



FEDERAL RESERVE

press release

For immediate release

September 7, 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 June 8, 1971.

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 June 8, 1971

1. Authority to effect transactions in System Account.

According to revised official estimates, real output of goods and services had increased at an annual rate of 7.1 per cent in the first quarter, somewhat more than preliminary estimates had indicated. The size of the advance was primarily a consequence of the post-strike recovery of production in the automobile industry, and real GNP appeared to be rising at a slower pace in the second quarter.

In May expansion in the labor force exceeded growth in employment, and the unemployment rate edged up further to 6.2 from 6.1 per cent in April. Industrial production, which had increased only a little in March and April, was tentatively estimated to have advanced at a somewhat faster pace in May. According to weekly figures retail sales were about unchanged in May. In April private housing starts remained close to the very high level they had reached in March.

Wholesale prices of industrial commodities, which had risen at a moderate pace in the first quarter and then advanced sharply in April, increased considerably further in May. However, average prices of farm products and foods declined in May, and the over-all wholesale price index rose at a slower pace than in the first 4 months of the year. In April, as in the first quarter, the rate of advance in the

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consumer price index was less than earlier largely because of a decline in mortgage interest costs. Wage rates recently had continued to increase at a rapid pace.

Despite the upward revision in the official estimates of GNP for the first quarter, staff projections continued to suggest that activity would expand at a relatively moderate rate over the rest of 1971. Prospects still favored further large increases in outlays by State and local governments and in expenditures on residential construction. As before, the advance in housing activity was expected to slow as the year progressed; but the projected rates of growth had been increased significantly in light of the recent strength of housing starts, the large volume of outstanding mortgage commitments, and the continued heavy flows of savings funds to nonbank thrift institutions.

On the other hand, it now appeared from various kinds of evidence that business fixed investment outlays would expand little over the second half of the year. The latest Commerce-SEC survey, taken in May, revealed that since February businesses had revised downward their planned spending on new plant and equipment in 1971; and a recent survey by the National Industrial Conference Board indicated that in the first quarter manufacturers had reduced their appropriations for new plant and equipment--the sixth such reduction in the last seven quarters.

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The rate of increase in consumer spending was still expected to moderate considerably in the second quarter--mainly because outlays on new cars were no longer rising sharply in the aftermath of the auto strike--and then to step up somewhat in the second half of the year. It was anticipated that growth in consumer spending during the second half would be sustained in part by the recently enacted increase in social security benefits, including retroactive payments scheduled for late June; by a possible military pay raise around midyear; and by some decline in the personal saving rate. The possibility of a steel strike at the end of July lent an element of uncertainty to the outlook for the rest of 1971. It appeared, however, that if the duration of any such strike were limited to 2 months or less, the effect on the average rate of growth in real GNP in the third and fourth quarters taken together would not be great.

Following the small surplus of the first quarter, U.S. merchandise trade moved into deficit in April as a result of a large increase in imports and an even larger decline in exports. The deficit in the over-all balance of payments, which had been extremely heavy earlier in the year, reached enormous proportions in late April and early May as a consequence of capital outflows in response to expectations of upward revaluations in the exchange rates of the German mark and some other European currencies. Since May 9--when it was announced that the mark and the Dutch guilder would be allowed

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to float for the time being and that the Swiss franc and Austrian schilling were being revalued--there had been some capital flows into Japanese yen and probably also into Euro-dollars. Although the differentials between short-term interest rates in the United States and in major foreign countries had narrowed on balance in April and May, the spread between rates in the United States and those in the Euro-dollar market had been widened by sharp increases in the latter in early May.

In recent weeks the mark had fluctuated in a range up to 4.6 per cent above its par value, and the guilder also had traded beyond its normal margin above par. In the week before this meeting the German Federal Bank had reentered the exchange market, buying marks for dollars at rates above the previous ceiling.

Interest rates on most types of domestic market securities, which had been under upward pressure since mid-March, rose sharply further during much of May. In the third week of the month--against the background of uncertainties in foreign exchange markets, expectations of increased monetary restraint, and continuing heavy demands on capital markets--yields on Treasury and corporate bonds reached new peaks for the year and municipal bond yields held at the highs they had attained in the previous week. Subsequently, however, a rally developed in bond markets and long-term bond yields declined to or below the levels prevailing at the time of the May 11 Committee

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meeting. In contrast, short-term interest rates had advanced further on balance in recent weeks. For example, the market rate on 3-month Treasury bills, at about 4.45 per cent on the day before this meeting, was 60 basis points above the level of 4 weeks earlier.

Interest rates on conventional new-home mortgages declined much less in April than in earlier months of the year, and there were scattered reports of advances during May. Secondary-market yields on federally insured mortgages turned up in late April and rose to a high for the year in early June. Inflows of savings funds at nonbank thrift institutions slowed in May from the exceptionally high rates that had prevailed earlier in the year, but they still were large.

Inflows of consumer-type time and savings deposits at commercial banks continued in May at about the same rate as in April, which was quite high by historical standards but well below the first-quarter pace. The volume of large-denomination CD's outstanding rose in May by about as much as it had declined in April, reflecting to a large extent an increase in holdings of foreign official institutions. Banks lifted their offering rates on such CD's during the month, and holdings of domestic depositors also increased. Business loans outstanding (including loans that had been sold to affiliates) expanded sharply after having changed little in April. While banks continued to add to their investments in securities other than U.S. Government issues, the rate of growth in such holdings slowed further.

