FEDERAL RESERVE

press release

For immediate release

November 22, 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 August 24, 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 August 24, 1971

1. Authority to effect transactions in System Account.

Real output of goods and services, which had increased at an annual rate of 4 per cent in the second quarter, apparently was expanding at a somewhat slower pace in the third quarter, mainly because steel users and producers were working down excess stocks following the August 1 agreement on a new labor contract in the steel industry. Expectations of faster growth in real GNP during the rest of 1971 were enhanced when the President announced a new economic program on August 15. In addition to a number of fiscal proposals, the program included a 90-day freeze on prices and wages, a temporary surcharge of 10 per cent on dutiable imports, and suspension of full convertibility of dollars into gold and other reserve assets for settlement of international transactions.

Industrial production dropped in July, reflecting mainly reductions in output of steel and some other industrial materials. Nonfarm payroll employment declined substantially further, and the unemployment rate rose to 5.8 per cent; in June the unemployment rate had fallen 0.6 percentage point to 5.6 per cent, but that decline apparently was attributable in part to technical measurement problems. Retail sales, which had increased considerably in June, declined in

July to about the average monthly level in the second quarter. The volume of private housing starts advanced sharply further.

The rise in consumer prices slowed in July from the rapid pace of the second quarter, but the increase in wholesale prices of industrial commodities accelerated. Over the 6 months through July wholesale industrial prices had risen more than in any comparable period since 1956. Major labor contract settlements of recent months continued to provide for large increases in wage rates.

According to a tentative staff reappraisal of the outlook for the rest of 1971 in light of the new economic program, growth in real GNP would moderate less in the third quarter and speed up considerably more in the fourth quarter than had been anticipated earlier. Also, the rate of advance in prices was now expected to slow significantly. As a consequence of the changed outlook for prices, the projected increases in current-dollar GNP for both quarters had been reduced somewhat.

It now appeared that the real volume of consumer purchases would rise more than had seemed likely earlier, as a result of the stimulus to automobile sales of the proposed elimination--retroactive to August 15--of the Federal excise tax on autos and the more general stimulus provided by improved consumer confidence. It was expected that business inventory investment would decline in the third quarter--not only because stocks of steel would be worked down but also because part of any step-up in final sales probably would be met initially out of inventories--and that such investment would rebound in the fourth quarter. The growth in Federal outlays projected for both quarters had been reduced, reflecting the various economy measures included in the new program and the assumption that the military pay increase, previously assumed to take effect in early October, would be deferred until the beginning of 1972.

The projections for other key sectors of activity had been changed relatively little. Thus, it was still anticipated that the rise in residential construction expenditures would slow as the year progressed but would remain sizable, and that State and local government outlays would expand at a substantial rate. Also, the projections continued to suggest little change in capital outlays by business in the third and fourth quarters, on the assumption that the proposed investment tax credit would not significantly increase outlays before 1972.

The deficit in the U.S. balance of payments, which had been extremely large in the first and second quarters, increased sharply further after midyear mainly because of an acceleration of capital outflows in anticipation of shifts in exchange rates. In the first half of August the deficit reached massive proportions.

Following the mid-August suspension of dollar convertibility, all major European central banks discontinued operations in their foreign exchange markets. These markets were reopened on August 23 under diverse arrangements, including a continuation of floating rates for the German mark and the Dutch guilder; suspension of the upper intervention limit for the British pound; and a dual exchange rate system, separating commercial from other transactions, for the French franc. On the day of this meeting rates of exchange between these currencies and the dollar were all somewhat above the previous upper intervention limits, at least for certain types of transactions.

In contrast to the European markets, the Japanese exchange market had remained open throughout the period, and the Bank of Japan had purchased a large amount of dollars in preventing the yen from moving above its upper intervention limit. Japanese exchange controls were tightened further during the period.

In the Treasury's mid-August refunding, $2.7 billion of the $4.1 billion of maturing securities held by the public were exchanged for the new issues--$251 million for the 10-year bonds and the remainder for the 51-month notes. Cash subscriptions for the bond by individuals, which were permitted in amounts up to $10,000, totaled $192 million. On August 5, to cover the attrition in the refunding and to raise additional cash, the Treasury auctioned $2.5 billion of 18-month, 6-1/2 per cent notes at an average yield of 6.54 per cent.

