FEDERAL RESERVE

press release

For immediate release October 26, 1971

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 27, 1971.

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 27, 1971

Authority to effect transactions in System Account.

Preliminary estimates of the Commerce Department indicated that real output of goods and services had increased at an annual rate of 3.6 per cent in the second quarter, after having risen sharply--at a rate now estimated at 8.0 per cent--in the first quarter when automobile production and sales were recovering from the strike of late 1970. Growth in real GNP was expected to continue at a moderate pace during the remainder of 1971.

Retail sales increased considerably in June from April and May levels that had been revised upward, and sales in the second quarter as a whole were appreciably higher than in the first quarter. Industrial production continued to rise moderately in June, but payroll employment declined in both manufacturing and other nonfarm sectors. A reported drop in the unemployment rate to 5.6 from 6.2 per cent in May appeared to be attributable in large part to technical measurement problems. The volume of private housing starts was again very high in June.

Wholesale prices of industrial commodities and consumer prices rose substantially further in June. Over the second quarter as a whole both price measures increased appreciably faster than they had earlier in the year. Wage rates continued to advance rapidly.

Staff projections suggested that growth in real GNP would slow a little from the second to the third quarter, and then step up in the final quarter of the year. Although it was assumed that there would not be a strike in the steel industry when wage contracts expired at the end of July, it appeared likely that efforts of steel users and producers to work off excess stocks accumulated earlier against the threat of a strike would temporarily depress the rate of over-all inventory investment in the third quarter. Projections of gains in consumer spending for both the third and the fourth quarters had been raised somewhat as a result of the recent vigor in retail sales, even though it was now believed that the military pay increase--previously assumed to take effect around midyear--was not likely to occur until early October. The latest projections, like those of 4 weeks earlier, suggested that the rise in residential construction outlays would slow as the year progressed but would remain sizable; that State and local government expenditures would expand at a substantial rate; and that business fixed investment outlays would increase little in the second half of the year.

The deficit in the U.S. balance of payments was again extraordinarily large in the second quarter. The merchandise trade balance, which had been in small surplus in the first quarter, moved into substantial deficit in the second quarter as exports declined and the earlier uptrend in imports accelerated sharply. Outflows of capital remained heavy. Relative to those of the first quarter, the second-quarter outflows were occasioned less by interest rate differentials and more by expectations of shifts in exchange rates.

In July foreign exchange markets experienced renewed tensions, and the dollar weakened against most major foreign currencies. The German mark rose to a new high 5.6 per cent above parity.

On July 21 the Treasury announced the terms on which it would refund securities maturing in mid-August, including $4.1 billion held by the public. Holders of the maturing obligations were offered the choice of a 51-month, 7 per cent note priced to yield 7.06 per cent and a 10-year, 7 per cent bond priced to yield 7.11 per cent. The bond, which was the first long-term security to be issued since the Treasury received legislative authority to sell a limited number of bonds at interest rates above the 4-1/4 per cent ceiling, was also offered to individuals for cash subscription in amounts up to $10,000.

Short-term interest rates generally had risen further since the Committee meeting of June 29. For example, the market rate on 3-month Treasury bills, at 5.45 per cent on the day before this meeting, was 50 basis points above its level 4 weeks earlier. The rate advances reflected additional heavy sales of Treasury bills by foreign official accounts early in the period, the emergence of firmer money market conditions after mid-July, and investor expectations of large-scale offerings of short-term securities by the Treasury during the rest of the year. Against the background of rising short-term market rates, most major commercial banks increased their prime lending rate from 5-1/2 to 6 per cent in early July. Federal Reserve discount rates were raised 1/4 of a percentage point, to 5 per cent, at four Reserve Banks on July 16 and at the other Banks during the following week.

Yields on long-term market securities had changed little on balance in recent weeks, after having increased substantially during the second quarter. The volume of public offerings of new corporate bonds declined in July, and it appeared that offerings in August would remain below the high rates of the first half of 1971. Also, bond flotations by State and local governments seemed to be moderating somewhat.

Contract interest rates on conventional new-home mortgages and secondary-market yields on federally insured mortgages rose somewhat further in June. Inflows of consumer-type savings funds at nonbank thrift institutions continued rapid in June, but over the second quarter as a whole such inflows--although strong--were below the exceptionally high rate of the first quarter.

At commercial banks also, inflows of consumer-type time and savings deposits had moderated from the first to the second quarter.

