FEDERAL RESERVE

press release

For immediate release November 10, 1969

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 August 12, 1969. Such records are made available approximately 90 days after the date of each meeting of the Committee and will be found in the Federal Reserve Bulletin and the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on August 12, 1969

Authority to effect transactions in System Account.

According to preliminary Commerce Department estimates, real GNP had expanded in the second quarter at an annual rate of 2.4 per cent, close to the 2.5 per cent rate of the first quarter and somewhat slower than the 3.5 per cent rate of the second half of 1968. However, substantial upward pressures on prices and costs were persisting; average prices, as measured by the GNP deflator, had increased at an annual rate of nearly 5 per cent in both the first and second quarters. Staff projections suggested some further slowing of growth in real GNP in the second half of 1969 but only a moderate reduction in the rate of price advance.

Recent economic developments continued to present a mixed picture. Industrial production was tentatively estimated to have risen sharply further in July. On the other hand, weekly figures suggested that retail sales were about unchanged from June and no higher than they had been in February. Nonfarm employment expanded less than it had on the average in earlier months of the year, and the unemployment rate rose to 3.6 from 3.4 per cent in June.

Average wholesale prices increased only slightly further from mid-June to mid-July. Average prices of farm products and foods, which had accounted for most of the rise in the wholesale price index in recent months, were unchanged. Price advances continued widespread among industrial commodities, but the average for such commodities rose only moderately because of further declines in prices of lumber and plywood. The consumer price index increased sharply in June with foods, particularly meats, accounting for much of the advance.

In the second quarter, according to the preliminary Commerce Department figures, expansion in real GNP had been sustained by a rise in inventory investment. Declines were recorded in residential construction expenditures and Federal outlays on goods and services, and the rate of increase was slower than in the first quarter for consumer spending and business capital outlays.

One uncertainty in the outlook for the second half of 1969 had been removed by the enactment in early August of legislation to extend the income tax surcharge at 10 per cent through the end of the year. The mid-1969 Government pay raise was expected to lead to an increase in Federal outlays in the third quarter and to provide some temporary stimulus to growth in disposable income and consumer spending, but it seemed likely that the decline in Federal outlays would resume in the fourth quarter and that growth in consumer income and spending would again be moderating. Prospects were that residential construction activity would continue to decline in the third and fourth quarters. Further slowing in the expansion of business capital outlays was anticipated in both quarters, as suggested by the June Commerce-SEC survey of business plans and also by a special Federal Reserve survey of capital spending authorizations of about 200 large corporations conducted in late July.

With respect to the balance of payments, it appeared that outflows of U.S. capital remained sizable in July and that the very large deficits that had been recorded on the liquidity basis earlier in the year were continuing. The official settlements balance was still in surplus in the first half of July, a period in which the outstanding Euro-dollar borrowings of U.S. banks increased considerably further. After mid-July, however, there was relatively little net change in such borrowings and the official settlements balance shifted toward deficit. Interest rates in the Euro-dollar market declined from early July to early August but remained at relatively high levels.

On the Friday before this meeting the French Government announced an 11.1 per cent devaluation of the franc. This action was taken against the background of recent substantial losses of international reserves by France and in the interests of avoiding a deflationary policy "that would impose unbearable sacrifices and massive unemployment on the country." Although certain Western European currencies had come under some selling pressure following the announcement, the initial reaction in foreign exchange markets appeared on the whole to be orderly. Earlier--around mid-July--the Bank of Canada had increased its discount rate and the German Federal Bank had announced an increase in reserve requirements against deposit liabilities of domestic banks; and around the end of the month discount rates had been increased by the central banks of Belgium and the Netherlands.

In its August refunding the Treasury offered a new 18-month, 7-3/4 per cent note priced to yield about 7.82 per cent in exchange for $3.4 billion of securities maturing on August 15. The new issue was well received and was quoted at a premium in the market. Of the $3.2 billion of maturing issues held by the public, about 14 per cent were redeemed for cash. The Treasury was expected to raise about $1-1/2 billion to $2 billion of new cash later in the month through an offering of short-term securities.

The atmosphere in securities markets had improved recently--partly because of the enactment of legislation extending the income tax surcharge, of further indications that the rate of real economic expansion was gradually slowing, and of signs that credit demands from some sectors might be moderating. Yields on new long-term corporate bonds and municipal securities, which had been rising in the latter part of July, declined somewhat in early August. Municipal bond markets had been under particularly severe pressures partly as a result of congressional discussion of possible changes in the tax treatment of earnings on such bonds, and these pressures moderated after the House Ways and Means Committee modified certain earlier proposals in this area. Various short-term interest rates also had declined recently. For example, the market rate on 3-month Treasury bills, at about 7 per cent on the day before this meeting, was down from a peak of 7.13 per cent in late July, although it was little changed from its level 4 weeks earlier.

