



FEDERAL RESERVE

press release

For immediate release

May 20, 1974

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 February 20, 1974.

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 February 20, 1974

Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services--which had grown at an annual rate of about 1.5 per cent in the fourth quarter of 1973--was declining in the first quarter of this year, mainly because of the oil situation, and that the GNP implicit deflator was continuing to rise rapidly. Staff projections suggested that weakness in economic activity would continue in the second quarter and that the rise in prices would remain rapid.

In January industrial production declined appreciably further, as output of automobiles and residential and commercial use of electricity and gas continued to decline while output of business equipment and other major categories of goods changed little; the January level was below the average in the fourth quarter of 1973. Nonfarm payroll employment fell sharply--reflecting sizable reductions in durable goods manufacturing and in contract construction--and the average workweek in manufacturing also declined considerably. The unemployment rate rose from 4.8 to 5.2 per cent. The dollar volume of retail sales recovered, following a sizable decline in December; although the January level was somewhat above the fourth-quarter average, the gain appeared to be less than the rise in prices of consumer goods.

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Wholesale prices of industrial commodities continued to rise at a rapid pace in January; increases again were large for fuels and were substantial and widespread among other commodity groups. Wholesale prices of farm and food products also rose sharply, with increases especially large for prices of livestock, meats, and grains. In December the consumer price index had risen appreciably further, although the increase was tempered by declines in retail prices of meats and used cars. The index of average hourly earnings of production workers on nonfarm payrolls also had continued to advance in recent months, but at a less rapid pace than prices.

The latest staff projections for the first half of 1974 suggested that nominal GNP would expand somewhat less, and that real GNP would decline somewhat more, than had been anticipated at the time of the Committee's meeting in mid-January. Declines were concentrated in real consumption expenditures and residential construction activity, both of which were now projected to be weaker than had been expected 4 weeks earlier. As before, it was anticipated that the expansion in business fixed investment would remain relatively strong and that growth in State and local government purchases of goods and services would continue at a substantial rate. Business inventory investment was projected to be moderately below the high rate experienced in the fourth quarter of 1973, when stocks of large automobiles accumulated as sales fell off.

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In foreign exchange markets the strong appreciation of the dollar that had begun in October gave way to depreciation near the end of January, reflecting in part the removal of U.S. controls on outflows of capital, relaxation of some foreign restraints on inflows of capital, and declines in U.S. interest rates relative to those abroad. In December U.S. merchandise exports had remained strong while imports had dropped from the very high level in November; the trade surplus had increased sharply both in December and in the fourth quarter as a whole.

Growth in total loans and investments at U.S. commercial banks accelerated in January, reflecting increases in most categories of loans and in banks' holdings of both Treasury and other securities. Expansion in business loans, which had been moderate in the fourth quarter of 1973, was especially strong in January, and business borrowing in the commercial paper market also was heavy. Between late January and mid-February, most banks lowered the prime rate applicable to large corporations from 9-3/4 to 9 per cent.

The narrowly defined money stock (M_1)^{1/} --which had grown at a rapid pace in the last 2 months of 1973--declined in January; weekly data suggested that M_1 was expanding in early February. Inflows of consumer-type time and savings deposits increased substantially; as a result,

^{1/} Private demand deposits plus currency in circulation.

growth in the more broadly defined money stock (M_2)^{2/} remained near the moderate rate in December. The outstanding volume of large-denomination CD's rose appreciably in January and, along with a large increase in U.S. Government deposits, contributed to an acceleration of growth in the bank credit proxy.^{3/}

Net deposit inflows at savings and loan associations in January remained near the improved rate in the final months of 1973, but inflows to mutual savings banks fell off again. Growth in the measure of the money stock that includes such deposits (M_3)^{4/}--like growth in M_2 --continued near the moderate rate in December. Contract interest rates on conventional mortgages and yields in the secondary market for Federally insured mortgages declined between early January and early February.

