FEDERAL RESERVE

press release

For immediate release December 9, 1974

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 September 10, 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 September 10, 1974

1. Domestic policy directive

The information reviewed at this meeting continued to suggest that real output of goods and services--which had declined in the first half of the year--was changing little in the current quarter and that both the GNP implicit deflator and wage rates were continuing to rise at a rapid pace. Staff projections, like those of 3 weeks earlier, suggested that weakness in real economic activity would persist in the fourth quarter of the year and in the first half of 1975 and that the rate of increase in prices would remain rapid, although not so rapid as in recent quarters.

In August, according to preliminary indications, industrial production had remained near the level of the preceding 3 months. Although employment in manufacturing establishments declined somewhat during the month--only in part because of strikes--total nonfarm payroll employment rose moderately. The unemployment rate edged up further to 5.4 per cent. Weekly data suggested that retail sales, after a sharp advance in July, had expanded somewhat further in August.

Wholesale prices of farm products rose further in the period from mid-July to mid-August, and price increases for industrial products continued numerous. The advance in the index of average hourly earnings for private nonfarm production workers had remained rapid over recent months. In July the consumer price index had risen somewhat less than in the preceding 2 months, reflecting a decline in retail prices of foods.

Staff projections that weakness in economic activity would persist in the fourth quarter of this year and in the first half of 1975, like those of 3 weeks earlier, were based on the following expectations: that the contraction in residential construction outlays would continue; that the expansion in business fixed investment would taper off; that growth in disposable personal income and in personal consumption expenditures would be little, if any, greater than the rate of increase in prices; and that the pace of business inventory accumulation would moderate.

In recent weeks the exchange rate for the dollar against leading foreign currencies had continued to appreciate, apparently in part because of a favorable shift in net capital flows. In July there had been a net inflow of bank-reported capital, reflecting both a lessening of the outflow of U.S. bank credit to foreigners and a significant increase in liabilities to private foreigners. Foreign lending by U.S. banks appeared to have declined further in August. The U.S. trade deficit, which had narrowed in June, increased appreciably in July, as imports rose somewhat further while exports declined.

Expansion in total loans and investments at U.S. commercial banks was moderate in August. Growth in business loans remained relatively strong, but growth in total loans slowed from the fast pace in July and banks further reduced their holdings of U.S. Government securities.

The narrowly defined money stock (M_1)1/ grew at an annual rate of 3 per cent in August, up somewhat from the slow July pace but still well below the 6 per cent rate of the first half of the year.2/ Growth in the more broadly defined money stock (M_2)3/ also picked up a little in August; whereas the performance of passbook savings continued weak, inflows of total time and savings deposits other than large-denomination CD's

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1/ Private demand deposits plus currency in circulation.

2/ The growth rate cited for the quarter is 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.

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

remained relatively strong. U.S. Treasury deposits increased substantially, and banks reduced their outstanding volume of large-denomination CD's and their use of nondeposit sources of funds. On September 4 the Board announced the removal of the 3 per cent marginal reserve requirement on large time deposits and related instruments maturing in 4 months or more.

Deposit experience at nonbank thrift institutions continued weak in August, and growth in the measure of the money stock that includes such deposits (M_3)[4/] remained near the reduced rate of July. Contract interest rates on conventional mortgages in the primary market and yields in the secondary market for Federally underwritten mortgages continued to rise during August.

Market interest rates on most private short-term securities had fluctuated narrowly in the period since the Committee's meeting on August 20. However, yields on Treasury bills moved through a wide range; they rose sharply in late August--when market supplies increased as the Treasury auctioned $2 billion of 299-day bills and raised the size of the regular weekly bill auctions--and then declined in early September. On

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

the day before this meeting the market rate on 3-month Treasury bills was 9.15 per cent, down from an inter-meeting high of 9.74 per cent on August 23 but up from 8.84 per cent on the day before the August meeting.

Yields on long-term securities rose moderately, on balance, over the inter-meeting period, reflecting market anticipation of a large volume of Federal agency and corporate offerings. Public offerings of corporate bonds were unseasonally large in August, and a moderate increase was in prospect for September. Offerings of State and local government bonds declined in August but were expected to rise considerably in September.

System open market operations since the August meeting 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 developments in domestic and international financial markets. Data that had become available a few days after the meeting suggested that in the August-September period M_1 would grow at a rate slightly below the lower limit of the range of tolerance that had been specified by the Committee while M_2 would grow at a rate within its range; data available a week later suggested that growth rates for both aggregates had weakened. Accordingly, System operations were directed toward some easing in bank reserve and money market conditions, with the expectation that the Federal funds rate would decline in the 11-1/2 to 12-1/2 per cent range that the Committee had specified. At the time of this meeting the funds rate was about 11-3/4 per cent, compared with 12-1/4 per cent at the time of the August meeting.

The Committee concluded that the economic situation and outlook called for moderate growth in the monetary aggregates over the longer run, at rates slightly higher than those contemplated earlier. A staff analysis suggested that monetary growth--although apparently remaining sluggish in September--would pick up in later months as transactions demands for money strengthened. Nevertheless, it appeared likely that if M_1 were to grow at a rate consistent with the Committee's longer-run objectives for the monetary aggregates, money market conditions would ease somewhat further in the period immediately ahead. Such easing would probably lead to additional declines in market interest rates.