Commercial bank holdings of U.S. Government securities rose during July as a result of bank underwriting of the tax-anticipation bills sold by the Treasury at midmonth, but holdings of other securities decreased considerably. Business loans outstanding were about unchanged for the second successive month after expanding rapidly earlier in the year. To some extent the lack of growth in business loans since May reflected outright sales of loans to bank affiliates. Even with the inclusion of such loans, however, the increase in the last 2 months would have been at a rate only about one-third of that earlier in the year.

Total bank credit, as measured by the adjusted proxy series, was estimated to have declined at an annual rate of about 12 per cent from June to July, as a large reduction in daily-average member bank deposits was only partly offset by a rise in the average level of Euro-dollar liabilities of U.S. banks to their foreign branches. Banks increased their reliance on funds from other nondeposit sources, including funds obtained by selling assets to affiliates and to customers with bank guarantees. Rough estimates suggested that with a further adjustment for such funds the proxy series would have declined at an annual rate of 7 to 8 per cent from June to July.

Private demand deposits[1/] and the money stock rose on the average in July--the latter at an annual rate of 6 per cent--partly as a consequence of a large further contraction of U.S. Government deposits. The run-off of large-denomination CD's continued without abatement; since mid-December the outstanding volume of such CD's at weekly reporting banks had been reduced by more than $10.5 billion, or about 45 per cent. There also were sizable outflows of other time and savings deposits following midyear interest crediting. Nonbank thrift institutions similarly experienced heavy outflows early in July.

1/ Estimates of private demand deposits--and hence of the money stock and the bank credit proxy--had recently been corrected for a downward bias produced, under previously employed accounting procedures, by the recent growth in cash items generated by Eurodollar transactions of U.S. banks. For the money stock the correction raised the estimated annual rate of increase for July by about 2-1/2 percentage points--from 3.7 to 6.1 per cent; and for the first 6 months of the year by about 1-1/2 percentage points--from 2.2 to 3.6 per cent. The effects of the correction on the adjusted proxy series were smaller. For July, the estimated annual rate of decline was reduced by about 1-1/2 points, from 13.5 to 11.8 per cent; and for the first half of the year an estimated decline at an annual rate of about 1 per cent was revised to an estimate of no change.

In general, System open market operations since the previous meeting of the Committee had been directed at maintaining firm conditions in the money and short-term credit markets. Money market pressures had tended to ease for a time after mid-July as a result of a shift of reserves toward the money center banks. This tendency was not fully offset through System operations because bank credit appeared to be significantly below earlier projections. However, the extent to which operations were influenced by bank credit developments was affected by "even keel" considerations related to the Treasury refunding. Subsequently, a redistribution of reserves away from major banks had contributed to tighter money market conditions despite sizable reserve-supplying operations by the System. In the two statement weeks following the July 15 meeting, the effective rate on Federal funds had averaged about 8-1/4 per cent--compared with a rate centering around 9 per cent in earlier weeks--and since then had risen to a range around 9-3/4 per cent. In the 4 weeks ending August 6, member bank borrowings had averaged $1,250 million, down somewhat from the previous period. A corresponding decline in excess reserves had left net borrowed reserves about unchanged on the average.

Prospective changes in the bank credit proxy and related variables were affected by the expected consequences of certain regulatory actions taken by the Board of Governors on July 24, 1969.

These were (1) an amendment to Regulation D, effective July 31, requiring member banks to include in deposits used to compute reserve requirements all so-called "London checks" and "bills payable checks" used in settling transactions involving foreign branches; and (2) amendments to Regulations D and Q defining deposit liabilities subject to those regulations to include, beginning August 28, every bank liability on a repurchase agreement (RP) entered into on or after July 25 with a person other than a bank and involving any assets other than direct and fully guaranteed obligations of the United States or its agencies.

