



FEDERAL RESERVE

press release

For immediate release

December 14, 1970

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 15, 1970. 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 September 15, 1970

Authority to effect transactions in System Account.

Information reviewed at this meeting suggested that real GNP, which had edged up in the second quarter, was expanding somewhat further in the third. Wage rates generally were continuing to increase at a rapid pace, but improvements in productivity appeared to be slowing the rise in costs and some major price measures were advancing less rapidly than before.

In August industrial production declined slightly; on balance production had changed little since May. Retail sales also moved down a little in August, according to advance estimates, and were only moderately above their average level in the second quarter. The labor market eased slightly further: nonfarm payroll employment declined and the unemployment rate edged up to 5.1 from 5.0 per cent in July. On the other hand, the latest data for private housing starts indicated that such starts had risen sharply in July after increasing appreciably in June.

Average wholesale prices declined from mid-July to mid-August as a result of a reduction in prices of farm products and foods; this volatile series had risen sharply in the previous month. At the

9/15/70

-2-

same time the advance in prices of industrial commodities slowed further. In July the rate of increase in the seasonally adjusted consumer price index was below that of June and was significantly below the average monthly rise in the first half of the year.

According to the latest staff estimates, the advance in real GNP expected for the third quarter was to an important extent attributable to the recovery of residential construction activity. Also, growth in State and local government outlays had stepped up from the low second-quarter pace, and consumer spending was expanding at a rate close to that of the first half--although not so rapidly as had been projected earlier. On the other hand, the estimates suggested that business capital outlays were beginning to edge down and that defense spending was continuing to decline.

The economic outlook was clouded by uncertainty regarding the duration of a strike, which had begun on the day of this meeting, at a major automobile manufacturer. Staff projections suggested that, apart from possible effects of the strike, real GNP would pick up somewhat in the fourth quarter of 1970 and would expand further in the first two quarters of 1971, but would still remain well below the economy's potential. However, it was noted that the rise in real GNP projected for the fourth quarter was not likely to be realized if the automobile strike continued well into that quarter. At the same time, it appeared that much of the loss of output and income that would result from such an extended strike would probably be made up in the first quarter of 1971.

9/15/70

-3-

With respect to the U.S. balance of payments, the deficit on the liquidity basis in July and August--while still large--was considerably smaller than earlier in the year. A major part of the recent improvement had occurred in private capital flows. In addition, in July both exports and imports declined about equally and the foreign trade surplus remained at the high level to which it had risen in June. On the official settlements basis the deficit continued very high after midyear as a result of repayments of Euro-dollar borrowings by U.S. banks.

In foreign exchange markets sterling had been under selling pressure recently, particularly in early September. The Italian lira had strengthened significantly in the latter part of August. On August 27 the Bank of France reduced its discount rate from 8 to 7-1/2 per cent, and on September 1 the Bank of Canada cut its rate from 7 to 6-1/2 per cent.

System open market operations since the August 18 meeting had been directed at promoting some easing of conditions in credit markets and moderate growth in the money supply. Reserves had been provided liberally during the period, first to foster somewhat easier money market conditions and later to resist a persistent tendency toward firmness that developed. In the latter part of August Federal funds traded mostly in a range of 6-1/8 to 6-3/8 per cent, well below the 6-1/2 to 7 per cent range generally prevailing earlier in the month. In the first half of September, however, the funds rate rose to levels

9/15/70

-4-

above 6-1/2 per cent largely as a result of a shift in the distribution of reserves away from the major money centers. Member bank borrowings averaged about \$690 million in the 4 weeks ending September 9, down sharply from the \$1.2 billion average of the previous 4 weeks. However, part of this decline reflected a further reduction in special accommodations at the discount window for banks lending to firms that were encountering difficulties in rolling over maturing commercial paper.

Most short- and long-term interest rates declined in the latter part of August, to a large extent because of growing expectations among investors of a significant near-term easing of monetary policy. These expectations were stimulated in part by the announcement of the Board of Governors on the day before the August 18 meeting of a reduction in reserve requirements on time and savings deposits^{1/} and by the easing of money market conditions following that meeting. Most yields turned up in early September, however, against the background of the firmer money market conditions that developed then and of the continuing heavy volume of new offerings in capital markets.

On balance, yields on corporate and municipal bonds had changed little since mid-August, but yields on Treasury notes and bonds and on

^{1/} The Board reduced from 6 to 5 per cent the reserves that member banks must hold against time and savings deposits in excess of \$5 million. At the same time, it applied regular time and demand deposit reserve requirements on funds obtained by member banks through the issuance of commercial paper by their affiliates. The Board announced that both actions would become effective in the reserve computation period beginning October 1 and would be applicable on such deposits and commercial paper outstanding in the week beginning September 17.

9/15/70

-5-

most types of short-term securities had declined somewhat. On the day before this meeting the market rate on 3-month Treasury bills was 6.33 per cent, 20 basis points below its level 4 weeks earlier. The relationships among yields on market securities of different grades suggested that investors continued to be highly concerned about credit quality.

