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 May 27, 1969. Such records are made available approximately 90 days after the date of each meeting of the Committee and will be found in the Federal Reserve Bulletin and the Board's Annual Report.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting Held on May 27, 1969

1. Authority to effect transactions in System Account.

According to the information reviewed at this meeting, the pace of expansion in economic activity was moderating slightly further but substantial upward pressures on prices and costs were persisting. New staff projections for the second quarter suggested that the increase in real GNP would be a little less than the 2.8 per cent annual rate now estimated by the Commerce Department for the first quarter. Prices, however, were expected to continue rising rapidly.

Available data for April showed some signs of a less rapid pace of economic advance. Growth in personal income, industrial production, and nonfarm employment slowed, and the unemployment rate edged up by 0.1 per cent for the second successive month, to 3.5 per cent. Housing starts declined for the third successive month. Retail sales increased considerably, but from a March figure that had been revised downward; in April retail sales were only moderately above the level of September 1968, even though prices had risen substantially in that period. On the other hand, new orders for durable goods rebounded in April after declining in March. Much of the April surge of orders may have been in anticipation of the administration's recommendation, made on April 21, for repeal of the 7 per cent investment tax credit as of that date.

Advances in wholesale prices of industrial commodities remained widespread in April, but the average of such prices rose relatively little because of an abrupt reversal of the earlier rapid run-up for lumber and plywood. The consumer price index increased sharply further, with much of the rise accounted for by higher food prices and homeownership costs. Over the past year consumer prices had increased by 5.4 per cent. Unit labor costs in the private nonfarm sector as a whole were reported to have risen markedly in the first quarter.

The staff projections for the second quarter suggested that business inventory accumulation would remain at about the first-quarter rate but that expansion in total final sales would slow. It was anticipated that consumer spending would rise less than in the first quarter, that Federal expenditures on goods and services would increase relatively little, and that residential construction outlays would decline. Only a small increase appeared in prospect for business spending on plant and equipment after the sharp expansion of the first quarter. Net exports were still expected to turn up as a result of the ending of the longshoremen's strike, but by considerably less than had been thought likely earlier.

Projections for the second half of 1969 suggested that expansion in real GNP would slow further but that upward pressures on costs and prices would still be strong. The GNP projections assumed that Federal expenditures would remain under substantial restraint and that, as recommended by the administration, the surtax would be continued at 10 per cent through the end of the year and the investment tax credit would be repealed. Although growth in disposable income was expected to be stimulated temporarily in the third quarter by the ending of retroactive tax payments and by the scheduled Federal pay increase, it seemed probable that generally moderate rates of expansion in employment and income in the second half of the year would limit increases in consumer spending. Prospects appeared to be for a continuing downdrift in residential construction outlays and for only small further increases in business capital expenditures.

In April both exports and imports of the United States were above normal as movements of merchandise recovered from the earlier longshoremen's strike. With respect to the over-all international payments of the United States, another large deficit was incurred on the liquidity basis in April while payments on the official settlements basis--which had been in substantial surplus in the first quarter--were about in balance. Extremely large deficits were incurred on both bases in the first half of May, when expectations of a revaluation of the German mark led to a massive flow of capital into Germany.

Beginning in late April, funds moved into marks out of dollars, sterling, French francs, and many other currencies, causing relatively severe reserve losses for a number of countries. Movements out of dollars, from both the United States and the Euro-dollar market, were exceptionally heavy, and earlier flows of Euro-dollars to the United States through foreign branches of U.S. banks were temporarily reversed. Interest rates in the Euro-dollar market, already high in April in consequence of U.S. bank demands and of reduced supplies from banks in some European countries, rose sharply further in the first half of May. Subsequently, despite interest costs in the neighborhood of 9-1/2 per cent, U.S. banks again increased their liabilities to foreign branches.

In its May refunding the Treasury offered two new notes--a 15-month, 6-3/8 per cent note priced to yield 6.42 per cent and a 7-year, 6-1/2 per cent note priced at par--in exchange for securities maturing in mid-May and mid-June. Of the $5.9 billion of maturing issues held by the public, about $2.1 billion were exchanged for the shorter-term note, and $2.2 billion--considerably more than had been anticipated in the market--for the 7-year note. The rate of attrition, slightly more than one-fourth of public holdings, was high by historical standards but lower than had been generally expected.