On January 30 the Treasury announced that in early February it would auction up to \$4.05 billion of notes and bonds to refund the bulk of \$4.5 billion of publicly held notes and bonds maturing on February 15; the remainder would be retired by drawing down cash balances. In auctions on February 5, 6, and 7, respectively, the Treasury sold \$1.50 billion of 7-year, 7 per cent notes at an average price to yield 6.95 per cent; \$2.25 billion of 3-1/4-year, 6-7/8 per cent notes at an average price to yield

^{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/} M_2 plus time and savings deposits at mutual savings banks and at savings and loan associations.

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6.70 per cent; and \$300 million of 19-1/2-year, 7-1/2 per cent bonds at a price to yield 7.46 per cent to maturity.

System open market operations since the January 21-22 meeting had been guided by the Committee's decision to seek bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the months ahead, while taking account of the Treasury's mid-February refunding and of international and domestic financial market developments. Soon after the meeting, incoming data suggested that in the January-February period the monetary aggregates would grow at rates well within the ranges of tolerance specified by the Committee; therefore, operations were directed toward a slight easing in bank reserve and money market conditions, in accordance with the Committee's instructions that such easing would be sought promptly if the data then available did not suggest that the aggregates were growing rapidly.

Around the beginning of February available data suggested that growth both in reserves available to support private nonbank deposits (RPD's) and in M_1 might fall below the specified ranges of tolerance. Therefore, the System sought some further easing in bank reserve and money market conditions. In the 2 weeks preceding this meeting the Federal funds rate was close to 9 per cent, compared with around 9-5/8 per cent in the days before the

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January meeting; member bank borrowings averaged around \$1,140 million in the 4 weeks ending February 13, little changed from the average in the preceding 5 weeks. Data that became available a few days before this meeting indicated that M_1 was expanding rapidly in early February and that it was likely to grow in the January-February period at a rate within the specified range; however, growth in RPD's still appeared likely to fall short of the specified range.

Short-term market interest rates had fallen appreciably since the Committee's meeting on January 21-22, in large part because money market conditions had eased, but also, apparently, because market participants expected them to ease further. On the day before this meeting the market rate on 3-month Treasury bills was 7.03 per cent, down from 7.97 per cent on the day before the January meeting.

Yields on longer-term securities also had declined somewhat, despite a large volume of financing in the capital markets and the sizable Treasury refunding. The over-all volume of new public offerings of corporate and State and local government bonds rose substantially in January, and an equally large volume was in prospect for February.

The Committee agreed that the economic situation and outlook continued to call for moderate growth in monetary aggregates over the longer run. Staff analysis suggested that,

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because of the lower projected rate of expansion in nominal GNP, the demand for money was likely to expand less over the first half of 1974 than had been expected earlier. In the February-March period, however, M_1 was expected to grow relatively rapidly, assuming little or no change in money market conditions; in February in particular, monetary expansion was expected to be spurred temporarily by an extremely sharp reduction in Treasury deposits. Relatively rapid M_1 growth over the February-March period appeared consistent with the Committee's longer-run objectives for the monetary aggregates because it would follow the sizable decrease of January and because it seemed likely to be temporary. In the event that money market conditions did remain about unchanged in the period immediately ahead, little or no further decline appeared likely in short-term market interest rates in general, and--to the extent that recent declines had been based on expectations of prompt further easing in money market conditions--rates could move up again.

Over the February-March period, according to the staff analysis, net inflows of consumer-type time and savings deposits to banks and nonbank thrift institutions were expected to remain sizable--with the effects of the recent declines in short-term market interest rates bolstered, perhaps, by increases in precautionary balances. Reflecting the availability of such funds,

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banks were not likely to issue substantial amounts of large-denomination CD's, even though business loan expansion might not moderate very much from the fast pace of January.

