FEDERAL RESERVE

press release

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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 21, 1973.

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 21, 1973

Domestic policy directive

Estimates of the Commerce Department indicated that real output of goods and services had increased at an annual rate of only about 2.5 per cent in the second quarter of the year, after having grown at a rate of about 8.5 per cent in the first quarter and of 8.0 per cent in the last quarter of 1972. Staff projections continued to suggest that growth would be moderate in the third quarter.

In July retail sales rose sharply, recovering much more than they had declined in June. Expansion in industrial production picked up somewhat, reflecting widespread gains among consumer goods, business equipment, and industrial materials. Nonfarm payroll employment changed little, after having expanded at a more moderate pace during the spring than in earlier months, but the average factory workweek lengthened. The civilian labor force declined, and the unemployment rate edged down further to 4.7 per cent.

Average hourly earnings of production workers on non-farm payrolls advanced in July at about the moderate average rate of the first 6 months of the year. Between mid-June and mid-July average wholesale prices of farm and food products fell sharply, in large part because of the imposition of export controls on some commodities; decreases were especially large for animal feeds, grains, and oil seeds. However, the temporary price freeze imposed on June 13 was lifted for most foods on July 18, and wholesale prices of farm and food products adjusted sharply upward. Moreover, crop conditions as of August 1 suggested that the 1973 harvests--although still at record levels--would not be quite so large as had been expected, and prices of corn, wheat, and soybeans soared. Wholesale prices of industrial commodities changed little from mid-June to mid-July; the freeze on these prices remained in force until August 12.

The latest staff projections suggested that growth in real GNP over the balance of the year would be somewhat greater than the slow pace in the second quarter. It was anticipated that business fixed investment would expand more rapidly and that inventory investment would increase appreciably; in the second quarter growth in fixed investment had slowed and inventory investment had changed little. It was also expected that personal consumption expenditures would rise at a slightly faster pace but that residential construction outlays would decline substantially.

In June the value of U.S. exports continued to expand while the value of imports changed little, and the deficit in merchandise trade declined appreciably. The trade deficit in the second quarter as a whole was well below that in the first quarter--which in turn was much lower than the deficit in the fourth quarter of 1972--and the balance on goods and services moved into surplus for the first time since the third quarter of 1971.

The evidence of progress toward equilibrium in the U.S. balance of payments--along with a rise in interest rates relative to those abroad--had contributed to a strong recovery in the exchange rate for the dollar against continental European currencies since the end of July and also to a continued firming against sterling, the Japanese yen, and the Canadian dollar. In the first half of August, moreover, the over-all balance of payments on an official settlements basis was in surplus. By mid-August, the price of gold had fallen about one-fourth from a peak in early July.

At U.S. commercial banks, business loans expanded sharply further in July, and growth in both real estate and consumer loans--although below the average rates in the second quarter--remained strong. Banks liquidated a substantial amount from their holdings of Treasury bills, but the increase in total bank credit remained large. The prime rate that banks applied to large corporations was raised in four steps from 8-1/4 per cent in mid-July to 9-1/4 per cent in mid-August.

Growth in both the narrowly defined money stock (M_1)[1/] and the broadly defined money stock (M_2)[2/], which had been rapid in June and during the second quarter as a whole, slowed markedly in July. Inflows of time and savings deposits other than large-denomination CD's slackened further. After the Regulation Q actions of early July--in which rate ceilings were removed on consumer-type time deposits in denominations of at least $1,000 having maturities of 4 years or more and maximum rates were raised on time and savings deposits with shorter maturities--many banks increased their offering rates, and net inflows of such deposits picked up in late July and early August. Banks also raised the rates paid on large-denomination CD's, and the outstanding volume of such CD's expanded by a substantial amount; as a result, growth in the bank credit proxy[3/] remained relatively rapid despite a sizable drop in U.S. Government deposits. Over the first 7 months of the year, M_1, M_2, and the proxy grew at annual rates of about 6.0, 7.5, and 13 per cent, respectively.[4/]

1/ Private demand deposits plus currency in circulation.

2/ M_1 plus commercial bank time and savings deposits other than large-denomination CD's.

3/ Daily-average member bank deposits, adjusted to include funds from nondeposit sources.

4/ Growth rates cited are calculated on the basis of the daily-average level in the last month of the period relative to that in the last month preceding the period.

Nonbank thrift institutions experienced net outflows of savings in July for the first time since January 1970, even though these institutions, like commercial banks, generally had raised rates paid on deposits following changes in rate ceilings effective at the beginning of July. To meet deposit withdrawals and mortgage commitments made earlier, savings and loan associations borrowed a record amount from Federal home loan banks. Contract interest rates on conventional mortgages and yields in the secondary market for Federally insured mortgages rose sharply.

On July 25 the Treasury announced that on July 31 it would auction up to $2 billion of an existing issue of 7-3/4 per cent notes due to mature in 4 years and that on August 1 it would auction up to $500 million of 20-year, 7-1/2 per cent bonds (callable in 15 years) to refund part of $4.7 billion of publicly held securities maturing on August 15. In those auctions the Treasury sold $2 billion of the notes at an average price to yield 8.03 per cent and $500 million of the bonds at the lowest bid price (paid by all successful bidders) to yield about 8.00 per cent; of the bonds, $240 million were acquired by Government accounts. The Treasury also announced on July 25 that on August 8 it would auction $2 billion of 35-day tax-anticipation bills, dated August 15; the bills were sold at an average price to yield 9.80 per cent. In the interim, the Treasury experienced an unexpected one-day cash need, which it financed by selling $351 million of special certificates of indebtedness to the Federal Reserve Banks on August 15; the certificates were redeemed the next day. On August 20 the Treasury announced that in a new cash financing on August 24 it would auction $2 billion of 25-month notes.

