FEDERAL RESERVE
press release

For immediate release November 18, 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 August 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

REVISED DRAFT

CONFIDENTIAL (FR) October 11, 1974

RECORD OF POLICY ACTIONS OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on August 20, 1974

Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services was changing little in the current quarter, after having declined in the first half of 1974, and that the GNP implicit deflator and wage rates were continuing to rise at a rapid pace. Staff projections suggested that weakness in real economic activity would persist in the final quarter of the year and in the first half of 1975 and that the rate of increase in prices would remain rapid, although not so rapid as in recent quarters.

In July industrial production remained at the May-June level, and total nonfarm payroll employment declined for the second consecutive month. The unemployment rate edged up to 5.3 per cent. According to the advance report, retail sales increased sharply in July; from the first to the second quarter sales had advanced at a rate that was no greater than the rise in prices.

Wholesale prices of farm and food products--which had declined appreciably from February to June--rose sharply in July, in part because of unfavorable weather. Among industrial commodities, price increases were widespread and extraordinarily large in July, as they had been throughout the first half of the year. The advance in the index of average hourly earnings for private nonfarm production workers had remained at a rapid rate over recent months. In June the consumer price index had continued to rise at a fast pace.

Soon after he took the oath of office on August 9, President Ford indicated that high priority would be given to bringing inflation under control. Toward that end, he proposed to call a summit meeting of national leaders at an early date, to be preceded by several sub-summit meetings, and he recommended legislation to create an agency that would monitor prices and wages in order to expose abuses.

Staff projections that weakness in economic activity would persist in the fourth quarter of this year and in the first half of 1975 were based on the following expectations: that the contraction in residential construction outlays would continue; that the expansion in business fixed investment would taper off; that growth in disposable income and in personal consumption expenditures would be little, if any, greater than the rate of increase in prices; and that the pace of business inventory accumulation would moderate.

In foreign exchange markets the gradual appreciation of the dollar against leading foreign currencies that had begun in mid-May continued between mid-July and mid-August. U.S. commercial bank loans to foreigners, especially to Japanese borrowers, apparently remained large; however, inflows of foreign capital, particularly from oil-exporting countries, also were large. In June the U.S. merchandise trade deficit was well below the extraordinary deficit of May, as exports rose much more than imports; from the first quarter to the second quarter, however, the trade deficit had deepened considerably, primarily as a result of a large further increase in the value of petroleum imports.

The rate of expansion in loans and investments at U.S. commercial banks--which had moderated throughout the second quarter, even though business loan growth had remained strong--picked up in July, reflecting a substantial further increase in business loans. Business demands for bank loans had begun to strengthen in late June, as some demands for credit were diverted from the commercial paper and capital markets in response to a marked deterioration in conditions in those markets and to increases in market interest rates relative to effective rates on bank loans. After mid-July, however, business loan growth subsided, as financial market conditions improved and commercial paper rates declined relative to bank rates. To finance the July expansion in loans, banks increased their outstanding volume of large-denomination CD's and reduced their holdings of Government securities by substantial amounts.

The narrowly defined money stock (M_1)1/ grew at an annual rate of 1.7 per cent in July--down from a rate of 7.8 per cent in June and of 6 per cent over the first half of the year.2/ Reflecting the behavior of M_1, growth in the more broadly defined money stock (M_2)3/ also slowed appreciably in July; net inflows to banks of time and savings deposits other than large-denomination CD's were only a little below the relatively strong pace of June.

Net deposit inflows at nonbank thrift institutions weakened considerably in July, in part because of the more attractive rates available on market securities. The deterioration in deposit experience apparently was progressive during the month, and it continued in early August. Growth in the measure of the money stock that includes such deposits (M_3)4/ slowed appreciably in July. Contract interest rates on conventional mortgages in the primary market and yields in the

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 and on the basis of the revised statistics published on August 22.

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

4/ M_2 plus time and savings deposits at mutual savings banks and at savings and loan associations.

secondary market for Federally underwritten mortgages rose substantially further from early July to early August.

On July 31 the Treasury announced that it would auction up to $4.4 billion of notes and bonds to refund publicly held notes that were to mature in mid-August. In auctions on August 6, 7, and 8, respectively, the Treasury sold $2.25 billion of 33-month, 9 per cent notes at an average price to yield 8.59 per cent; $1.75 billion of 6-year, 9 per cent notes at an average price to yield 8.75 per cent; and $400 million of 24-3/4-year bonds at an average price tc yield 8.63 per cent. In addition, $1.5 billion of 244-day bills of the Federal Financing Bank were auctioned on July 23 at an average price to yield 8.05 per cent on a discount basis.