The staff analysis suggested that a modest recovery in flows of savings at both banks and nonbank thrift institutions might develop and that upward pressures on mortgage rates might lessen. Demands for bank credit were likely to be tempered by the projected slowdown in the rate of expansion in nominal GNP.

In view of sluggish monetary growth since midyear, the Committee decided that the tolerance ranges specified for rates of expansion in the monetary aggregates over the September-October period should be wide enough to accommodate somewhat higher growth rates, should they develop, than those presently thought to be consistent with the money market conditions contemplated. Specifically, for the September-October period the members adopted ranges of tolerance of 3 to 6 per cent and 5 to 7-1/2 per cent for the annual rates of growth in M_1 and M_2, respectively, and they agreed that such growth rates would be likely to involve growth in reserves available to support private nonbank deposits (RPD's) within a range of 6 to 8-1/2 per cent. The members also 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 10-1/2 per cent to as high as 12 per cent, if necessary, in the course of operations. It was understood that in the early weeks of the period the weekly average funds rate would be permitted to decline gradually from its present level of 11-3/4 per cent to about 11-1/4 per cent so long as the monetary aggregates did not appear to be growing at rates above their specified ranges.

The members also agreed that, in the conduct of operations, account should be taken 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 inconsistences 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 is changing little in the current quarter, following the first-half decline, and that price and wage increases are continuing large. In August industrial production, according to preliminary indications, remained near the level of recent months, while the unemployment rate edged up to 5.4 per cent. Wholesale prices of farm products rose further, on average, and announcements of increases for industrial commodities continued numerous.
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> In recent weeks the dollar has continued to appreciate against leading foreign currencies. U.S. bank lending to foreign borrowers diminished in July and apparently also in August, while inflows from abroad increased. The foreign trade deficit, which had narrowed in June, widened in July.
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> In August growth of the narrowly defined money stock was above the low pace of July but well below the 6 per cent annual rate of the first half of the year. Net inflows of time deposits other than money market CD's continued at about the July rate, but the performance of passbook savings at banks--and of total deposits at nonbank thrift institutions--remained weak. Although growth in business loans

remained relatively strong in August, growth in total bank credit was moderate, and banks reduced their reliance on large-denomination CD's and nondeposit funds. Interest rates on most short-term market instruments have changed little on balance since mid-August, while rates on most types of longer-term securities have risen further. On September 4 the Federal Reserve announced the removal of the 3 per cent marginal reserve requirement on longer-term large-denomination CD's.

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 developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead.

Votes for this action: Messrs. Burns, Black, Bucher, Clay, Holland, Kimbrel, Mitchell, Sheehan, Wallich, and Winn. Vote against this action: Mr. Hayes.

Mr. Hayes, who dissented from this action, observed that inflation and inflationary expectations continued unabated whereas the probabilities, in his view, were against the development of a severe recession. He believed that the pursuit of somewhat higher rates of monetary growth than contemplated earlier--in accordance with the Committee's decision--would signify an inappropriate easing of policy in terms of an immediate decline in the Federal funds rate and in other market interest rates. He favored maintenance of about the current policy of firm monetary restraint, particularly since fiscal restraint was by no means assured at present.

Subsequent to the meeting it appeared that in the September-October period the annual rates of growth in the monetary aggregates would be below the lower limits of the ranges of tolerance that had been specified by the Committee. The Federal funds rate recently had been fluctuating around 11 per cent, 1/2 of a percentage point above the lower limit of its specified range, and the System Account Manager was endeavoring to supply reserves at a rate consistent with some further easing in money market conditions. The members--with the exception of Messrs. Hayes and Winn--concurred in the Chairman's recommendation of October 3 that, in order to provide operating flexibility in the event of evidence of further weakening in the behavior of the aggregates, the lower limit of the funds rate constraint be reduced by 1/4 of a percentage point, to 10-1/4 per cent, for the period remaining until the next Committee meeting.

2. Special authorization relating to foreign currency operations

On September 25, 1974, Committee members were advised that the Federal Reserve Bank of New York, after discussions with Franklin National Bank, had developed a plan to purchase the foreign exchange position of Franklin, amounting to approximately $800 million equivalent; that the Board of Governors of the Federal Reserve System had concurred in the proposed arrangement; and that the New York Bank was requesting the Committee's specific approval of such open market transactions in foreign currencies as might be necessary to carry out the arrangement.

The members of the Committee voted to approve the following special authorization:

> The Federal Reserve Bank of New York is authorized and directed, under the provisions of 270.4(e) of the Regulation relating to Open Market Operations of Federal Reserve Banks, to engage in such open market transactions in foreign currencies, including transactions for the System Open Market Account, as may be necessary to carry out the arrangements that have been made by the Federal Reserve Bank of New York, with the concurrence of the Board of Governors of the Federal Reserve System, for the disposition of assets and liabilities of the Franklin National Bank.

> Votes for this action: Messrs. Burns, Hayes, Black, Bucher, Clay, Holland, Kimbrel, Mitchell, Sheehan, Wallich, and Winn. Votes against this action: None.

This action was taken against the background of the problems that Franklin had been experiencing in covering its foreign exchange commitments, and for the purpose of assisting the foreign exchange markets by avoiding the weakening of confidence that appeared likely to ensue if contracts in the volume Franklin had outstanding were not honored. Under the agreement proposed (and subsequently implemented), Franklin would indemnify the New York Bank against any losses it might incur in fulfilling Franklin's foreign exchange position.