FEDERAL RESERVE

press release

For immediate release January 18, 1971

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 October 20, 1970. 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 October 20, 1970

Authority to effect transactions in System Account.

Preliminary estimates of the Commerce Department indicated that real output of goods and services had risen at an annual rate of 1.4 per cent in the third quarter, compared with a 0.6 per cent rate of growth in the second. Nonfarm payroll employment declined on the average in the third quarter and the unemployment rate rose further. Wage rates generally were continuing to increase at a rapid pace, but it appeared that gains in productivity were slowing the advance in costs and some major price measures were rising less rapidly than earlier. A strike at a major automobile manufacturer that had begun in mid-September was retarding current economic activity and clouding the near-term outlook.

Industrial production, which had been declining irregularly since July 1969, fell considerably in September; much of the reduction in that month was directly attributable to the strike in the automobile industry. Retail sales were about unchanged from August, and in the third quarter as a whole sales rose less than in any of the three preceding quarters. Nonfarm payroll employment leveled off in September, following earlier declines, but the unemployment rate advanced sharply from 5.1 to 5.5

per cent. Private housing starts, on the other hand, increased substantially in the third quarter.

The wholesale price index rose considerably from mid-August to mid-September after having declined in the previous month; to a large extent these fluctuations reflected the volatile behavior of prices of farm products and foods. Average prices of industrial commodities continued upward in September, but in the third quarter as a whole the rate of advance was somewhat slower than in the second quarter. In August the increase in the consumer price index was smaller than in any other month since December 1968. It appeared that output per manhour in the private nonfarm sector of the economy had increased appreciably in both the second and third quarters, contributing to a significant slowing of the rise in unit labor costs.

Staff projections suggested that real GNP might edge up in the fourth quarter at about the same pace as in the third if the strike in the automobile industry were settled by the end of October. On this assumption it appeared likely that the main effects of the strike on business activity would be to hold down inventory accumulation and to keep consumer spending from accelerating very much from the low rate of expansion recorded in the third quarter.

With respect to other sectors, the projections for the fourth quarter contemplated an acceleration of the advance in residential construction outlays that had begun in the third quarter, continued

growth in State and local government expenditures at a rather rapid rate, and declines in business capital investment and defense outlays. Some rebound in over-all economic activity was expected in the first quarter of 1971, but it was anticipated that the rate of expansion would moderate in the second quarter when it was assumed that production and sales lost by the strike would have been largely made up.

The surplus on U.S. foreign trade fell substantially in August from the unusually high level of the previous 2 months. Preliminary estimates indicated that the over-all balance of payments deficit had declined markedly on the liquidity basis from the second to the third quarters--reflecting mainly improvements in private capital flows. On the official settlements basis, however, the deficit remained close to its high second-quarter level as U.S. banks made sizable repayments of their Euro-dollar liabilities to foreign branches. By mid-October several large banks had reduced, or had announced intentions to reduce, such Euro-dollar liabilities by amounts large enough to lower their "reserve-free" bases.[1/]

1/ Amendments by the Board to its Regulations D and M, effective September 4, 1969, had (among other things) placed a 10 per cent reserve requirement on borrowings by member banks from their foreign branches, to the extent that these borrowings exceeded the daily-average amounts outstanding in the 4 weeks ending May 28, 1969. At the same time the Board had provided that the reserve-free base so established would be reduced when and to the extent that the liabilities of any bank to its foreign branches dropped below the original base in any subsequent period used to compute the reserve requirement.

In foreign exchange markets, sterling had strengthened recently, after having been under selling pressure in early September. The rate for the Canadian dollar had declined sharply from its mid-September peak. On the day of this meeting the Bank of France reduced its discount rate from 7-1/2 to 7 per cent.

On October 15 the Treasury auctioned a $2.5 billion issue of tax-anticipation bills due to mature in June 1971. The Treasury was expected to announce on October 22 the terms on which it would refund $7.7 billion of notes maturing November 16. It was anticipated that the Treasury would offer intermediate-term notes in exchange for the maturing securities and that it would engage in a subsequent cash financing to cover attrition and perhaps to raise additional new cash.

System open market operations since the September 15 meeting of the Committee had been directed at promoting some easing of conditions in credit markets and moderate growth in the money stock. Money market conditions varied considerably--tending toward ease in the latter part of September and toward firmness in early October--as a result of unexpectedly wide swings in market factors affecting reserves; but on balance such conditions eased somewhat. Thus, the average rate on Federal funds since the preceding meeting was about 6-1/8 per cent, compared with 6-1/2 per cent in the previous intermeeting period; and member bank borrowings in the 5 weeks ending October 14 averaged about $490 million, $200 million below the average of the previous 4 weeks.

Interest rates on short-term securities and on Treasury notes and bonds also had declined on balance since mid-September, in reflection of the easing of money market conditions, indications of sluggishness in the economy, and the reduction in the prime lending rate of banks--from 8 to 7-1/2 per cent--in the latter part of September. On the day before this meeting the market rate on 3-month Treasury bills was 5.94 per cent, about 40 basis points below its level 5 weeks earlier. Yields on corporate and municipal bonds had changed little over the period, however, in the face of a continuing very heavy flow of new issues.

