FEDERAL RESERVE

press release

For immediate release December 20, 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 September 21, 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 September 21, 1971

Authority to effect transactions in System Account.

Information reviewed at this meeting suggested that real output of goods and services was expanding in the third quarter at a pace significantly slower than the annual rate of 4.8 per cent now estimated for the second quarter. Growth in real GNP was expected to accelerate in the fourth quarter, owing in part to the Government's new economic program.

In August industrial production declined further, mainly because output of steel was curtailed sharply as producers and users worked down the inventories they had accumulated against the possibility of a strike. Nonfarm payroll employment was unchanged following 2 months of decline. The unemployment rate rose further to 6.1 per cent, nearly equaling the high of last spring. Retail sales, which had declined in July, rose sharply in August, and the average for those 2 months was appreciably above that for the second quarter. Sales of new automobiles were exceptionally strong in late August and early September, no doubt in part because of expectations of rebates of Federal excise taxes. The volume of private housing starts, already at a very high level in July, edged up in August.

Wage rates and wholesale prices of industrial commodities continued to rise rapidly prior to the imposition of the wage-price freeze in mid-August.

The business outlook continued to be more uncertain than usual because various elements of the new economic program remained to be determined and because only limited information was as yet available on the program's initial effects. Staff projections--which were still highly tentative--suggested that growth in real output would be appreciably faster in the fourth quarter of 1971 and the first half of 1972 than had been expected before announcement of the program, and that the rise in prices would be significantly slower.

For the most part, the projections for the fourth quarter were similar to those prepared 4 weeks earlier, shortly after the President's mid-August address. The real volume of consumer purchases was expected to rise substantially, not only because of the proposed elimination of the auto excise tax but also because of the general stimulus that a slower rise in prices and improved consumer confidence were expected to provide. It was still anticipated that residential construction expenditures and State and local government outlays would expand appreciably further, and that business capital outlays would change little. Business inventory investment was projected to rise moderately in the fourth quarter.

The deficit in the U.S. balance of payments was still large in late August and early September, although it was well below the extraordinarily high level of the first half of August. Outflows of speculative capital moderated after mid-August, as a result of the policy measures adopted in this country and the decisions taken abroad to allow some appreciation of exchange rates and to raise barriers against capital inflows. In July the U.S. merchandise trade balance had been in substantial deficit for the fourth successive month.

In foreign exchange markets, the Bank of Japan permitted the rate for the yen to rise above its former intervention limit on August 28, and at the time of this meeting the yen was slightly more than 6 per cent above that limit. Most other major currencies were at rates against the dollar a few per cent higher than on August 13, prior to the suspension of dollar convertibility. Earlier in September, negotiations had begun on additional measures to reduce payments imbalances and on other improvements in the international monetary system.

Interest rates on short- and long-term market securities generally had fluctuated irregularly since the August 24 meeting of the Committee, after having fallen appreciably in response to the mid-August announcement of the new economic program. Rates on Treasury bills continued to decline for a time after the August meeting, in large part because of persisting strong demands for bills from foreign central banks. Subsequently, those demands subsided as dollar inflows to foreign central banks moderated, and on the day before this meeting the market rate on 3-month bills was about 4.70 per cent, only a few basis points below its level 4 weeks earlier.

In capital markets the volume of new issues of corporate and State and local government bonds changed little from July to August. However, the declines in yields following announcement of the Government's new economic program stimulated additional offerings of corporate bonds, and it appeared that the volume of new issues would be substantially higher in September and October.

Contract interest rates on conventional new-home mortgages increased slightly further in August, but yields edged down in the more sensitive secondary market for federally insured mortgages. Inflows of savings funds to nonbank thrift institutions moderated further from the very high rates recorded earlier in the year.

At commercial banks, business loans expanded by an extraordinary amount in August, apparently as a result of borrowings by domestic and foreign corporations in connection with developments in foreign exchange markets during the month. The Treasury sold a large volume of special securities to certain foreign central banks that had experienced heavy inflows of dollars, and U.S. Government deposits increased sharply. The rate of increase in total time and savings deposits declined as the volume of large-denomination CD's outstanding expanded much less than in July and inflows of consumer-type time and savings deposits remained near the reduced rate of that month.