At commercial banks growth in the outstanding volume of large-denomination CD's was relatively rapid in August--although it moderated considerably from the unusually rapid pace that had been recorded in July following the suspension in late June of rate ceilings on such CD's maturing in 30 to 89 days. Inflows of consumer-type time and savings deposits also remained substantial in August, although not so large as in July. As a result of these gains in time and savings deposits and a marked increase in private demand deposits, the bank credit proxy--daily-average member bank deposits--rose sharply further from July to August. During the month banks reduced their reliance on funds obtained through the issuance of commercial paper by their affiliates, in anticipation of the application of reserve requirements to such funds. After adjustment for this development and for repayments of Euro-dollar borrowings by U.S. banks, the bank credit proxy increased at an annual rate of about 24 per cent from July to August. Growth of the adjusted proxy series appeared to be slowing considerably in September.

The money stock, according to the latest published statistics, rose sharply in the first part of August but then moved down through

9/15/70

-6-

early September. On the average in August, the published measure showed an increase at an annual rate of about 11 per cent--compared with annual rates of about 4 per cent in July and close to 4 per cent over each of the first two quarters of the year.^{2/} Including a projection for the rest of September, growth over the third quarter was estimated at about a 4.5 per cent annual rate.

It was noted at the meeting, however, that the rates of growth calculated for money would be somewhat different if adjustments were made for biases that had developed in the data because of the accounting procedures employed in connection with certain types of international transactions. It was reported that work was now in process on statistical revisions, including not only adjustments for these biases but also benchmark corrections and revisions of seasonal factors. Although the final revisions were not expected to be available until late autumn, tentative calculations based on the preliminary information now available suggested that the adjustments for biases due to these types of international transactions might in themselves raise the growth rates for the first two quarters by about 1 or 2 percentage points and might lower the rate for the third quarter by about 1 percentage point.

^{2/} 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.

9/15/70

-7-

Staff analysis suggested that some easing of currently prevailing money market conditions probably would be required if the money stock series, adjusted for bias, were to grow at an annual rate of about 5 per cent over the fourth quarter. The analysis also suggested that such a growth rate for money would be associated with a 10 per cent rate of expansion in the adjusted bank credit proxy. The anticipation of marked slowing in bank credit growth--from a third-quarter rate tentatively estimated at 17.5 per cent--reflected in part expectations that the rate of increase of time deposits would slacken as banks completed their adjustments to the suspension of rate ceilings on large-denomination CD's of shorter term. Also, it appeared likely that there would be a considerable abatement in the shift of credit flows from market to banking channels that had followed earlier pressures in the commercial paper market and that had contributed importantly to the rapid growth of the bank credit proxy in the third quarter.

The Committee agreed that some easing of conditions in credit markets and moderate growth in the money stock--at an annual rate of about 5 per cent in the fourth quarter--remained appropriate as the objectives of monetary policy at this time, although a few members felt that somewhat faster expansion of money would be preferable. A few members also expressed the view that it would be desirable to place less emphasis on a specific growth rate for the money stock, particularly in light of present data uncertainties.

It was noted in the discussion that prospects for a satisfactory rate of economic growth depended importantly on continued recovery in residential construction outlays and State and local government expenditures. In view of the sensitivity of these types of spending to

9/15/70

-8-

interest rates, some members stressed the desirability of fostering somewhat lower levels of interest rates over the months ahead.

There was some sentiment in the Committee for increasing the weight given to developments in bank credit in day-to-day decisions regarding open market operations, now that the period of rapid reintermediation appeared to be drawing to a close. The Committee concluded, however, that for the time being the practice should be continued of giving preponderant weight to the money stock in assaying the implications of the behavior of financial aggregates for System operating decisions.

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

The information reviewed at this meeting suggests that real economic activity, which edged up slightly in the second quarter, is expanding somewhat further in the third quarter, led by an upturn in residential construction. Wage rates generally are continuing to rise at a rapid pace, but improvements in productivity appear to be slowing the rise in costs, and some major price measures are rising less rapidly than before. Interest rates declined in the last half of August, but most yields turned up in early September, as credit demands in securities markets have continued heavy; existing yield spreads continue to suggest concern with credit quality. The money supply rose rapidly in the first half of August but moved back down through early September. Bank credit expanded sharply further in August as banks continued to issue large-denomination CD's at a relatively rapid rate, while reducing their reliance on the commercial paper market after the Board of Governors acted to impose reserve requirements on bank funds obtained from that source. The balance of payments deficit on the liquidity basis diminished somewhat in July and August from the very large second-quarter rate, but the deficit on the official settlements basis remained high as banks repaid Euro-dollar liabilities. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions

conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee seeks to promote some easing of conditions in credit markets and moderate growth in money and attendant bank credit expansion over the months ahead. System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining bank reserves and money market conditions consistent with that objective.

Votes for this action: Messrs.
Burns, Brimmer, Daane, Francis, Heflin,
Hickman, Maisel, Robertson, Sherrill,
and Swan. Vote against this action:
Mr. Hayes.

Absent and not voting: Mr. Mitchell.

In dissenting from this action, Mr. Hayes indicated that he was concerned about again calling in the directive for an easing of conditions in credit markets. Short-term interest rates had declined since the last Committee meeting and he was not convinced that further easing would be required to achieve the objective, which he favored, of moderate growth in money and bank credit. He feared the possible inflationary effects of a policy calling for progressive easing of credit conditions.