FEDERAL RESERVE

press release

For immediate release December 18, 1972

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 September 19, 1972.

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

CONFIDENTIAL (FR)

# RECORD OF POLICY ACTIONS
# OF THE FEDERAL OPEN MARKET COMMITTEE

## Meeting held on September 19, 1972

### Current economic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the third quarter would be substantial although well below the annual rate of 9.4 per cent recorded in the second quarter. Growth was expected to be more rapid in the fourth quarter than in the third and to remain at a fast pace in the first half of 1973.

In August retail sales continued to expand, according to the advance report, and they were substantially greater than the monthly average in the second quarter. Industrial production rose moderately, after having increased little in June and July; part of the gain was attributable to recovery from the effects of tropical storm Agnes. Nonfarm payroll employment, which had been adversely affected by strikes as well as by the storm, rose appreciably in August. Reflecting a large increase in the labor force as well as in employment, the unemployment rate--at 5.6 per cent--was essentially unchanged from the rate in June and July.

The advance in hourly earnings of production workers on private nonfarm payrolls in August, as in July, was moderately faster than in the second quarter. The rise in wholesale prices of farm products and foods remained rapid, and the advance in prices of industrial commodities, which had slowed in July, resumed the somewhat faster pace of earlier months this year. In July the increase in the consumer price index was larger than in the immediately preceding months, chiefly because of a sharp rise in retail prices of foods.

Staff projections continued to suggest that expansion in consumption expenditures would be strong in the fourth quarter, in part because of the 20 per cent increase in social security benefits scheduled to begin in early October. It was also anticipated that growth in State and local government purchases of goods and services would be raised by enactment of Federal revenue sharing; that business fixed investment would continue to increase, in line with recent surveys; that residential construction would level off; and that, in response to sustained expansion in final takings of goods, inventory investment would rise appreciably further.

Foreign exchange markets had remained relatively quiet since mid-August. An increase in short-term interest rates in the United States relative to those in other major countries had contributed to a further strengthening of the dollar against major European currencies, and central bank reserves of most industrial countries had continued to change little. In July both U.S.

merchandise imports and exports increased, and the trade deficit was virtually unchanged from the high level of the two preceding months.

Market interest rates generally advanced in the interval between the August and September meetings of the Committee. Increases in rates were significantly larger for short-term than for long-term securities and were greatest for Treasury bills. Bill rates had been unusually low relative to other short-term rates, reflecting mainly demands for bills associated with foreign central bank acquisitions of dollars and with the absence of a short-term issue in the Treasury's August refunding. In the inter-meeting period, however, foreign central banks sold bills on balance, and Treasury financing operations added to the market supply of bills. The impact of the change in supply-demand relationships was magnified when a firming in money market conditions just before the Labor Day weekend strengthened market expectations of further increases in interest rates in an environment of strong economic expansion. On the day before this meeting the market rate on 3-month bills was 4.65 per cent, compared with 3.87 per cent on the day before the August meeting.

In markets for long-term securities, increases in rates were greater for Treasury issues than for other securities, chiefly because the rise in short-term rates induced dealers to reduce their inventories of the new longer-term issues acquired in the Treasury's August refunding. The volume of new publicly issued corporate bonds had declined moderately from July to August, and a large decline appeared in prospect for September. While the volume of new State and local government bonds had increased somewhat in August, it appeared likely to decline again in September.

Contract interest rates on conventional new-home mortgages and yields in the secondary market for Federally insured mortgages were stable from July to August. Inflows of savings to nonbank thrift institutions slowed from the rapid rates in June and July.

At commercial banks, outstanding business loans increased sharply further in August, and real estate and consumer loans continued to expand rapidly. Banks again reduced their holdings of U.S. Government securities--as the Treasury's net borrowing demands remained smaller than customary for that season of the year--but they increased their holdings of other securities. Late in the month, in response to the strength in loan demands and to increases in short-term market rates of interest, most banks raised their prime rates from 5-1/4 to 5-1/2 per cent.

Growth in the narrowly defined money stock ($M_1$),[1/] which was rapid in July following relatively slow growth on the average

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1/ Private demand deposits plus currency in circulation.

in May and June, fell back in August. Expansion in the more broadly defined money stock ($M_2$)[2/] and in the bank credit proxy[3/] also slowed, despite substantial increases in consumer-type time and savings deposits and in the oustanding volume of large-denomination CD's. In late August and early September, however, the money stock grew more rapidly than it had on the average in August.