In September secondary market yields on federally insured residential mortgages again edged down, and the average contract interest rate on new-home mortgages declined for the first time in 2 years. The availability of mortgage funds had continued to improve recently as savings inflows to nonbank thrift institutions remained substantial.

At commercial banks also, inflows of consumer-type time and savings deposits remained substantial in September. Outstanding large-denomination CD's continued to expand at a relatively rapid pace despite reductions in the interest rates offered by banks for such deposits. Private demand deposits and the money stock had increased slightly from August to September, according to the latest published statistics. Growth in the money stock over the third quarter was now estimated to

have been at an annual rate of about 5 per cent,[2] after a tentative allowance for the biases resulting from the accounting procedures employed in connection with certain types of international transactions.

There was a sharp decline during September in business loans at banks, adjusted to include loans that had been sold to affiliates. Growth in bank holdings of U.S. Government securities moderated substantially, but holdings of municipal and Federal agency securities increased markedly further. Banks continued to reduce their reliance on funds obtained from nondeposit sources--both Euro-dollar borrowings and funds obtained through the sale of commercial paper by bank affiliates. The bank credit proxy--daily-average member bank deposits--increased at an annual rate of about 10 per cent in September, after adjustment for changes in nondeposit funds. Over the third quarter the adjusted proxy series expanded at an annual rate of about 17 per cent.

Staff analysis suggested that if money market conditions similar to those recently prevailing were maintained the money stock series, roughly adjusted for the biases related to international transactions, would grow at annual rates of about 4.5 per cent in October and about 5 per cent over the fourth quarter. It appeared that such growth rates for money would be associated with expansion in the adjusted bank credit proxy at an annual rate of about 9 per cent in the quarter.

2/ Calculated on the basis of the daily-average level in the last month of the quarter relative to that in the last month of the preceding quarter.

In the Committee's discussion considerable concern was expressed about the indications of actual and prospective weakness in economic activity, apart from the effects of the auto strike, and about the level to which the unemployment rate had risen. Concern also was voiced about the continuing advances in prices and costs, although some members expressed the view that progress was being made toward controlling inflation.

The Committee agreed that some easing of conditions in credit markets and moderate growth in the money stock--at an annual rate of about 5 per cent in the fourth quarter--remained appropriate as the objectives of policy. As at the previous meeting, some members advocated a somewhat faster growth rate for the money stock, and a few observed that data uncertainties argued for reducing the emphasis placed on a specific growth rate for money. Several members again stressed the desirability of fostering declines in interest rates over coming months in order to encourage needed recovery in residential construction outlays and State and local government spending. It was noted that in the weeks immediately ahead account would have to be taken of "even keel" considerations arising from the forthcoming Treasury financings.

The following current economic 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 increased slightly further

in the third quarter but that employment declined and unemployment continued to rise; activity in the current quarter is being adversely affected by a major strike in the automobile industry. Wage rates generally are continuing to rise at a rapid pace, but improvements in productivity appear to be slowing the increase in costs, and some major price measures are rising less rapidly than before. Most interest rates have declined since mid-September, although yields on corporate and municipal bonds have been sustained by the continuing heavy demands for funds in capital markets. The money supply rose slightly on average in September and increased moderately over the third quarter as a whole. Bank credit expanded further in September but at a rate considerably less than the fast pace of the two preceding months. Banks continued to issue large-denomination CD's at a relatively rapid rate and experienced heavy inflows of consumer-type time and savings funds, while making substantial further reductions in their use of nondeposit sources of funds. The balance of payments deficit on the liquidity basis diminished in the third quarter from the very large second-quarter rate, but the deficit on the official settlements basis remained high as banks repaid Euro-dollar liabilities. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to orderly reduction in the rate of inflation, while encouraging the resumption of sustainable economic growth and the attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee seeks to promote some easing of conditions in credit markets and moderate growth in money and attendant bank credit expansion over the months ahead. System open market operations until the next meeting of the Committee shall be conducted with a view to maintaining bank reserves and money market conditions consistent with those objectives, taking account of the forthcoming Treasury financings.

Votes for this action: Messrs. Burns, Brimmer, Francis, Hickman, Maisel, Mitchell, Robertson, Sherrill, Swan, and Morris. Vote against this action: Mr. Hayes.

Absent and not voting: Messrs. Daane and Heflin. (Mr. Morris voted as Mr. Heflin's alternate.)

In dissenting from this action, Mr. Hayes said that he favored moderate growth in the monetary aggregates--including expansion in money and bank credit at annual rates of about 5 and 9 per cent, respectively, in the fourth quarter--and that he would have no objection to some easing of credit market conditions if that was the natural result of demand factors under such a policy course. As at the two preceding meetings, however, he was concerned about the directive language reading "the Committee seeks to promote some easing of conditions in credit markets," because it implied to him that a persistent push toward lower interest rates was intended, irrespective of market forces. Such a course, in his view, would involve undue risks of rekindling inflationary expectations and of weakening the international position of the dollar.