System open market operations since the previous meeting of the Committee had been directed at maintaining firm conditions in the money and short-term credit markets. Money market conditions were quite taut during the interval. The effective rate on Federal funds fluctuated mostly in a range of 8 to 9 per cent, compared with rates in the 7-3/4 to 7-7/8 per cent area in the latter part of April. Member bank borrowings rose to an average of about $1.3 billion in the 4 weeks ending May 21 from about $1.0 billion in the previous 4 weeks, and net borrowed reserves increased by a corresponding amount.

The tautness in the money market in part reflected aggressive bidding for funds by large banks as they adjusted to the cumulative effects of monetary restraint, the reduced availability of funds from the Euro-dollar market, and a shift of reserves away from the money centers over the course of the period. Although the System supplied a substantial volume of reserves on balance, it did not fully offset reserve drains stemming from market factors in light of the tendency during much of the interval for short-term Treasury bill rates to move to or below the lower end of recent ranges. For example, the market rate on 3-month Treasury bills, which had been in a range of 6.00 to 6.20 per cent during most of April, declined to a low for the year--5.87 per cent--at the end of that month and subsequently fluctuated mostly in a range below 6.10 per cent. Relatively strong investor demands for bills in the period were augmented by heavy foreign official purchases resulting from the speculative flows into the German mark.

Interest rates on other short-term debt instruments and on long-term securities had risen in recent weeks under the influence of taut money market conditions, expectations of a possible increase in the prime lending rate of banks, and dampened hopes for a settlement of the Vietnamese war in the near future. Also contributing to upward pressures was the sizable calendar of corporate bond offerings in May and June. The advance in municipal yields was particularly sharp, reflecting limited bank interest in new issues and efforts by dealers to dispose of bonds for which they had made commitments in April in the expectation of declining yields. Postponements of municipal offerings increased in May, and the calendar for that month--as well as for June--was considerably smaller than the unusually large volume marketed in April.

Business loan demands at banks, which were augmented in April by needs to finance tax payments, apparently continued strong in early May. Bank holdings of municipal securities declined slightly in April but holdings of U.S. Government securities increased a little, in part because of bank participation in the Treasury's late-March bill financing.

Bank credit and the money stock had risen sharply in the first week of April, and although both had declined later in the month, their average levels for April as a whole were considerably above those for March. According to revised estimates, the adjusted bank credit proxy--daily-average member bank deposits, adjusted to include changes in the daily average of U.S. bank liabilities to foreign branches--expanded at an annual rate of 6 per cent from March to April, and the money stock grew at a rate of more than 10 per cent. However, total time and savings deposits of banks declined slightly. Tentative estimates for May indicated that the average level of both the adjusted proxy series and the money stock would be about the same as in April, and that time and savings deposits would again decline slightly. The volume of large-denomination CD's outstanding was being reduced further in May, and other time and savings deposits apparently were recovering sluggishly from the sizable net outflows that marked much of April. The data available for savings flows at nonbank thrift institutions in early May also suggested only modest improvement over the weak April performance.

It appeared likely that the banking system--and financial markets generally--would be under heavy pressure in June. A near-record volume of corporate income tax payments due at midmonth was expected to contribute both to substantial demands for business loans and to continuing run-offs of outstanding large-denomination CD's. Staff projections suggested that bank credit would grow relatively little from May to June if prevailing conditions were maintained in money and short-term credit markets. Specifically, the proxy series adjusted for changes in Euro-dollar liabilities was projected to increase at an annual rate in a range from zero to 5 per cent. Some further recovery was anticipated in consumer-type time and savings deposits, at least until the midyear interest-crediting period. U.S. Government deposits were projected to decline on the average in June as a result of net debt repayments by the Treasury in the latter half of the month. Partly for this reason, and partly in consequence of the expected heavy demands for business loans, sharp increases appeared in prospect for private demand deposits and the money stock; the latter was projected to rise at an annual rate of 7 to 10 per cent.

