improving since early 1973, was in large surplus in both September and October.

Outstanding business loans at U.S. commercial banks increased in November--following 2 months of little or no change--in association with a rise in interest rates in the commercial paper market relative to effective rates on bank loans. However, total bank credit expansion remained moderate, as growth in most other types of loans slowed further and banks liquidated significant amounts of their holdings of Government and other securities.

The narrowly defined money stock (M_1),[2/] after changing little over the third quarter, grew moderately in October and rapidly in November. It appeared that the November rate of growth had been affected by such temporary influences as expansion in precautionary balances held by the public in response to the new economic uncertainties and increases in deposits of foreign commercial and central banks. Inflows of time and savings deposits other than large-denomination CD's--while down from the October level--were still large, and growth in the more broadly defined money stock (M_2)[3/] remained substantial. The outstanding volume of large-denomination CD's declined further in November, on the average, although the volume turned up around the middle of the month as banks raised the rates paid on such CD's in response to the expansion in business loan demand at banks. Treasury deposits also declined, and the bank credit proxy[4/] changed little for the second consecutive month. On December 7 the Federal Reserve announced a reduction from 11 to 8 per cent in marginal reserve requirements on large-denomination CD's, effective in the statement week beginning on December 27 against deposits held 2 weeks earlier.

2/ Private demand deposits plus currency in circulation.

3/ M_1 plus commercial bank time and savings deposits other than large-denomination CD's.

4/ Daily-average member bank deposits, adjusted to include funds from nondeposit sources.

Net deposit inflows at nonbank thrift institutions improved somewhat further in November, and expansion in the measure of the money stock that includes such deposits (M_3),[5/] like growth in M_2, remained substantial. Contract interest rates on conventional mortgages and yields in the secondary market for Federally insured mortgages declined for the second consecutive month.

Since the Committee's meeting on November 19-20 most short- and long-term market interest rates had fluctuated in response to changing expectations with regard to monetary policy and to the impact of the fuel shortage on economic activity. Short-term rates in general had fallen following the December 7 announcement of the reduction in marginal reserve requirements against large-denomination CD's, and on balance, most had declined somewhat over the inter-meeting period. Just before this meeting, the market rate on 3-month Treasury bills was 7.47 per cent, compared with an interim high of 7.82 per cent on November 23 and with 7.50 per cent just before the November meeting.

In long-term markets, some rates had increased slightly since the November meeting while others had declined, and on balance, rates had changed little. The volume of new public

5/ M_2 plus time and savings deposits at mutual savings banks and at savings and loan associations.

offerings of corporate bonds--which had risen sharply in October--increased somewhat further in November, and a less-than-seasonal decline was in prospect for December. The volume of new State and local government bonds remained high in November, and a seasonal decline appeared likely in the current month.

System open market operations since the meeting in mid-November had been guided by the Committee's decision to seek bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead, while taking account of international and domestic financial market developments. Soon after the November meeting, available data suggested that growth in M_1 and M_2 in the November-December period might exceed acceptable ranges. Although it appeared that growth in reserves available to support private nonbank deposits (RPD's) would fall below the range of -1 to -3 per cent that the Committee had specified, for the most part the shortfall was attributable to a larger-than-expected drop in required reserves against large-denomination CD's.

In view of the behavior of the monetary aggregates, the System, under ordinary circumstances, would have become more restrictive in its reserve-supplying operations, expecting as a result that money market conditions would tighten somewhat.

On November 30, however, the available members of the Committee concurred in a recommendation by the Chairman that, in light of current uncertainties regarding the economic outlook and the sensitive state of financial market psychology, current money market conditions be maintained for the time being. In the two statement weeks preceding this meeting, the Federal funds rate averaged about 10-1/8 per cent, little changed from the rate prevailing in the days preceding the November meeting. In the 4 weeks ending December 12, member bank borrowings averaged about $1,410 million, close to the average of about $1,446 million in the preceding 5 weeks.

A staff analysis suggested that, if prevailing money market conditions were maintained, the rate of growth of the narrowly defined money stock would be dampened over the months ahead because of the effects on transactions demands for money of the anticipated weakening in economic activity. Some easing of money market and reserve conditions, and the further declines in short-term market rates of interest likely to accompany such easing, would help to sustain moderate growth in M_1 and also--by encouraging expansion in consumer-type time and savings deposits at banks and nonbank thrift institutions--in M_2 and M_3. The analysis also suggested that the outstanding volume of large-denomination CD's would grow moderately, reflecting continuation of fairly strong business demands for short-term credit and also the lower net cost of such deposits to banks resulting from the recent reduction in marginal reserve requirements against large-denomination CD's.

