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 July 16, 1974.

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 July 16, 1974

1. Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services had changed little in the second quarter, after having declined at an annual rate of 6.3 per cent in the first quarter, and that the increase in the GNP implicit deflator had not been quite so large as in the first quarter. No significant forces of economic expansion appeared to be emerging, and staff projections suggested that in the second half of the year real economic activity would grow at a minimal pace and that prices would increase less rapidly than in the first half.

In June industrial production was unchanged, after having advanced moderately in the preceding 2 months; for the second quarter as a whole, the level of output was essentially the same as that in the first quarter. Total nonfarm payroll employment edged down in June, following 2 months of substantial gains, and the unemployment rate remained at 5.2 per cent. According to the advance report, the dollar volume of retail sales had declined in June; the gain in sales from the first to the second quarter appeared to be little if any greater than the rise in average retail prices.

Wholesale prices of farm and food products dropped substantially in June for the fourth consecutive month. However, wholesale prices of industrial commodities continued upward at a fast pace, reflecting further large increases for most commodity groups. The advance in the index of average hourly earnings of production workers on nonfarm payrolls remained rapid in June, and the increase for the second quarter as a whole was much larger than that in the first quarter. In May the rise in the consumer price index had accelerated again to about the rate in the first quarter, reflecting in part an appreciable rise in retail prices of foods following a small decline in April.

The latest staff projections suggested that real economic activity would grow somewhat less in the second half of the year than had been anticipated 4 weeks earlier, in large part because an upturn in residential construction was no longer expected and a somewhat greater decline in net exports now appeared in prospect. Moreover, the projected rise in consumption expenditures had been scaled down slightly further. It was still anticipated that business fixed investment would expand moderately and that

State and local government purchases of goods and services would continue to grow at a substantial rate.

In recent weeks the exchange rate for the dollar against leading foreign currencies had appreciated somewhat further to a level significantly above the low reached in mid-May after 3-1/2 months of decline. The U.S. balance of payments on the official settlements basis was in substantial deficit in June, but the deficit reflected a large increase in investments in the United States by oil-producing countries rather than purchases of dollars by foreign monetary authorities for exchange market intervention purposes. In May the U.S. merchandise trade deficit had increased sharply, as exports had dropped while imports had continued to expand.

Growth in loans and investments at U.S. commercial banks continued to moderate in June, reflecting for the most part a further slowing in business loan growth; banks enlarged their holdings of Federal agency and other securities. In late June and early July, however, outstanding business loans at banks expanded considerably, as some credit demands were diverted from the commercial paper and capital markets in response to sharp deterioration in conditions in those markets and to increases in market interest rates relative to effective rates on bank loans. The prime rate applicable to large corporations was raised by most banks in two steps from 11-1/2 to 12 per cent.

The narrowly defined money stock (M_1)[1/] grew somewhat more rapidly in June than in May, but a major part of the step-up was attributable to a temporary increase in foreign official deposits arising from payments to oil exporters. Net inflows to banks of time and savings deposits other than large-denomination CD's rose sharply. Banks again added a substantial amount to their outstanding volume of large-denomination CD's, but the addition was far below that for April or May. During the second quarter M_1 grew at an annual rate of 6.7 per cent, compared with 7.1 per cent in the first quarter, while the more broadly defined money stock (M_2)[2/] grew at a rate of 7.7 per cent, down from 10 per cent in the first quarter.[3/]

Net deposit inflows at nonbank thrift institutions--which had been weak in April and May--strengthened in June, although deposit experience deteriorated late in the month. Growth in the measure of the money stock that includes such

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1/ Private demand deposits plus currency in circulation.

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

3/ Growth rates cited are 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. Measures of the money stock subsequently were revised to reflect new benchmark data for deposits at nonmember banks; on the revised basis M_1 grew at annual rates of 5.6 and 6.4 per cent in the first and second quarters, respectively.

deposits (M_3)[4/] also picked up in June; over the second quarter, however, M_3 grew at an annual rate of about 6.6 per cent, compared with 9.4 per cent in the first quarter. Contract interest rates on conventional mortgages and yields in the secondary market for Federally insured mortgages rose further from early June to early July.

