



FEDERAL RESERVE

press release

For immediate release

February 7, 1972

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached records of policy actions taken by the Federal Open Market Committee at its meetings on November 16 and December 14, 1971. These records will be published in the Board's Annual Report for 1971 and in the Federal Reserve Bulletin. 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 meetings, rather than on data as they may have been revised since then.

Attachments

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on December 14, 1971

1. Authority to effect transactions in System Account.

The latest estimates of the Commerce Department indicated that real output of goods and services had risen at an annual rate of about 4 per cent in the third quarter of 1971 despite the sharp cut in inventory investment associated with elimination of the steel strike threat on August 1. It appeared that real GNP was increasing at a more rapid rate in the fourth quarter--mainly because of an upturn in inventory investment and a greater gain in the real volume of consumer spending--and that prices were rising at a relatively slow pace from the third to the fourth quarter. Staff projections suggested that the faster rate of growth in real GNP would be sustained in the first half of 1972.

In November industrial production rose substantially further, reflecting gains in output for both finished goods and materials in addition to expansion in coal mining after the strike settlement in midmonth. Nonfarm payroll employment advanced moderately, but the unemployment rate rose from 5.8 to 6.0 per cent as growth in the civilian labor force picked up again after having slowed in October. Contrary to earlier indications, it now appeared that total retail sales had declined in October, but early estimates for November

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suggested an upturn despite some slackening in sales of new automobiles.

Industrial commodity prices and average hourly earnings in manufacturing changed little from October to November. During the period of the 90-day freeze--mid-August to mid-November--the rate of increase in prices and wages was sharply lower than earlier in the year. In late November and early December, after the freeze ended, the Price Commission received requests for increases from many of the companies required to obtain prior approval. Some requests were granted in full and some in part, and others were held in abeyance pending receipt of additional information. Thus far the Pay Board had announced only a few decisions under the post-freeze guidelines.

The latest staff projections for the first half of 1972 were generally similar to those of 4 weeks earlier, although--in line with recent surveys of business spending intentions--the projected rise in business capital outlays had been revised upward somewhat. As before, it was anticipated that the rate of expansion in consumer spending would remain substantial, reflecting reductions in taxes and assumed increases in social security benefits as well as gains in wage and salary payments; that State and local government expenditures would continue to grow rapidly; that residential construction would advance moderately; and that business inventory investment would increase further.

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The flow of U.S. merchandise trade declined sharply in October, after having accelerated in September in anticipation of the strike at East Coast and Gulf ports that began on October 1. The decline--like the earlier rise--was greater for exports than for imports. Moreover, exports in October were adversely affected by the coal strike, and they benefited less than imports from the resumption of work at West Coast ports. Consequently, the trade surplus that had emerged in September was succeeded in October by a deficit of record proportions.

In foreign exchange markets attitudes had been influenced in recent weeks by the introduction of legislation that would give the President authority to change the dollar price of gold and by reports of progress in international negotiations at the Rome meeting of the Group of Ten. These developments were interpreted as enhancing prospects for a near-term realignment of exchange rates in which most major currencies would appreciate further against the dollar. As a consequence, outflows of short-term capital from the United States were substantial in late November and early December. Official reserves of some countries increased considerably and market exchange rates for most major currencies appreciated against the dollar. Another meeting of the Group of Ten was scheduled to begin in Washington on December 17.

In domestic financial markets, interest rates on long-term bonds and on Treasury bills rose in late November, but they turned

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down again in early December and by midmonth they were close to or below the levels of 4 weeks earlier. In capital markets dealers' inventories of U.S. Government securities increased sharply following the Treasury's mid-November financing--which included a pre-refunding of issues maturing in May and August 1972--and the volume of new offerings of corporate and State and local government bonds rose moderately from October to November. These developments contributed to the upward pressures on bond yields in late November, but thereafter markets were strengthened by reports of progress at the Group of Ten meeting in Rome and by Federal Reserve purchases of Treasury coupon issues for System account and for foreign official accounts.

