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 September 18, 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 September 18, 1973

Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services, which had dropped to an annual rate of about 2.5 per cent in the second quarter from rates above 8.0 per cent in the two preceding quarters, would pick up somewhat in the current quarter. Staff projections suggested that growth in real output would slow slightly in the fourth quarter and would slacken further in the first half of 1974; the rise in prices was expected to remain rapid.

In August industrial production declined slightly as output of automobiles and trucks was reduced sharply by shortages of parts, hot weather, and work stoppages. Nonfarm payroll employment, which had been stable in July, increased appreciably, although employment in manufacturing continued to change little; over the latest 3 months, the rate of growth in nonfarm employment was about two-thirds of the rate over the preceding 9 months. In August the unemployment rate edged up to 4.8 per cent. Retail sales, according to the advance report, remained at the high level reached in July, and the average for the 2 months was above that for the second quarter.

Average hourly earnings of production workers on nonfarm payrolls advanced moderately in August, but increases in June and July were now reported to have been larger than had been indicated by earlier data; as a result, the rise over the 3-month period was more rapid than that earlier in the year. Wholesale prices of farm and food products rose sharply between mid-July and mid-August, after the temporary price freeze that had been imposed on June 13 was lifted for most foods on July 18. Later, prices of grains, livestock, poultry, and other farm products dropped, but in general prices of farm and food products remained far above pre-freeze levels. Wholesale prices of industrial commodities increased appreciably between mid-July and mid-August, although for these commodities, the freeze remained in force until August 12. Reflecting the freeze, the rise in the consumer price index had slowed markedly in July.

Staff projections for the fourth quarter suggested that residential construction outlays would decline substantially and that consumption expenditures would expand at a rate below that in the third quarter. It was also expected, however, that both Federal and State and local government purchases of goods and services would rise substantially and that business inventory investment would increase further.

U.S. merchandise exports continued to expand in July--reflecting sustained gains in exports of nonagricultural goods--and imports declined; the trade balance, after registering progressively smaller deficits from the fourth quarter of 1972 to the second quarter of 1973, shifted into surplus. Net foreign purchases of U.S. equity securities, which had fallen sharply in the second quarter, rose substantially in July.

Foreign exchange markets in general had been quiet in recent weeks, although a 5 per cent revaluation of the Dutch guilder announced on the weekend before this meeting provoked some speculation that other continental currencies also would be revalued. The exchange rates for the dollar against major foreign currencies--which had strengthened significantly in the first half of August--had changed little since then. In August, moreover, the U.S. balance of payments on an official settlements basis was in surplus, after having been in small deficit in July.

At U.S. commercial banks, business loans expanded at a very rapid rate in August--although the expansion appeared to have slackened late in the month--and growth in other types of loans remained strong. Banks continued to liquidate substantial amounts from their holdings of Government securities, but total bank credit increased considerably further. The prime rate that banks charged on loans to large corporations was raised in three steps from 9-1/4 per cent in mid-August to 10 per cent in mid-September.

The narrowly defined money stock (M_1),[1/] which had grown at an annual rate of about 10.5 per cent in the second quarter and of 5 per cent in July,[2/] declined somewhat in August. Inflows of time and savings deposits other than large-denomination CD's increased sharply--reflecting in part inflows into 4-year time deposits in response to the higher interest rates generally being offered on these instruments, which had been exempted from Regulation Q ceilings at the beginning of July--and the more broadly defined money stock (M_2)[3/] grew at a slightly higher rate in August than in July. Banks raised further the rates paid on large-denomination CD's, and the outstanding volume of such CD's expanded by a substantial amount in August, as in July; growth in the bank credit proxy[4/] was rapid. On September 7 the Federal Reserve announced an increase from 8 to 11 per cent in marginal reserve requirements on large-denomination CD's, effective in the statement week beginning October 4 against deposits held 2 weeks earlier.

1/ Private demand deposits plus currency in circulation.

2/ 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.