The Treasury was expected to announce on July 31 the terms of its mid-August refunding. Of the maturing issues, $4.3 billion were held by the public.

System open market operations immediately after the June 18 meeting had been guided by the Committee's decision to maintain about the prevailing restrictive money market conditions, provided that the monetary aggregates appeared to be growing at rates within the specified ranges of tolerance, while taking account of developments in domestic and international financial markets. In the statement week ending June 26 the Federal funds rate edged up to an average of about 12 per cent, compared with 11-3/4 per cent in the days before the June meeting. In the statement week ending July 3, however, the Federal funds rate was consistently above 13 per cent and averaged about 13-1/2 per cent, despite System efforts to bring

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

the rate down into the 11-1/4 to 12-1/4 per cent range of tolerance that had been specified by the Committee. On July 5 the Committee held a telephone meeting to discuss the situation and to consider whether any Committee actions would be appropriate.

On the day of the telephone meeting it appeared that in the June-July period growth in M_1 would be within its range of tolerance and that growth in M_2 would be at about the upper limit of its range. The Manager reported that, in order to bring the funds rate back within its range of tolerance, he would have had to expand reserve-supplying operations substantially. In his view, the high level of the funds rate was a reflection of the great uncertainty prevailing in both domestic and foreign financial markets, compounded by the effects of market transactions related to the midyear statement date for banks and by the July 4 holiday. In view of the likelihood that the high level of the rate was primarily a consequence of technical factors that might well prove temporary, the Committee concluded that there was no immediate need to press hard to bring the funds rate down within the specified range of tolerance.

Subsequent to the telephone meeting the volume of reserves provided through open market operations was deemed sufficient to have reduced the Federal funds rate to about

12 per cent under normal circumstances. Member bank borrowing at the Reserve Banks was unexpectedly low, however, and the funds rate remained at an extremely high level; its average for the statement week ending July 10 was estimated at about 13-1/2 per cent. The Manager reported that to bring the weekly average rate down to the 12-1/4 per cent upper limit of the Committee's range of tolerance probably would be difficult without providing nonborrowed reserves on a very large scale. It now appeared that in the June-July period the growth rates of both M_1 and M_2 would be somewhat below the upper limits of their ranges of tolerance. A majority of the members of the Committee concurred in a recommendation by the Chairman on July 10 that the Manager be instructed to act to reduce the funds rate, but not so aggressively as to risk unduly rapid growth in reserves and monetary aggregates. Specifically, the members agreed that the Manager be instructed to undertake operations promptly with a view to reducing the funds rate to 13 per cent, on the understanding that the rate would be permitted to decline to the neighborhood of 12 per cent should money market factors work in that direction.

The funds rate remained near 13-1/2 per cent until the day of this meeting, when it dropped below 12-1/2 per cent.

In the 3 weeks ending July 10, member bank borrowings averaged about $2,955 million, down from an average of about $3,155 million in the preceding 4 weeks.

Private short-term market interest rates rose substantially in the period between the Committee's meeting on June 18 and this meeting, in response both to the rise in the Federal funds rate and to strong short-term credit demands of business, which were bolstered by the diversion of some demands from the capital market. Yield spreads between high- and lower-quality securities widened further as a result of uneasiness in financial markets. In contrast with private short-term rates, Treasury bill rates declined somewhat, reflecting not only the shift in investor preference toward securities of higher quality, but also a seasonal reduction in market supplies of bills and the persistence of substantial demands from foreign monetary authorities and from small investors. On the day before this meeting the market rate on 3-month Treasury bills was 7.62 per cent, down from 8.17 per cent on the day before the June meeting.

Yields on long-term private securities rose substantially in the inter-meeting period, while yields on long-term Government securities increased relatively little. The volume of public offerings of corporate bonds declined somewhat in June, as some scheduled offerings were postponed or canceled and other issues were reduced in size. An unseasonally large volume of corporate offerings appeared in prospect for July. Long-term offerings of State and local government bonds declined slightly from May to June and appeared likely to decline a little further in July.

The Committee concluded that the economic situation continued to call for moderate growth in monetary aggregates over the longer run and that, in view of the rapid monetary expansion recently, it would seek to achieve less rapid growth in monetary aggregates over the months ahead. A staff analysis suggested that if growth in M_1 were maintained at a rate consistent with the Committee's longer-run objectives for the monetary aggregates, money market conditions would ease somewhat in the period immediately ahead.