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Total bank credit, as measured by the adjusted proxy series-- daily-average member bank deposits, adjusted to include funds from nondeposit sources--increased moderately from April to May, according to preliminary estimates. However, sharp increases were recorded for both the narrow and broader measures of the money stock-- M_1 (private demand deposits plus currency in circulation) and M_2 (M_1 plus commercial bank time deposits other than large-denomination CD's). For all three aggregates, the advance in May was substantially greater than had been expected at the time of the previous meeting of the Committee.

System open market operations had been directed at maintaining prevailing money market conditions in the period immediately following the May 11 meeting, in light of the Treasury financing then in process and the sensitive state of conditions in capital markets. Subsequently, as the atmosphere in capital markets improved and incoming data indicated that the monetary aggregates were expanding significantly faster than had been expected, operations were directed at achieving a gradual firming of money market conditions. The Federal funds rate, which had fluctuated around 4-1/2 per cent early in the period, later moved into a range around 4-3/4 per cent. In the 4 weeks ending June 2 member bank borrowings averaged about \$330 million, compared with about \$150 million in the preceding 4 weeks.

Staff analysis suggested that, if prevailing money market conditions were maintained, M_1 would rise rapidly in June although not so

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rapidly as in May; and that it would expand at an annual rate of about 12 per cent over the second quarter as a whole, following the 9 per cent increase of the first quarter.^{1/} Growth in M_2 and the bank credit proxy, which had been at annual rates of 18 and 11 per cent, respectively in the first quarter, was expected to be somewhat more moderate in the second. As to the third quarter, tentative projections suggested that under prevailing money market conditions M_1 would continue to grow rapidly over the quarter as a whole--at a rate of perhaps 10 or 11 per cent--but that the pace of the expansion would slow as the quarter progressed.

The staff analysis also suggested that, if somewhat firmer money market conditions were attained during coming weeks, the effect on the growth rates of the aggregates in June and over the second quarter as a whole would be slight. It appeared, however, that the rates of increase in the third quarter might be reduced by about 1 percentage point.

In the Committee's discussion considerable concern was expressed about the rapid growth of the monetary aggregates, and the members agreed that it would be desirable to seek somewhat slower growth over coming months than appeared likely to eventuate if prevailing money market conditions were maintained. At the same time, a number of

^{1/} 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.

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members stressed the importance of moving gradually and cautiously in attaining somewhat firmer money market conditions, in order to minimize any resulting upward pressures on long-term interest rates. The Committee agreed that account should be taken of developments in capital markets in the conduct of open market operations.

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 is expanding moderately in the current quarter, following the first-quarter surge that primarily reflected the resumption of higher automobile production. The unemployment rate remained high in May. Wage rates in most sectors are continuing to rise at a rapid pace. In the first four months of 1971 the consumer price index increased at a slower pace than earlier, in considerable part because of a decline in mortgage interest rates; the rate of advance in wholesale prices of industrial commodities, which had moderated in the first quarter, stepped up again in April and May. The money stock both narrowly and broadly defined expanded even more rapidly in May than in April but growth in the bank credit proxy remained moderate. Interest rates on most types of market securities rose sharply further during much of May, reflecting continuing uncertainties about domestic and international financial prospects; more recently rates on long-term securities have declined on balance, but mortgage rates have risen. The U.S. merchandise trade balance, which was in small surplus in the first quarter, worsened in April. The deficit in the over-all balance of payments has diminished since early May, when capital outflows were swollen by expectations of changes in foreign exchange rates, but it remains large. Differentials between short-term interest rates in the United States and in major foreign countries narrowed on balance in April and May, but differentials between rates in the United States and in the Euro-dollar market recently have widened as rates in that market moved up sharply in early May. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive

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to the resumption of sustainable economic growth, while encouraging an orderly reduction in the rate of inflation, moderation of short-term capital outflows, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee seeks to moderate growth in monetary aggregates over the months ahead, taking account of developments in capital markets. System open market operations until the next meeting of the Committee shall be conducted with a view to achieving bank reserve and money market conditions consistent with those objectives.

Votes for this action: Messrs.
Burns, Brimmer, Clay, Daane, Kimbrel,
Maisel, Mayo, Mitchell, Morris,
Robertson, Sherrill, and Treiber.

Votes against this action: None.

Absent and not voting: Mr. Hayes.
(Mr. Treiber voted as his alternate.)

2. Amendment to continuing authority directive.

The Committee amended paragraph 2 of its continuing authority directive to the Federal Reserve Bank of New York with respect to domestic open market operations, to increase the dollar limit on Federal Reserve Bank holdings of short-term certificates of indebtedness purchased directly from the Treasury from \$1 billion to \$2 billion.

With this change, paragraph 2 read as follows:

The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, or, if the New York Reserve Bank is closed, any other Federal Reserve Bank, to purchase directly from the Treasury for its own account (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury; provided that the rate

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charged on such certificates shall be a rate 1/4 of 1 per cent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases, and provided further that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed \$2 billion.

Votes for this action: Messrs.
Burns, Brimmer, Clay, Daane, Kimbrel,
Maisel, Mayo, Mitchell, Morris,
Robertson, Sherrill, and Treiber.

Votes against this action: None.

Absent and not voting: Mr. Hayes.
(Mr. Treiber voted as his alternate.)

This action was taken on recommendation of the System Account Manager, who advised that an expected sharp decline in the Treasury's cash balances in the period before the mid-June tax-payment date probably would necessitate temporary borrowing from the System, and that the Treasury's needs might well exceed the existing \$1 billion limit on such borrowing. It was anticipated that the \$1 billion limit would be restored at the next meeting of the Committee.