Relatively low growth rates were recorded in August for both the narrow and the broader measures of the money stock--M_1 (private demand deposits plus currency in circulation) and M_2 (M_1 plus commercial bank time deposits other than large-denomination CD's). At the time of the previous meeting of the Committee it had been expected that growth in M_1 would slow from the average annual rate of 10 per cent recorded in the first 7 months of the year, in part in a lagged response to earlier increases in short-term interest rates, and that M_2 would continue to expand at about the moderate rate that had emerged in July. For both measures, however, actual growth rates in August were lower than had been anticipated--partly for reasons related to the flows of funds into foreign currencies. Growth in the adjusted bank credit proxy--daily-average member bank deposits, adjusted to include funds from nondeposit sources--was faster than in July mainly because of the sharp increase in Government deposits.

System open market operations in the period immediately following the August 24 meeting had been directed at maintaining prevailing money market conditions. Later, when data becoming available indicated that the monetary aggregates were growing more slowly than had been expected, slightly easier money market conditions were sought. Operations were complicated in early September by persistent money market pressures partly related to international flows of funds, and the Federal funds rate--which had been fluctuating between 5-1/2 and 5-5/8 per cent in the period before the preceding meeting--rose to 5-3/4 per cent for a time. Subsequently, however, the funds rate moved down to around 5-1/2 per cent. In the 4 weeks ended September 15, member bank borrowings averaged $675 million, compared with $770 million in the preceding 4 weeks.

As at the previous meeting, staff analysis suggested that the effects of the new economic program on demands for money, together with lagged reactions to earlier increases in short-term interest rates, should tend to produce much lower average rates of growth in the monetary aggregates over the rest of 1971 than had been recorded earlier in the year. Including rough estimates for September, it appeared that M_1 and M_2 would expand over the third quarter at annual rates substantially below those of 11.5 and 12.5 per cent recorded in the second quarter.[1/] According to the analysis, if prevailing money market conditions were maintained growth in M_1 would slow further in the fourth quarter.

It was noted in the Committee's discussion that an appropriate mix of fiscal and monetary policies would be required if the Government's new economic program was to be successful. A number of members stressed

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.

the difficulties of determining the proper longer-run stance of monetary policy at this juncture in light of the existing uncertainties about the nature of the fiscal measures that would be enacted, the general outlines of the post-freeze stabilization effort, and the manner in which the economy would respond to the new program.

The Committee decided that open market operations in the period immediately ahead should be directed at achieving moderate growth in the monetary and credit aggregates, while taking account of developments in capital markets. Although it was recognized that the pursuit of these objectives might involve operations designed to attain somewhat easier money market and reserve conditions, the members agreed that aggressive easing operations should be avoided in order to minimize the risk of rekindling inflationary expectations. Also, the sentiment was widespread among members that, in view of the unusually rapid growth in M_1 through July, relatively low rates of expansion for a few months would not be inconsistent with the Committee's general objectives for the monetary aggregates.

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

> The information reviewed at this meeting suggests that the Government's new economic program has reduced inflationary expectations and has improved prospects for higher rates of growth in real economic activity and employment. In the current quarter, however, real output of goods and services is expanding modestly and unemployment remains substantial. Prior to the imposition of the 90-day freeze, prices and

wages were rising rapidly on average. In August inflows of consumer-type time and savings funds to nonbank thrift institutions moderated and inflows to banks remained at a reduced rate. Growth in the narrowly defined money stock, which had been rapid through July, slowed sharply in August; and growth in broadly defined money continued to slacken. However, the rate of expansion in the bank credit proxy stepped up, mainly reflecting a marked rise in U.S. Government deposits. Market interest rates, which declined sharply following the announcement of the new program, have since fluctuated irregularly. The U.S. balance of payments continues to be in a position of substantial basic deficit. Speculative capital outflows have diminished recently. Most major foreign currencies are trading in the exchange markets at rates against the dollar a few per cent higher than on August 13. Negotiations have begun on additional measures to reduce payments imbalances and on other improvements in the international monetary system. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions consistent with the aims of the new governmental program, including sustainable real economic growth and increased employment, abatement of inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee seeks to achieve moderate growth in monetary and credit aggregates, taking account of developments in capital markets. 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 that objective.

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