According to the staff analysis, the tightening in money market conditions that had occurred in recent weeks reflected in part uncertainties that caused member banks to attempt to protect their liquidity positions; their willingness to borrow from Federal Reserve Banks was reduced and their willingness to hold excess reserves was increased at given levels of the Federal funds rate. Bank attitudes concerning borrowings and excess reserves appeared to be returning to normal, and that development--

along with open market operations directed toward accommodating any lingering increased demands for liquidity--was expected to ease money market pressures. Such easing would probably lead to a more general relaxation of pressures in markets for short- and long-term securities, although any declines in interest rates that might occur were likely to be moderate and short-lived in view of the rate of inflation, continuance of strong credit demands, and the forthcoming Government financings.

The analysis suggested that inflows of consumer-type time and savings deposits to banks and to nonbank thrift institutions would continue to be constrained and that rates of growth in both M_2 and M_3 would decline. The rate of expansion in total bank credit was expected to be reduced substantially. Although credit demands at banks would continue large, in part because of diversions of some demands from the unsettled financial markets, it seemed likely that many banks would find it difficult to expand their outstanding volume of large-denomination CD's and would meet loan demands by curtailing acquisitions of securities.

Taking account of the staff analysis, the Committee decided that ranges of tolerance for rates of expansion in the monetary aggregates over the July-August period should be wide enough to accommodate lower rates of growth in the monetary aggregates than were expected at present, in the event that growth appeared to be falling short of present expectations, given the range of tolerance specified for the Federal funds rate. Specifically, for the July-August period the Committee adopted ranges of tolerance of 2 to 6 per cent and 4-1/2 to 7-1/2 per cent for the annual rates of growth in M_1 and M_2, respectively. The members agreed that rates of growth within those ranges would be likely to involve growth in reserves available to support private nonbank deposits (RPD's) during the same period at an annual rate within a range of tolerance of 8-3/4 to 11-3/4 per cent, and they decided that in the period until the next meeting the weekly average Federal funds rate might be permitted to vary in an orderly fashion from as low as 11-1/2 per cent to as high as 13 per cent, if necessary, in the course of operations.

The members also agreed that, in the conduct of operations, account should be taken of the forthcoming Treasury financing and of developments in domestic and international financial markets. 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 suggests that real output of goods and services changed little in the second quarter and that no significant expansive forces appear to be emerging. The over-all rate of price rise, while very large, was not quite so rapid in the second as in the first quarter, but the advance in wage rates accelerated. In June industrial production was unchanged, following 2 months of moderate advance, while nonfarm payroll employment edged down. The unemployment rate remained at 5.2 per cent. Wholesale prices of farm and food products declined substantially further, but increases among industrial commodities continued widespread and extraordinarily large.

Since mid-May the dollar has appreciated somewhat against leading foreign currencies. In June there was a large increase in foreign official assets in the United States, mainly reflecting investments by oil-exporting countries. The foreign trade deficit increased sharply in May, as exports declined and imports rose further.

Growth in the narrowly defined money stock was somewhat more rapid in June than in May; growth during the second quarter was close to the 7 per cent first-quarter pace. Net inflows of consumer-type time deposits at banks and at nonbank thrift institutions increased in June, but deposit experience at the nonbank institutions deteriorated late in the month. Growth in business loans and in total bank credit slowed in June, and banks added much less to their outstanding volume of large-denomination CD's than in April and May. Private market interest rates have risen substantially in recent weeks, and in association with uneasy conditions in financial markets, yield spreads between prime and lower quality issues have widened. Yields on long-term Government securities have increased relatively little, and those on Treasury bills have declined somewhat.

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, supporting a resumption of real economic growth, and achieving equilibrium in the country's balance of payments.

> To implement this policy, while taking account of the forthcoming Treasury refunding and of developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions that would moderate growth in monetary aggregates over the months ahead.

> Votes for this action: Messrs. Burns, Hayes, Black, Clay, Holland, Kimbrel, Mitchell, Sheehan, Wallich, and Winn. Vote against this action: Mr. Bucher.
>
> Absent and not voting: Mr. Brimmer.