At the time of the Committee meeting in mid-July money market conditions had begun to ease FROM AN EXCEPTIONALLY TAUT POSITION, reflecting abatement of the uncertainties that temporarily had reduced the willingness of member banks to borrow from Federal Reserve Banks and had increased their desire to hold excess reserves. The Federal funds rate dropped to around 12-1/4 per cent on the day of the July 16 meeting, after having been in a range of 13 to 14 per cent in late June and early July. Following the July 16 meeting System open market operations had been guided by the

Committee's decision to seek bank reserve and money market conditions that would moderate growth in monetary aggregates over the months ahead, while taking account of the forthcoming Treasury financing and of developments in domestic and international financial markets. As the inter-meeting period progressed, available data suggested that in the July-August period the annual rates of growth in the monetary aggregates would be within the ranges of tolerance that had been specified by the Committee. Accordingly, System operations were directed toward maintaining the funds rate around the middle of the 11-1/2 to 13 per cent range the Committee had specified; on the day before this meeting the rate was about 12-1/4 per cent, the same as on July 16. In the four statement weeks ending August 14, member bank borrowings averaged about $3,365 million, about $350 million more than the average in the preceding 4 weeks.

Market interest rates on most short- and long-term private securities had declined somewhat in the period since the Committee's meeting on July 16, and yield spreads between high- and lower-quality securities--which had widened sharply last spring--had narrowed, in association with the lessening of tensions in financial markets. The over-all volume of public offerings of corporate and State and local government bonds declined further in July, even though an unseasonally large volume had appeared in prospect, as some issues were postponed or canceled and other issues were reduced in size. A moderate increase in the volume appeared to be in prospect for August.

In contrast, yields on Treasury and Federal agency securities generally advanced in the inter-meeting period, in part because of the considerable increase in market supplies of such securities, particularly short-term issues, resulting from the recent Treasury offerings. On the day before this meeting the market rate on 3-month Treasury bills was 8.84 per cent, up from 7.62 per cent on the day before the July meeting.

The Committee concluded that the economic situation continued to call for moderate growth in monetary aggregates over the longer run. A staff analysis suggested that the unusually slow pace of monetary growth in July was not likely to persist in view of the continued sizable rate of growth in prospect for nominal GNP; in fact, data available for early August indicated that some strengthening had occurred already. Nevertheless, it appeared likely that if M_1 were to grow at a rate consistent with the Committee's longer-run objectives for the monetary aggregates, money market conditions would ease somewhat in the period immediately ahead. Such easing would probably lead to only a modest downward adjustment in market interest rates in general, because in the weeks ahead the volume of offerings of both private and Government securities was expected to be substantial.

The staff analysis suggested that inflows to banks of time and savings deposits other than money market CD's would slow somewhat further in the months ahead and that the deposit experience of nonbank thrift institutions would remain weak, as many small savers continued to find market instruments more attractive than deposit accounts. It was expected that expansion in business loans--and in total bank credit--would moderate, because of both a decline in the rate of business inventory accumulation and a tightening of bank lending policies, and that, consequently, growth in the outstanding volume of money market CD's would moderate.

Taking account of the staff analysis, the Committee concluded that growth in M_1 and M_2 over the August-September period at annual rates within ranges of tolerance of 4-3/4 to 6-3/4 per cent and 5-1/2 to 7-1/2 per cent, respectively, would be consistent with its longer-run objectives for the monetary aggregates. The members agreed that such growth rates would be likely to involve growth in reserves available to support private nonbank deposits (RPD's) within a range of tolerance of 7-3/4 to 9-3/4 per cent, 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 11-1/2 per cent to as high as 12-1/2 per cent, if necessary, in the course of operations.

The members also agreed that, in the conduct of operations, account should be taken of developments in domestic and international financial markets. 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 changing little in the current quarter, following the first-half decline, and that price and wage increases are continuing large. In July industrial production was unchanged from the May-June level, and nonfarm payroll employment declined further. The unemployment rate edged up to 5.3 per cent. Wholesale prices of farm and food products rose sharply, after having declined for 4 months, and increases among industrial commodities continued widespread and extraordinarily large.
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> The new Administration has indicated that it will give high priority to combating inflation and that it will convene a summit meeting of the nation's economic leaders to that end.

In recent weeks the dollar has appreciated somewhat further against leading foreign currencies. U.S. bank lending to foreign borrowers, especially in Japan, has apparently continued large, but inflows of foreign capital, particularly from oil-exporting countries, have also been large. The foreign trade deficit, although smaller in June than in May, widened substantially from the first to the second quarter as the value of petroleum imports increased.

The narrowly defined money stock rose only slightly in July, after having grown at an annual rate of 6 per cent over the first half of the year. Net inflows at banks of time deposits other than money market CD's slowed somewhat in July, and deposit experience at nonbank institutions worsened materially in July and early August. Growth in business loans and in total bank credit was substantial in July, although the pace of expansion slackened after the early part of the month. To finance loan growth, banks reduced their holdings of Treasury securities and increased their outstanding volume of large-denomination CD's by substantial amounts. Interest rates on most private market instruments have declined a little in recent weeks, and in association with some easing of tensions in financial markets, yield spreads between prime- and lower-quality issues--which had widened sharply--have narrowed. Yields on Government securities, particularly Treasury bills, have increased, in part because new Treasury offerings relieved a market shortage of such securities.

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, supporting a resumption of real economic growth, and achieving equilibrium in the country's balance of payments.

To implement this policy, while taking account of developments in domestic and international financial markets, 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, Black, Bucher, Clay, Holland, Kimbrel, Mitchell, Sheehan, Wallich, and Winn. Votes against this action: None.

Absent and not voting: Mr. Brimmer.