The rise in Treasury bill rates in late November was related in part to a large issue of tax-anticipation bills, and the subsequent decline to a sharp expansion in demands for bills by the foreign central banks experiencing gains in reserves. The market rate on 3-month bills was about 3.95 per cent on the day before this meeting of the Committee, compared with 4.15 per cent 4 weeks earlier. Federal Reserve discount rates, which had been reduced 1/4 of a percentage point in mid-November, were lowered by an additional 1/4 of a point, to 4-1/2 per cent, at four Reserve Banks effective December 13.

Yields in the secondary market for federally insured mortgages apparently declined further in November. According to

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preliminary estimates, inflows of savings to nonbank thrift institutions continued to slow.

At commercial banks, business loans declined somewhat in November, and total loans advanced relatively little even though real estate and consumer loans continued to expand rapidly. Banks increased their holdings of securities.

The narrowly defined money stock (private demand deposits plus currency in circulation, or M_1) changed little from October to November and had not grown on balance since August. The broader measure of money (M_1 plus commercial bank time deposits other than large-denomination CD's, or M_2) continued to expand at a moderate rate, however, as inflows of consumer-type time and savings deposits remained rapid. Growth in the adjusted bank credit proxy--daily-average member bank deposits, adjusted to include funds from nondeposit sources--rose sharply, reflecting expansion in U.S. Government deposits and in nondeposit liabilities. Owing in part to the weakness in business loan demands, banks had reduced offering rates on large-denomination CD's in September and October, and the average volume of such CD's outstanding declined in November.

System open market operations in the period since the last meeting of the Committee had been directed at achieving a further gradual relaxation of money market conditions, with cognizance being taken of the behavior of the monetary aggregates, particularly the

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continuing lack of growth in M_1 . Operations were complicated in late November by an unanticipated shortfall in nonborrowed reserves, and the Federal funds rate and member bank borrowings increased temporarily. At the time of this meeting the funds rate was about 4-3/8 per cent, down from the level of about 4-3/4 per cent prevailing shortly before the preceding meeting. In the 4 weeks ending December 8, borrowings averaged about \$395 million, compared with about \$270 million in the preceding 4 weeks.

Staff analysis suggested that an easing of money market conditions during coming weeks probably would be required if M_1 were to expand at moderate rates in December and January, and that such easing would be associated with some step-up in the rate of growth in M_2 . It was noted, however, that the outlook for the monetary aggregates was particularly uncertain at this time because of factors related to possible international flows of funds. It appeared likely that an agreement on new exchange rates in the current negotiations would stimulate reflows of funds from abroad, which in turn could have substantial--if perhaps temporary--effects on the monetary aggregates. However, the size and timing of any such reflows could not be foreseen with assurance. In addition, there was considerable uncertainty about the extent to which recent amendments to regulations of the Office of Foreign Direct Investment would delay the usual year-end corporate repatriation of liquid funds.

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In the Committee's discussion a number of members expressed the view that more aggressive actions to stimulate monetary growth were needed at this time in the interest of fostering the desired expansion of economic activity and employment. In their judgment the risk of rekindling inflationary pressures and expectations by such actions was considerably less now than it had been earlier in the year. Considerable concern was expressed about the persistent weakness of key monetary aggregates despite the progressive easing of money market conditions in recent months. Reference was made in this connection not only to the absence of net growth in M_1 since August but also to the low average rate of increase in total member bank reserves during that period.

Other members, while agreeing that it would be desirable to promote adequate growth in the aggregates over coming months, advocated more cautious and gradual measures. They noted that the rate of increase in M_1 had been very high in the first 7 months of the year, and they expressed concern about unduly aggressive action to ease money market conditions at this time in part because of the risk that such action might generate excessive rates of monetary growth in the near future. They also suggested that substantial weight should be given to the behavior of other key aggregates, noting in this connection that M_2 and the bank credit proxy had been expanding more rapidly than M_1 in recent months.