It was noted at the meeting that in recent months banks had begun to draw increasingly on nondeposit sources of funds other than Euro-dollars--such as funds obtained through sales of commercial paper by bank holding companies and sales of loan participations to nonbank customers under agreements to repurchase--and that credit based on funds from these sources was not reflected in the proxy series as currently calculated. While data for firm estimates of the amounts involved were lacking, it was suggested that funds raised from such nondeposit sources might have grown at a rate equivalent to 1 or 2 percentage points in the adjusted proxy series in May and might possibly grow more in June.

In its discussion of policy the Committee took note of the signs of some slowing in the economic expansion and of the indications of stringency in financial markets. In view of the persistence of strong inflationary pressures and expectations, however, the members agreed that a relaxation of the existing degree of monetary restraint would not be appropriate at this time. There was some comment about the possible need for a slight further firming of policy, but it was noted that the strains anticipated in financial markets in connection with corporate tax payments in June militated against such a course. A number of members expressed the view that--while disorderly market conditions should be avoided--concern among market participants over the possibility of a "credit crunch" would not in itself warrant an easing of monetary policy.

The Committee decided that open market operations should be directed at maintaining the prevailing pressure on money and short-term credit markets, with the proviso that operations should be modified if bank credit appeared to be deviating significantly from current projections. Although not all members were of the same view on the matter, a number suggested that it would be desirable for the change in the adjusted bank credit proxy in June to be kept to the lower end of the projected range, particularly since the measure currently understated the resources actually available to the banking system. And a number of members expressed the hope that growth in the money stock in June could be held below the rate projected.

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

The information reviewed at this meeting suggests that expansion in real economic activity is continuing to moderate slightly, but that substantial upward pressures on prices and costs are persisting. Interest rates have risen in recent weeks. Bank credit and the money supply appear to be changing little on average in May after bulging in April. The outstanding volume of large-denomination CD's has continued to decline, and the available evidence suggests only modest recovery in other time and savings deposits at banks and in savings balances at nonbank thrift institutions following the outflows of the first half of April. The U.S. balance of payments on the liquidity basis was in sizable deficit in the first 4 months of 1969 but the balance on the official settlements basis remained in surplus as a result of large inflows of Euro-dollars. However, there were substantial outflows of funds from the United States in the first half of May, during the period of intense speculation on a revaluation of the German mark, and the payments balance was in very large deficit on both bases. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to the reduction of inflationary pressures, with a view to encouraging a more sustainable rate of economic growth and attaining reasonable equilibrium in the country's balance of payments.

To implement this policy, System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining the prevailing pressure on money and short-term credit markets; provided, however, that operations shall be modified if bank credit appears to be deviating significantly from current projections.

Votes for this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Coldwell, Daane, Maisel, Mitchell, Robertson, Scanlon, and Sherrill. Votes against this action: None.

2. Amendment to authorization for System foreign currency operations.

The Committee ratified an action taken by members on May 14, 1969, effective on that date, equalizing the System's swap arrangements with the National Bank of Belgium and the Netherlands Bank at $300 million, and making the corresponding amendment to paragraph 2 of the authorization for System foreign currency operations. Previously, the arrangement with the National Bank of Belgium had been in the amount of $225 million and that with the Netherlands Bank in the amount of $400 million. As a result of this action, paragraph 2 of the authorization read as follows:

> The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	100
National Bank of Belgium	300
Bank of Canada	1,000
National Bank of Denmark	100
Bank of England	2,000
Bank of France	1,000
German Federal Bank	1,000
Bank of Italy	1,000
Bank of Japan	1,000

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Bank of Mexico	130
Netherlands Bank	300
Bank of Norway	100
Bank of Sweden	250
Swiss National Bank	600
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,000

Votes for ratification of this action: Messrs. Martin, Hayes, Bopp, Brimmer, Clay, Coldwell, Daane, Maisel, Mitchell, Robertson, Scanlon, and Sherrill. Votes against ratification of this action: None.

The System's swap arrangements with the two central banks in question had been of equal size for several years before the gold crisis of March 1968, when the arrangement with the Netherlands Bank had been increased by $175 million. Members of the Committee had voted in mid-May to approve the restoration of equality in the size of the two swap arrangements at $300 million upon recommendation of the Special Manager, who advised that the action was agreeable to the central banks of Belgium and the Netherlands.