In July business credit demands at banks and in the commercial paper market remained moderate and the volume of new corporate bond issues declined to the lowest level in 16 months. The volume of corporate bond offerings in prospect for August and September also was appreciably below the monthly average in the first half of the year. Bond flotations by State and local governments, while still large, appeared to be moderating slightly.

Despite the easing of such credit demands, interest rates on most types of market securities had remained steady or had increased somewhat further in the interval between the July 27 meeting of the Committee and the President's announcement of the new economic program. Among the contributing factors were the continuation of rapid advances in prices and costs, the further firming of money market conditions that occurred during the period, and the uncertainties generated by developments in international financial markets.

Following the announcement of the new economic program, interest rates on long-term market securities declined sharply, reflecting the improved prospects for more effective control of inflation and of the balance of payments problem. For the most part, rate declines on short-term securities were much less pronounced. However, Treasury bill yields--which, in an exception to the general trend, had been moving down earlier as a result of heavy demands from foreign official accounts--fell considerably further. For example, on the day before this meeting the market rate on 3-month bills was 4.75 per cent, 40 basis points lower than on August 13 and 75 basis points lower than on the day before the July 27 meeting.

Contract interest rates on conventional new-home mortgages and secondary market yields on federally insured mortgages rose somewhat further in July. Inflows of savings funds to nonbank thrift institutions were again large.

At commercial banks, inflows of consumer-type time and savings deposits slowed markedly in July. The volume of large-denomination CD's outstanding increased substantially further, however, and growth in total time and savings deposits remained relatively large. Although business loans rose considerably, the expansion was only a little greater than the contraction that had occurred in June and it appeared to reflect irregular and seasonal influences rather than a significant strengthening in underlying demands. Holdings by banks of U.S. Government securities declined sharply, but their holdings of other securities increased substantially.

The narrow measure of the money supply (private demand deposits plus currency in circulation, or M_1) continued to grow rapidly in July, at an annual rate only slightly below the 11.5 per cent pace of the second quarter.[1/] The broader measure of money (M_1 plus commercial bank time deposits other than large-denomination CD's, or M_2) moderated from the 12.5 per cent second-quarter rate as a result of the marked slowing of inflows of consumer-type time and savings deposits. Total bank credit, as measured by the adjusted credit proxy--daily-average

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.

member bank deposits, adjusted to include funds from nondeposit sources--increased slightly faster than in the second quarter, when it had expanded at a rate of 6.5 per cent.

System open market operations in the period immediately following the July 27 meeting had been directed at maintaining prevailing money market conditions, against the background of the Treasury financing then in process. Later, as incoming data indicated that the monetary aggregates--in particular M_1--were continuing to grow at a rapid pace, slightly firmer money market conditions were sought. For the period as a whole the average Federal funds rate was somewhat higher than 5-1/2 per cent, compared with 5-1/4 per cent in the previous period between meetings. Member bank borrowings, which had increased substantially in the preceding period, declined somewhat; in the 4 weeks ending August 18, borrowings averaged $770 million compared with $880 million in the preceding 4 weeks.

Staff analysis suggested that the new economic program, along with other forces--including lagged reactions to earlier increases in short-term interest rates--should tend to produce lower rates of growth in the monetary aggregates over the rest of the year. The new program was expected to reduce transactions demands for money insofar as it led to a smaller rise in prices and thus to slower growth in current-dollar GNP; and to reduce desired money holdings generally insofar as it allayed uncertainties about the economic and financial outlook and moderated expectations of continuing inflation and further firming of money market conditions.

It was noted, however, that because of the difficulties of assessing the precise impact of such forces, any projections of the monetary aggregates at this time were subject to larger-than-usual margins of error. According to tentative staff projections, if prevailing money market conditions were maintained growth in M_1 would moderate somewhat in August and September and would slow substantially further in the fourth quarter. Growth in M_2, which was projected to remain near the July pace during the rest of the third quarter, appeared likely to moderate less than M_1 in the fourth quarter because banks were expected to be reasonably successful in competing for consumer-type time and savings deposits. The rate of growth in the bank credit proxy over the latter half of the year was projected to remain somewhat above that of the second quarter, in part because prospects favored some strengthening of the demands for bank credit and, therefore, more aggressive solicitation of funds by banks through sales of large-denomination CD's.