These inflows appeared to be slowing sharply further in July. However, expansion in total time and savings deposits at commercial banks was still relatively large in July, as a result of a substantial further increase in the volume of large-denomination CD's outstanding.

Growth in the narrow measure of the money stock (private demand deposits plus currency in circulation, or M_1) increased in the second quarter to an annual rate of about 11.5 per cent from 9 per cent in the first quarter.[1/] Growth in the broader measure of money (M_1 plus commercial bank time deposits other than large-denomination CD's, or M_2) also was rapid in the second quarter--at an annual rate of about 12.5 per cent--but it was appreciably below the 18 per cent rate reached in the first quarter, reflecting the less rapid inflows of consumer-type time and savings deposits. Expansion in the adjusted bank credit proxy (daily-average member bank deposits, adjusted to include funds from nondeposit sources) moderated to a 6.5 per cent annual rate in the second quarter from 11 per cent in the first.

According to partial data for July, M_1 and the adjusted proxy series were continuing to expand at approximately their rates in the second quarter. Growth in M_2, however, was slowing further.

1/ 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.

Following the June 29 meeting of the Committee, when data becoming available for late June suggested that the rise in the monetary aggregates might be moderating, System open market operations had been directed at maintaining money market conditions similar to those prevailing shortly before that meeting. Later, however, data for early July revealed that the aggregates--particularly M_1-- were again rising strongly, and somewhat firmer money market conditions were sought. The effective rate on Federal funds, which had fluctuated around 5-1/8 per cent in late June and early July, moved up to the neighborhood of 5-1/2 per cent after mid-July. With the Federal funds rate well above the discount rate, member bank borrowings rose substantially during the period; for the 4 weeks ending July 21, borrowings averaged about $885 million compared with about $455 million in the preceding 4 weeks.

Staff analysis suggested that if prevailing money market conditions were maintained, M_1 and M_2 would expand at annual rates of about 9 and 8 per cent, respectively, over the third quarter as a whole, and at substantially lower rates over the final 3 months of the year. On the other hand, expansion in bank credit was expected to step up temporarily in the third quarter, reflecting in part anticipated bank purchases of new securities to be offered by the Treasury. According to the analysis, if somewhat firmer money market conditions were attained in coming weeks, the expected rates of growth in the monetary and credit aggregates would be reduced slightly in the third quarter and more significantly in the fourth.

The Committee decided that the achievement of more moderate growth in the monetary aggregates over the months ahead remained the appropriate objective of System open market operations. At the same time, it was noted that operations during the period until the next meeting would be influenced by even-keel considerations related to the current Treasury financing. Also, as at other recent meetings, the members agreed that account should be taken of developments in capital markets in the conduct of operations. In these circumstances, the Committee decided that the Manager should be given more than the usual amount of discretion to make operating decisions in light of actual market developments during the coming period.

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

> The information reviewed at this meeting suggests that moderate expansion in real output of goods and services is continuing and that unemployment remains substantial. Wage rates in most sectors are continuing to rise at a rapid pace. The rate of advance in both consumer prices and wholesale prices of industrial commodities has stepped up again recently after moderating earlier in the year. In the second quarter inflows of consumer-type time and savings funds at banks and nonbank thrift institutions were large, but below the unusually rapid first-quarter pace. Growth in bank credit and the broadly defined money stock slowed in the second quarter, but the rate of expansion in the narrowly defined money stock increased. In July, according to partial data, it appears that both bank credit and the narrowly defined money stock are growing at rates close to those of

the second quarter, but that expansion in broadly defined money is slowing. While interest rates on most types of long-term market securities have changed relatively little on balance in recent weeks, short-term interest rates have risen further. In mid-July Federal Reserve discount rates were increased by one-quarter of a percentage point to 5 per cent. The deficit in the U.S. balance of payments remained extraordinarily large in the second quarter, mainly reflecting capital outflows related to expectations of shifts in foreign exchange rates and the development of a substantial deficit in the merchandise trade balance. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to sustainable economic growth, while encouraging an orderly reduction in the rate of inflation, moderation of short-term capital outflows, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, taking account of the current Treasury financing and of developments in capital markets, the Committee seeks to achieve more moderate growth in monetary aggregates over the months ahead. System open market operations until the next meeting of the Committee shall be conducted with a view to achieving bank reserve and money market conditions consistent with those objectives.

Votes for this action: Messrs. Burns, Hayes, Brimmer, Clay, Daane, Kimbrel, Maisel, Mayo, Mitchell, Morris, Robertson, and Sherrill. Votes against this action: None.