In dissenting from this action, Mr. Bucher said he favored maintaining a generally restrictive policy stance in order to combat inflation. However, he thought that that longer-run objective would be best served by seeking in the short run to maintain growth in the monetary aggregates at recent rates; in his view, further efforts to moderate monetary growth at this point would involve an unduly high risk of creating economic conditions that would necessitate a marked relaxation of policy.

2. Amendment to authorization for domestic open market operations

The Committee amended paragraph 1(b) of the authorization for domestic open market operations to increase the limit on outright holdings of bankers' acceptances from $125 million to $500 million. With this amendment, paragraph 1(b) read as follows:

> To buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers' acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers' acceptances held at any one time shall not exceed $500 million.

> Votes for this action: Messrs. Burns, Hayes, Black, Bucher, Clay, Holland, Kimbrel, Mitchell, Sheehan, Wallich, and Winn. Votes against this action: None.
> Absent and not voting: Mr. Brimmer.

This action was taken on recommendation of the Account Manager, who reported that recent purchases had brought System holdings of bankers' acceptances close to the $125 million limit. The Manager noted that purchases of acceptances were particularly useful as a supplement to other reserve-supplying techniques under current circumstances, when the volume of Government securities available in the market was often limited, and in the Committee's current policy discussion earlier in this meeting, it had been suggested that the Manager give greater weight to the purchase of bankers' acceptances in the process of supplying reserves. Because the volume of bankers' acceptances outstanding had risen sharply over the past decade, the new limit was less than 5 per cent of outstandings, as the previous limit had been when it was established in 1964.

3. <u>Revision of guidelines for operations in Federal agency issues</u>

On recommendation of the Manager, the Committee amended the guidelines for the conduct of operations in securities issued by Federal agencies to delete those previously numbered 4 and 7, and to renumber as 4, 5, and 6 those previously numbered 5, 6, and 8. The guidelines deleted were as follows:

> 4. System holdings of maturing agency issues will be allowed to run off at maturity.
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> 7. No new issues will be purchased in the secondary market until at least 2 weeks after the issue date.

Votes for this action: Messrs. Burns, Hayes, Black, Bucher, Clay, Holland, Kimbrel, Mitchell, Sheehan, Wallich, and Winn. Votes against this action: None.
Absent and not voting: Mr. Brimmer.

Initial guidelines for operations in agency issues had been approved on August 21, 1971, with the understanding that they would be subject to review and revision as experience was gained, and revisions had been made on several subsequent occasions. At this meeting the Committee concurred in the Manager's judgment that experience had demonstrated both the absence of need for the technical restrictions embodied in the two guidelines in question and the advantages of their deletion. With respect to the latter, it was noted that the deletion of guideline 4 would make it possible to avoid the negative impact on reserves that automatically ensued when maturing issues were redeemed, and that the deletion of guideline 7 would increase the availability of agency issues for purchase by the System, since recent issues were the most actively traded in the market. These changes brought System operating practices for agency issues more closely in line with those for Treasury securities.

As a result of these changes, the guidelines for operations in agency issues read as follows:

1. System open market operations in Federal agency issues are an integral part of total System open market operations designed to influence bank reserves, money market conditions, and monetary aggregates.

2. System open market operations in Federal agency issues are not designed to support individual sectors of the market or to channel funds into issues of particular agencies.

3. System holdings of agency issues shall be modest relative to holdings of U.S. Government securities, and the amount and timing of System transactions in agency issues shall be determined with due regard for the desirability of avoiding undue market effects.

4. Purchases will be limited to fully taxable issues for which there is an active secondary market. Purchases will also be limited to issues outstanding in amounts of $300 million or over in cases where the obligations have a maturity of five years or less at the time of issuance, and to issues outstanding in amounts of $200 million or over in cases where the securities have a maturity of more than five years at the time of issuance.

5. System holdings of any one issue at any one time will not exceed 20 per cent of the amount of the issue outstanding. Aggregate holdings of the issues of any one agency will not exceed 10 per cent of the amount of outstanding issues of that agency.

6. All outright purchases, sales and holdings of agency issues will be for the System Open Market Account.