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

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

Nonbank financial institutions, like commercial banks, raised rates after the 4-year deposits were exempted from rate ceilings, but they experienced net outflows of total deposits in the July-August period. In both July and August savings and loan associations borrowed large amounts from Federal home loan banks to meet mortgage commitments, and they sharply reduced their new commitments. Contract interest rates on conventional mortgages and yields in the secondary market for Federally insured mortgages rose sharply further in August.

In the Treasury's cash financing of August 24, which had been announced on August 20, $2 billion of a 25-month, 8-3/8 per cent note were auctioned at a price to yield 7.94 per cent. The Treasury financed additional cash needs by selling special certificates of indebtedness to the Federal Reserve Banks; such certificates were outstanding on several days, and their volume reached a peak of $443 million on September 11.

System open market operations since the meeting on August 21 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 7 months 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 to 13 per cent during the August-September period, while avoiding unduly sharp changes in money market conditions.

Soon after the August meeting, available data suggested that in the August-September 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 been around 10-1/2 per cent at the time of the August meeting--rose to about 10-3/4 per cent in the statement week ending August 29. Later data suggested that growth in the monetary aggregates was slowing and that RPD's would grow in the August-September period at a rate within the specified range. The Federal funds rate remained about 10-3/4 per cent. In the 4 weeks ending September 12, member bank borrowings averaged $2,135 million, compared with $1,965 million in the preceding 5 weeks.

Short-term market interest rates, especially rates for Treasury bills, declined just after the August meeting of the Committee, in large part because of growing expectations among market participants that the maximum degree of monetary restraint had been reached. However, rates rose again in association with the further tightening of money market conditions early in the inter-meeting period and with the September 7 announcement of the increase in reserve requirements against large-denomination CD's. The market rate on 3-month Treasury bills dropped from 8.79 per cent on the day before the August meeting to 8.46 per cent a few days afterwards, rose to a high of 9.04 per cent on September 11, and then fell back to 8.70 per cent on the day before this meeting.

Yields on long-term securities, which had turned down in early August, continued to decline through most of the inter-meeting period--in part, like short-term rates, because of market expectations that the maximum degree of monetary restraint had been reached, but also because of light offerings of new securities. The volume of new public offerings of corporate bonds declined more than seasonally in August, and the recovery in the volume in prospect for September was less than seasonal. In the week before this meeting, long-term rates edged up.

The Committee agreed that the economic situation and prospects called for moderate growth in monetary aggregates over the months ahead. A staff analysis indicated that, although transactions demands for money probably would expand, growth in the money stock in the months ahead was likely to be limited in lagged response to the rise in short-term interest rates that had occurred in recent months. Consequently, achievement of moderate growth in monetary aggregates within an acceptable period of time was likely to require some easing in money market conditions. In the current environment of unusual sensitivity of expectations in financial markets, however, signs that monetary policy was moving toward a significant easing in money market conditions might result in large expectational declines in short-term interest rates and also in further declines in long-term rates, tending to erode the existing degree of monetary restraint.

The staff analysis also indicated that completion of the realignment in consumers' holdings of financial assets--which had been taking place in response to changes in the structure of interest rates--was likely to slow the growth in consumer-type time and savings deposits even if market interest rates declined moderately. It was expected that growth in business loans, although slowing from the exceptionally rapid pace in August, would remain relatively rapid and that banks' demands for funds would continue strong; however, expansion in the outstanding volume of large-denomination CD's was likely to be tempered by the recent increase in the marginal reserve requirement against such CD's. In large part because of the reserves required against the expanding volume of large-denomination CD's, rapid growth in RPD's in the September-October period--at an annual rate in a range of 15 to 17 per cent--was thought likely to be consistent with moderate growth in the narrowly and the more broadly defined money stock over the months ahead.