System open market operations since the meeting on July 17 had been guided by the Committee's decision to seek bank reserve and money market conditions consistent with slower growth in monetary aggregates over the months immediately ahead than had occurred on average in the first half of the year. Operations had been directed toward fostering growth in reserves available to support private nonbank deposits (RPD's) at an annual rate in a range of 11-1/2 to 13-1/2 per cent in the July-August period, while avoiding unduly sharp changes in money market conditions.

During the first 2 weeks after the July meeting, available data had suggested that in the July-August period RPD's would grow at a rate above the range that the Committee had specified and that the monetary aggregates would grow at rates in excess of an acceptable range. Therefore, the System had acted promptly to limit expansion in RPD's, and the Federal funds rate--which had averaged around 10-1/4 per cent in the statement week ending July 18--rose to around 10-1/2 per cent in the next two statement weeks. On August 3, a majority of the Committee members had concurred in a recommendation by the Chairman that money market conditions should be permitted to tighten still further if necessary to limit growth in RPD's and in the monetary aggregates, but in light of subsequent developments, tighter conditions were not sought and the funds rate remained close to 10-1/2 per cent. In the 5 weeks ending August 15, member bank borrowings averaged around $1,965 million, about the same as in the preceding 4 weeks.

The additional tightening in money market conditions early in the inter-meeting period along with sustained strength in credit demands led to further sharp increases in short-term market interest rates until mid-August, and then rates turned down. The market rate on 3-month Treasury bills rose from 7.85 per cent on the day before the July meeting to a high of 9.05 per cent on August 14 and then fell back to 8.79 per cent on the day before this meeting. On August 13 increases in Federal Reserve discount rates from 7 to 7-1/2 per cent were announced, effective at 10 Reserve Banks on August 14; shortly thereafter, rates were raised at the two remaining Banks.

In long-term markets, interest rates also rose sharply further from mid-July to mid-August, apparently in reaction to the advance in short-term rates. Later, however, long-term rates fell back appreciably. The over-all volume of new public offerings of corporate and State and local government bonds declined moderately in July, and little change in the volume was in prospect for August.

The Committee agreed that the economic situation and prospects called for slower growth in monetary aggregates over the months immediately ahead than had occurred on average thus far in 1973. A staff analysis suggested that despite the substantial growth expected in nominal GNP the demand for money in the period ahead would be limited by the sharp rise in short-term interest rates that had occurred in recent months. In the immediate future, moreover, monetary growth was likely to be restricted by a downward adjustment in the public's demand for cash balances in response to the increases in rates paid on time and savings deposits.

The analysis also suggested, however, that business demands for bank loans would remain strong and that banks would continue to expand the outstanding volume of large-denomination CD's at a relatively fast pace. Reflecting the expansion in such CD's and also the imposition in late June of marginal reserve requirements on them, a relatively rapid rate of growth in RPD's in the August-September period--at an annual rate in a range of 13 to 15 per cent--was thought likely to be consistent with slower growth in monetary aggregates over the months immediately ahead.

In view of the rapid pace at which RPD's had grown in recent months, the Committee decided that open market operations should be directed at fostering RPD growth during the August-September period at an annual rate within a range of 11 to 13 per cent, while avoiding marked changes in money market conditions. The members also agreed that, in the conduct of operations, account should be taken of international and domestic financial market developments, of the forthcoming Treasury financing, and of deviations in monetary growth from an acceptable range. It was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives and constraints.

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

> The information reviewed at this meeting suggests that growth in real output of goods and services, which slowed in the second quarter from the exceptionally rapid pace of the two preceding quarters, will be moderate in the third quarter. Increases in nonfarm employment also have slowed in recent months, but the unemployment rate has declined. The rate of rise in wage rates has remained relatively moderate. The exceptionally rapid advance in prices was interrupted in July by the temporary freeze imposed in mid-June. However, farm and food prices adjusted sharply upward after mid-July, when the freeze was lifted on most such products. The U.S. merchandise trade balance improved in June, and the balance on goods and services was in surplus in the second quarter for the first time in nearly two years. Since the end of July the dollar has strengthened markedly in foreign exchange markets, and the price of gold has dropped sharply.

Both the narrowly and more broadly defined money stock, which had increased rapidly in May and June, grew more slowly in July. Inflows of consumer-type time and savings deposits strengthened again at banks in late July and early August, while net outflows were experienced at nonbank thrift institutions. Expansion in bank credit has continued at a substantial pace. Since mid-July short-term market interest rates have advanced considerably further on balance. Long-term rates also rose substantially for much of that period, but most recently they have declined in the course of a sharp market rally. On August 13 increases were announced in Federal Reserve discount rates from 7 to 7-1/2 per cent.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to abatement of inflationary pressures, a sustainable rate of advance in economic activity, and progress toward equilibrium in the country's balance of payments.

To implement this policy, while taking account of international and domestic financial market developments and the forthcoming Treasury financing, the Committee seeks to achieve bank reserve and money market conditions consistent with slower growth in monetary aggregates over the months immediately ahead than has occurred on average thus far this year.

Votes for this action: Messrs. Burns, Hayes, Balles, Brimmer, Bucher, Daane, Holland, Mayo, Morris, and Sheehan. Vote against this action: Mr. Francis.
Absent and not voting: Mr. Mitchell.

Mr. Francis dissented from this action, although he agreed with the objectives of the policy adopted by the Committee, because he could not accept the constraint placed on money market conditions.