It was noted in the Committee's discussion that, while the new economic program had profoundly affected the economic atmosphere and outlook, the ultimate consequences for business activity and prices--and therefore the implications for monetary policy over the longer run--could not yet be assessed with assurance. Accordingly, it was suggested that any marked change in the stance of policy would be premature. Some members placed particular stress on the risk that an overt easing of money market conditions at this time, against the background of the recent rapid growth in M_1, could rekindle inflationary expectations and thus nullify the favorable impact that the announcement of the new program had had on confidence.

The Committee agreed that open market operations should continue to be directed at achieving growth rates in the monetary aggregates over the months ahead well below the rapid rates recorded in recent months. The following current economic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting indicates that real output of goods and services has been expanding moderately, that unemployment has remained substantial, and that prices and wages have been rising rapidly on average in recent months. However, the economic program announced by the President on August 15 enhances prospects for higher rates of growth in real economic activity, increased job opportunities, and curtailed inflationary pressures. In July inflows of consumer-type time and savings funds slowed markedly at banks, but inflows to nonbank thrift institutions continued large. Growth in the narrowly defined money stock remained rapid in July, but growth in broadly defined money slowed and bank credit continued to expand at about the second-quarter pace. Interest rates on most types of market securities declined sharply in the days following the announcement of the new program. The deficit in the U.S. balance of payments reached extraordinarily large proportions in early August, mainly reflecting an acceleration of capital outflows related to expectations of shifts in foreign exchange rates. Following the suspension of convertibility of the dollar into gold and other reserve assets, major European central banks discontinued foreign exchange market operations for a week. When most of the European markets were reopened on August 23 these central banks pursued diverse exchange rate policies,

page blank in original,
stapled packet.

accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement; provided that the aggregate amount of U.S. Government and Federal agency securities held in such Account at the close of business on the day of a meeting of the Committee at which action is taken with respect to a current economic policy directive shall not be increased or decreased by more than $2.0 billion during the period commencing with the opening of business on the day following such meeting and ending with the close of business on the day of the next such meeting.

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

This action, which was taken under legislation enacted in September 1966, was for the purpose of widening the base of System open market operations and at the same time adding breadth to the market for agency securities. In November 1966 the Committee had authorized repurchase agreements in agency issues, and on a number of subsequent occasions it had considered the desirability of also authorizing outright transactions. The decision to do so at this time was taken against the background of the substantial growth in the market for agency issues in recent years, and the consequent reduction of the risk that System purchases or sales could dominate the market.

The Committee also approved certain initial guidelines for the conduct of open market operations in agency issues, with the understanding that they would be subject to review and revision as experience was gained. These initial guidelines were 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. As an initial objective, the System would aim at building up a modest portfolio of agency issues, with the amount and timing dependent on the ability to make net acquisitions without undue market effects.

4. System holdings of maturing agency issues will be allowed to run off at maturity, at least initially.

5. 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 purchase, 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 purchase.

6. System holdings of any one issue at any one time will not exceed 10 per cent of the amount of the issue outstanding. There will be no specific limit on aggregate holdings of the issues of any one agency.

7. No new issue will be purchased in the secondary market until at least two weeks after the issue date.

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

3. <u>Amendment to authorization for System foreign currency operations</u>.

The Committee ratified actions taken by members on August 9 and 11, 1971, to increase the System's swap arrangements with the

National Bank of Belgium from $500 million to $600 million and with the Swiss National Bank from $600 million to $1 billion, and to make corresponding amendments to paragraph 2 of the authorization for System foreign currency operations. As a result of these actions, which were effective August 12, 1971, paragraph 2 of the authorization read as follows:

> 2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	200
National Bank of Belgium	600
Bank of Canada	1,000
National Bank of Denmark	200
Bank of England	2,000
Bank of France	1,000
German Federal Bank	1,000
Bank of Italy	1,250
Bank of Japan	1,000
Bank of Mexico	130
Netherlands Bank	300
Bank of Norway	200
Bank of Sweden	250
Swiss National Bank	1,000
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,000

Votes for ratification of these actions: Messrs. Burns, Hayes, Brimmer, Clay, Daane, Kimbrel, Maisel, Mayo, Mitchell, Morris, Robertson, and Sherrill. Votes against ratification of these actions: None.

These actions had been recommended by the Special Manager after consultation with the Treasury Department. The Special Manager had advised that the swap line increases in question should prove helpful in avoiding further immediate drains on U.S. reserve assets.