At the conclusion of the discussion the Committee agreed that open market operations should be directed at promoting the degree of ease in bank reserve and money market conditions essential to greater growth in monetary aggregates over the months ahead. 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 increasing more rapidly in the current quarter than it had in the third quarter, but the unemployment rate remains high. Increases in prices and wages were effectively limited by the 90-day freeze, which ended in mid-November. Since then some wage and price increases have occurred, but other increases requested have been cut back or not approved by the Pay Board and the Price Commission. The narrowly defined money stock changed little in November and has not grown on balance since August. Inflows of consumer-type time and savings deposits to banks remained rapid in November and the broadly defined money stock continued to increase moderately. Expansion in the bank credit proxy stepped up as U.S. Government deposits and nondeposit liabilities increased on average. After advancing in the latter part of November, most market interest rates have been declining recently, and discount rates at four Federal Reserve Banks were reduced by an additional one-quarter of a percentage point. The U.S. foreign trade balance was heavily in deficit in October. In recent weeks net outflows of short-term capital apparently have been substantial, market exchange rates for foreign currencies against the dollar on average have risen further, and official reserve holdings of some countries have increased considerably. In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions consistent with the aims of the new governmental program, including sustainable real economic growth and increased employment, abatement of inflationary pressures, and attainment of reasonable equilibrium in the country's balance of payments.

To implement this policy, the Committee seeks to promote the degree of ease in bank reserve and money market conditions essential to greater growth in monetary aggregates over the months ahead.

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Votes for this action: Messrs. Burns, Hayes, Brimmer, Clay, Daane, Kimbrel, Maisel, Mayo, Mitchell, Morris, and Robertson. Votes against this action: None.

Subsequent to this meeting, on December 20, 1971, Committee members voted unanimously to amend this current economic policy directive by adding the clause "while taking account of international developments" at the end of the final sentence. As amended, that sentence read as follows:

To implement this policy, the Committee seeks to promote the degree of ease in bank reserve and money market conditions essential to greater growth in monetary aggregates over the months ahead, while taking account of international developments.

This action was taken following the announcement that agreement regarding exchange rates and related matters had been reached on December 18 at the Group of Ten meeting in Washington. The Manager had advised that, if the agreement was followed by substantial reflows of funds to the United States, considerable flexibility in open market operations might be required to cope with the resulting churning in domestic financial markets. The members decided that the directive should be amended to affirm the Committee's intention to authorize the operations that might be needed.

2. Action with respect to continuing authority directive.

On December 23, 1971, a majority of Committee members voted to suspend, until close of business on the day of the next meeting of the

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Committee, the lower limit (set forth in paragraph 1(c) of the continuing authority directive with respect to domestic open market operations) on interest rates on repurchase agreements arranged by the Federal Reserve Bank of New York with nonbank dealers. The suspended provision specified that such repurchase agreements were to be made "at rates not less than (1) the discount rate of the Federal Reserve Bank of New York at the time such agreement is entered into, or (2) the average issuing rate on the most recent issue of 3-month Treasury bills, whichever is the lower."

This action was taken after the Manager had advised that occasions might arise in the next few weeks when it would be desirable to make fairly extensive use of repurchase agreements in order to supply reserves on a flexible temporary basis, in anticipation of possible large-scale sales of U.S. Treasury bills by foreign central banks; and that in light of prevailing costs of funds to dealers it was doubtful that the New York Reserve Bank would be able to arrange repurchase agreements in any significant volume under existing rate limitations. It was understood that the authority to make repurchase agreements at rates lower than those authorized previously would be used sparingly, and only as deemed necessary to accomplish Committee objectives; and that rates below 3-5/8 per cent would not be employed without prior notification to the Committee.

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Votes for this action: Messrs.
Brimmer, Clay, Daane, Kimbrel, Maisel,
Mayo, Mitchell, Morris, and Treiber.
Vote against this action: Mr. Robertson.

Unavailable and not voting: Messrs.
Burns and Hayes. (Mr. Treiber voted as
alternate for Mr. Hayes.)

Mr. Robertson dissented from this action because he believed that the desired injection of funds into the market by the Federal Reserve should be through the outright purchase of U.S. Government securities rather than through repurchase transactions which, in his judgment, actually constituted low-rate loans to securities dealers. He indicated that he was reluctant to increase the profits of dealers by providing them with low-cost Federal Reserve funds merely to avoid temporarily raising the price (lowering the yield) of Treasury securities by purchasing them outright.