In view of the relatively weak behavior of the monetary aggregates in August and prospects for limited expansion in the months immediately ahead, the Committee concluded that reserve-supplying operations should not become restrictive unless RPD's in the September-October period appeared to be growing at an annual rate of more than 18 per cent. Specifically, the Committee decided that operations should be directed at fostering RPD growth during that period within a range of 15 to 18 per cent, while taking account of deviations in monetary growth from an acceptable range and avoiding unduly sharp changes in money market conditions. Although the members recognized that pursuit of the objective for RPD's might be associated with some easing in money market conditions, a number of them cautioned against the risk of generating market impressions that monetary restraint was being relaxed significantly, and it was agreed that, in the conduct of operations, account should be taken of domestic financial market developments. As at other recent meetings, the Committee also agreed that account should be taken of international financial market developments. 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. Although nonfarm employment rose sharply in August, the average gain in recent months has been smaller than earlier and the unemployment rate has changed little at a level somewhat below 5 per cent. The exceptionally rapid advance in prices was interrupted in July by the temporary freeze imposed in mid-June. However, farm and food prices surged after mid-July--when the freeze was lifted on most such products--and despite later appreciable declines, they remained far above pre-freeze levels. The U.S. merchandise trade balance improved further in July, and net foreign purchases of U.S. stocks increased. In recent weeks exchange rates for the dollar against most foreign currencies have changed little on balance after strengthening in the first half of August, and the balance of payments has been in surplus on an official settlements basis.

The narrowly defined money stock, which had increased moderately in July, declined somewhat in August. The more broadly defined money stock continued to expand as a result of net inflows at banks of consumer-type time deposits. Nonbank thrift institutions experienced net deposit outflows in the July-August period. Expansion in bank credit has continued at a substantial pace. On September 7 the Federal Reserve announced an increase from 8 to 11 per cent in marginal reserve requirements on large-denomination CD's. Interest rates on long-term market securities declined from early August to early September, partly because of growing expectations that the maximum degree of monetary restraint had been reached. Later, however, such expectations weakened and some long-term rates turned up. Short-term rates generally remained under upward pressure in recent weeks.

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 continued progress toward equilibrium in the country's balance of payments.

To implement this policy, while taking account of international and domestic financial market developments, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead.

Votes for this action: Messrs. Burns, Balles, Bucher, Daane, Francis, Holland, Mayo, Mitchell, Morris, Sheehan, and Debs. Votes against this action: None.

Absent and not voting: Messrs. Brimmer and Hayes. (Mr. Debs voted as alternate for Mr. Hayes.)

On October 1 the System Account Manager reported that significant inconsistencies had developed among the Committee's various objectives and constraints. Incoming data had suggested that in the September-October period the annual rate of growth in RPD's would fall well below the range specified by the Committee at the September 18 meeting and that growth in both M_1 and M_2 would fall short of acceptable ranges. In domestic financial markets, however, short-term interest rates had dropped very sharply--although the Federal funds rate had remained close to 10-3/4 per cent--and long-term rates had continued to decline as many market participants had become convinced that the System had relaxed its policy of restraint and that in general interest rate peaks had been passed.

The Committee held a telephone meeting on October 2, in which all members other than Chairman Burns participated. A minority of the members--Messrs. Balles, Bucher, Francis, Morris, and Sheehan--favored proceeding to provide reserves at a rate consistent with an easing in money market conditions to the degree considered acceptable at the meeting on September 18, provided that market conditions did not become disorderly and that growth in the aggregates appeared to remain below acceptable ranges. The majority of the members, however, concluded that at least over the next few days money market conditions should be allowed to ease less than originally considered acceptable and then only if that did not threaten to reinvigorate the sharp rally in markets for short-term securities. It was understood that further consultation was likely to be desirable before the meeting scheduled for October 16.

The Committee held another telephone meeting on October 10, in which all members participated. The additional week's data available by then suggested that in the September-October period growth in RPD's and the monetary aggregates would be still weaker than had been expected earlier. Although System operations had supplied large amounts of reserves and short-term market interest rates had declined further on balance, the Federal funds rate on most days through October 8 had remained near 10-3/4 per cent. Committee members agreed unanimously that reserves should be supplied at a rate consistent with some easing in money market conditions beyond that decided upon on October 2 and that conditions should be eased somewhat further if the recent weakness in RPD's and in the monetary aggregates should be confirmed by data that would become available after the meeting.