Taking account of the staff analysis, the Committee concluded that progress toward its longer-run objective of moderate monetary growth could be achieved with rates of expansion in the aggregates over the February-March period that were temporarily above those desired for the longer term. For the February-March period it adopted ranges of tolerance of 6-1/2 to 9-1/2 per cent and 9-1/2 to 12-1/2 per cent for the annual rates of growth in M_1 and M_2 , respectively. The members agreed that rates of growth within those ranges would be likely to involve RPD growth during the February-March period at an annual rate within a 3-1/2 to 6-1/2 per cent range of tolerance, and they decided that in the period until the next meeting the weekly average Federal funds rate might be permitted to vary in an orderly fashion from as low as 8-1/4 per cent to as high as 9-1/2 per cent, if necessary, in the course of operations.

The members also agreed that, in the conduct of operations, account should be taken of international and domestic 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 real output of goods and services is declining in the current quarter, mainly because of the oil situation, and that prices are continuing to rise rapidly. In January industrial production declined again, nonfarm payroll employment dropped, and the unemployment rate rose above 5 per cent. Prices of both farm products and industrial commodities increased very sharply. Wage rates have continued to rise substantially in recent months, although not so sharply as prices.

After having appreciated for several months, the dollar has declined somewhat on the average against foreign currencies in recent weeks. U.S. controls on capital outflows were removed at the end of January, and several foreign countries have relaxed controls on capital inflows. The U.S. trade surplus rose sharply in December and in the fourth quarter as a whole.

The narrowly defined money stock, after increasing substantially in the last 2 months of 1973, declined in January; most recently, however, it has appeared to strengthen. Broader measures of the money stock continued to rise in January, as net inflows of consumer-type time deposits remained relatively strong. Expansion in business loans and in total bank credit accelerated, and banks stepped up issuance of large-denomination CD's. Since mid-January, short-term market interest rates have fallen appreciably, and long-term rates have declined somewhat.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to resisting inflationary pressures, cushioning declines in production and employment that are being induced in large part by the oil situation, and maintaining equilibrium in the country's balance of payments.

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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, Hayes, Balles, Brimmer, Daane, Holland, Mayo, and Mitchell. Votes against this action: Messrs. Bucher, Francis, Morris, and Sheehan.

The members dissenting from this action did so for different reasons. Messrs. Bucher, Morris, and Sheehan expressed concern about current and prospective weakness in aggregate economic demands. In order to encourage further declines in short- and long-term interest rates, including mortgage rates, they favored somewhat higher ranges of tolerance for the monetary aggregates and a lower range for the Federal funds rate than the Committee had agreed would be consistent with the directive. Mr. Francis expressed the view that the over-all economic situation was stronger than suggested by the staff projections and that inflation remained the major long-term economic problem. He dissented because he thought the policy adopted by the Committee would permit the money stock to grow at a faster rate than was consistent with progress in dealing with inflation.

Subsequent to the meeting it appeared that in the February-March period growth in the monetary aggregates would equal or exceed the upper limits of the short-run ranges of

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tolerance specified by the Committee. In view of that behavior, the System ordinarily would have become more restrictive in its reserve-supplying operations, expecting that the weekly-average Federal funds rate would rise toward the upper limit of its range of tolerance--namely, 9-1/2 per cent. On March 1, however, a majority of the available members^{5/} concurred in a recommendation by the Chairman that in light of the recent marked rise in market interest rates and the highly sensitive state of financial markets, the System conduct reserve operations in a manner expected to be consistent with maintenance of the funds rate at the prevailing level of about 9 per cent, for the time being.

One week later, it appeared that strong growth in the monetary aggregates was persisting. On March 11, in view of that behavior, the available members--with the exceptions of Messrs. Bucher and Sheehan--concurred in a recommendation by the Chairman that the System return to conducting reserve operations in a manner consistent with the full range of tolerance for the Federal funds rate agreed upon at the February meeting. However, in light of recent increases in market interest rates and the sensitive state of financial markets, the Account Manager would be expected to proceed very cautiously in operations thought likely to be consistent with a rise in the weekly average funds rate above 9 per cent.

^{5/} The members and alternate members of the Committee newly elected by the Federal Reserve Banks took office on March 1 for the term of one year commencing on that date. Mr. Coldwell, responding as alternate for Mr. Kimbrel, did not concur in the Chairman's recommendation.