The Committee concluded that the economic situation and outlook called for a modest easing of monetary policy. The members decided that for the period until the next meeting somewhat more emphasis should be placed on money market conditions than had been the case in recent months; specifically, they decided that operations should be directed toward achieving some easing in bank reserve and money market conditions, provided that the monetary aggregates did not appear to be growing excessively. Taking into account the staff analysis, the members expected that pursuit of that objective would be consistent with growth in RPD's in the December-January period at an annual rate within a range of 8-1/4 to 11 per cent. They agreed that, in the conduct of operations, account should be taken of international and domestic financial market developments, and as at other recent meetings, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives and constraints.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting--including recent developments in industrial production, residential construction, and retail sales--suggests that growth in economic activity is slowing in the fourth quarter. A further weakening in activity and an appreciable rise in prices are in prospect because of the curtailment in oil supplies. In November nonfarm payroll employment expanded further, but the unemployment rate, which had dropped in October, rose again to about the level that had prevailed since midyear. Wholesale prices of industrial commodities continued to rise sharply in November, reflecting large additional increases for petroleum products and widespread advances among other commodities; farm and food prices declined further.

In nearly all industrial countries abroad, concern has grown that a sustained cut in oil supplies will disrupt economic activity. Major foreign currencies have depreciated further against the dollar, and intervention sales of dollars by foreign monetary authorities have continued. The U.S. merchandise trade balance registered a strong surplus in the September-October period.

The narrowly defined money stock, following little net change over the third quarter, has grown at a relatively rapid pace over the past 2 months. Growth in the more broadly defined money stock has also been substantial, as net inflows at banks of consumer-type time deposits have been large. Net deposit inflows at nonbank thrift institutions improved somewhat further. Bank credit expansion remained moderate in November, although business loans increased after 2 months of little or no growth. On December 7 the Federal Reserve announced a reduction from 11 to 8 per cent in marginal reserve requirements on large-denomination CD's. Most short-term market interest rates have declined somewhat on balance in recent weeks, while movements in long-term market rates have been mixed.

> In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resisting inflationary pressures, cushioning the effects on production and employment growing out of the oil shortage, and maintaining equilibrium in the country's balance of payments.
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> To implement this policy, while taking account of international and domestic financial market developments, the Committee seeks to achieve some easing in bank reserve and money market conditions, provided that the monetary aggregates do not appear to be growing excessively.

Votes for this action: Messrs. Burns, Balles, Brimmer, Bucher, Daane, Holland, Mayo, Mitchell, Morris, Sheehan, and Kimbrel. Vote against this action: Mr. Hayes.

Absent and not voting: Mr. Francis. (Mr. Kimbrel voted as alternate for Mr. Francis.)

Mr. Hayes dissented from this action because, with the problems of inflation increasing rather than abating and with the monetary aggregates apparently growing more rapidly in 1973 than the Committee had considered desirable, he favored a continuation of the current degree of monetary restraint without noticeable relaxation unless signs of weakening in the economy became more apparent. He believed that, while there was not much that monetary policy could do to relieve the economic problems arising from the oil shortage, a premature easing of policy could exacerbate the problems of inflation.

Subsequent to the meeting it appeared that in the December-January period the annual rate of growth in RPD's might be close to the upper limit of the range that had been specified by the Committee and that rates of growth in M_1 and M_2 might exceed acceptable ranges, although a significant part of the growth in the monetary aggregates could be attributed to an unanticipated increase in deposits of foreign commercial banks at U.S. banks. On January 11 the available members--with the exception of Mr. Francis--concurred in a recommendation by the Chairman that, in view of the sensitive state of financial markets and the general economic situation, the System aim to maintain prevailing money market conditions for the time being.

2. Authorization for domestic open market operations

On January 4, 1974, a majority of Committee members voted to increase from $2 billion to $3 billion the limit on changes between Committee meetings in System Account holdings of U.S. Government and Federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective immediately, for the period ending with the close of business on January 22, 1974.

Votes for this action: Messrs. Burns, Hayes, Brimmer, Holland, Mayo, Mitchell, Morris, Sheehan, and Clay. Vote against this action: Mr. Francis.

Absent and not voting: Messrs. Balles, Bucher, and Daane. (Mr. Clay voted as alternate for Mr. Balles.)

This action was taken on recommendation of the System Account Manager. The Manager had advised that a substantial volume of open market purchases of securities had been required in the period since the Committee's meeting on December 18, 1973, in order to offset reserve absorption resulting from market factors and that a near-term need to supply reserves was in prospect; he had further advised that strength of the dollar in foreign exchange markets suggested that foreign official sales of U.S. Treasury bills might be heavy and that the System should be in a position to acquire some of those bills while offsetting any undesired effects on bank reserves by other means.

Mr. Francis dissented from this action because, in view of his concern over the continuing rapid rate of growth in the monetary aggregates, he preferred that additional reserves necessary to meet requirements over the next few weeks be obtained through member bank borrowings rather than provided through additions to System holdings of securities. Moreover, he believed that foreign official sales of Treasury bills should be absorbed in the market.