The first of these actions was expected to increase required reserves of member banks by about $450 million in the statement week ending August 20. The second action was not expected to have much effect on required reserves, since it appeared unlikely that a significant volume of newly written RP's of the types affected would be outstanding after late August. It was noted, however, that outstanding RP's were expected to decline as current agreements matured and that this decline would tend to reduce bank credit by an equivalent amount, other things equal. Moreover, it was considered likely that bank attitudes toward alternative sources of funds and toward their own lending and investing policies were already being affected by this action, and by the expectation that the Board would soon implement two other regulatory actions it had proposed near the end of June. The latter were proposals to amend

Regulations D and M, among other things to place a 10 per cent reserve requirement on borrowings by U.S. banks from their foreign branches, to the extent that these borrowings exceeded the daily-average amounts outstanding in the 4 weeks ending May 28, 1969; and a proposal to amend Regulations D and Q to bring a member bank's liability on certain Federal funds transactions within the coverage of those regulations.

The staff projections suggested that the adjusted bank credit proxy would decline at an annual rate of 9 to 12 per cent from July to August if prevailing conditions were maintained in money and short-term credit markets. The projections allowed for only a small further rise in the average level of Euro-dollar borrowings of U.S. banks. While no specific allowance was made in the projections for possible changes in the extent to which banks were utilizing funds from other nondeposit sources, it was noted that the outstanding volume of funds obtained from such sources probably would grow less rapidly than in July.

Among deposit categories, private demand deposits--and the money stock--were projected to decline moderately from July to August, and a further reduction in the average level of U.S. Government deposits was anticipated. Given prevailing levels of market interest rates, it was expected that large-denomination CD's would continue to run off, although less rapidly than earlier because the volume of maturing CD's was smaller. And it appeared unlikely that consumer-type time and savings deposits would show a marked expansion after the large net outflows of July.

In the Committee's discussion account was taken of the indications that the rate of expansion of over-all economic activity was moderating somewhat, of the recent legislation extending the 10 per cent income tax surcharge through the end of the year, and of the substantial degree of monetary restraint already in effect. The Committee agreed that no further increase in monetary restraint would be warranted at present. In particular, it agreed that any tendencies toward firmer money market conditions that might result from recent regulatory actions by the Board of Governors or from other causes should be resisted through open market operations.

At the same time, a majority of the members thought that action to ease money market conditions would not be warranted now, in view of the persistence of inflationary pressures and the risk that such action would encourage a new surge of inflationary expectations. Some members of the majority expressed the view that System operations should not necessarily be undertaken to offset fully any easing tendencies that might be produced by market forces. On the other hand, it was suggested that the implementation of policy should not be unduly influenced by temporary swings in market psychology.

The Committee concluded that open market operations should be directed at maintaining the prevailing firm conditions in money and short-term credit markets. The proviso was added that operations should be modified if bank credit appeared to be deviating significantly from current projections. It was also agreed that operations should be modified if pressures arose in the aftermath of the devaluation of the French franc or in connection with the regulatory actions taken by the Board of Governors.

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

> The information reviewed at this meeting indicates that expansion in real economic activity slowed somewhat in the first half of 1969 and some further moderation is projected. Substantial upward pressures on prices and costs are persisting. Most market interest rates recently have receded slightly from their earlier highs. In July the money supply expanded as U.S. Government deposits decreased further; bank credit declined on average, after adjusting for an increase in assets sold to affiliates and to customers with bank guarantees. The run-off of large-denomination CD's which began in mid-December continued without abatement in July, and there apparently were net outflows from consumer-type time and savings accounts at banks and nonbank thrift institutions combined. The over-all balance of payments deficit on the liquidity basis remained very large in July; the balance on the official settlements basis was still in surplus in the first half of the month but subsequently shifted toward deficit as U.S. banks' borrowings of Euro-dollars leveled off. Foreign exchange markets appear initially to be adjusting in an orderly fashion to the announced devaluation of the French franc. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging sustainable economic growth and attaining reasonable equilibrium in the country's balance of payments.
>
> To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing firm conditions in money and short-term credit markets; provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current projections or if pressures arise in connection with foreign exchange developments or with bank regulatory changes.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Coldwell, Daane, Robertson, Scanlon, Sherrill, and Swan. Votes against this action: Messrs. Maisel and Mitchell.

Absent and not voting: Mr. Clay. (Mr. Swan voted as his alternate.)

In dissenting from this action Messrs. Maisel and Mitchell indicated that they did not advocate lessening monetary and credit restraint. However, they did not want monetary policy to become more and more restrictive. It appeared to them that trends in monetary aggregates and the availability of credit were indicative of increased tightening that would be heightened if money market conditions were maintained at the levels called for in the directive favored by the majority. In order to guard against an undesired further tightening, they favored a directive calling for operations to moderate such contractive tendencies, if prospective declines in monetary aggregates should in fact occur, while maintaining the position of over-all monetary and credit restraint.