System open market operations in the period since the August 15 meeting had been guided by the Committee's objective of fostering growth in reserves available to support private nonbank deposits (RPD's) at an annual rate of between 5 and 9 per cent in the August-September period, subject to the proviso that money market conditions should not be permitted to firm markedly. Pursuit of the RPD target was complicated by the need to absorb reserves at a time when the market supply of Treasury bills was increasing. Early in the period, RPD's--and the monetary aggregates--appeared to be expanding rapidly. As the System acted to restrain growth in reserves, short-term interest rates began to rise sharply and financial markets became increasingly sensitive; this was especially evident just before the Labor Day weekend when a number of banks misjudged their reserve needs and bid the Federal funds rate up as high as

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

3/ Daily-average member bank deposits, adjusted to include funds from nondeposit sources.

5-1/2 per cent. In order to avoid a marked firming in money market conditions and unduly sharp increases in interest rates, for a time the System supplied reserves more generously.

At the time of this meeting it appeared that growth in RPD's would be quite rapid in September, and that the average rate of growth in the August-September period would exceed the upper limit of the target range by a significant amount. However, most of the overage evidently would reflect a temporary increase in excess reserves--and member bank borrowings--around the Labor Day weekend. Apart from the rise in excess reserves, growth in RPD's appeared to be at about the upper limit of the target range. The Federal funds rate, which had been around 4-3/4 per cent at the time of the preceding meeting, currently was about 5 per cent. In the 5 weeks ending September 13 member bank borrowings averaged about $440 million, compared with about $250 million in the preceding 4 weeks.

The Committee agreed that the economic situation called for growth in the monetary aggregates in coming months at rates less rapid than those that now appeared likely to be recorded for the third quarter. At the same time, the members noted that conditions in financial markets were still highly sensitive. They also noted that the prospective relationships among bank reserves, monetary aggregates, and money market conditions were more than usually uncertain because of the difficulties of forecasting the behavior of banks during the period of adjustment to the amendments to Regulations D and J that were scheduled to become effective September 21, 1972. The situation was further complicated by uncertainty as to whether implementation of the regulatory actions would be delayed as a consequence of certain court proceedings currently under way.

The Committee took note of a staff analysis suggesting that an average rate of expansion in RPD's in September and October in a range equivalent to 9.5 to 13.5 per cent[4/] would be likely to lead to more moderate growth in monetary aggregates over the months ahead. The members decided to seek an RPD growth rate in that range--preferably, in the lower part--unless disturbances arose in financial markets or unless growth rates in the monetary aggregates appeared to be falling far short of expectations. In view of the sensitive state of financial markets and the uncertainties associated with Regulations D and J, they also decided that the System Account Manager should have more than the usual degree of discretion in making operating decisions and that he should give

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4/ The RPD range originally considered by the Committee incorporated adjustments for the estimated effects that the scheduled changes in the Board's Regulations D and J would have on the prospective relationship between growth rates in RPD's and in the monetary aggregates. However, it was agreed that those adjustments would be inappropriate if there were a delay in implementing the changes, and since such a delay in fact occurred, the adjustments are omitted in the figures cited.

more than customary attention to money market conditions, while continuing to avoid marked changes in such conditions. It was agreed that account also should be taken of international financial developments, and it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if it appeared that the Committee's objectives and constraints were not being met satisfactorily.

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

> The information reviewed at this meeting suggests a substantial increase in real output of goods and services in the current quarter, although well below the unusually large rise recorded in the second quarter. In July and August, wages and prices advanced somewhat more rapidly on balance than in the immediately preceding months, while the unemployment rate remained substantial. Foreign exchange market conditions have remained quiet in recent weeks and the central bank reserves of most industrial countries have continued to change little. In July, the large excess of U.S. merchandise imports over exports persisted.
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> In August on average, growth slowed in the narrowly and broadly defined money stock and in the bank credit proxy, but in recent weeks the money stock has been expanding more strongly. Since mid-August, interest rates on Treasury bills have increased sharply, while yields on most other market securities have advanced more moderately.
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> In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions conducive to sustainable real economic growth and increased employment, abatement of inflationay pressures, and attainment of reasonable equilibrium in the country's balance of payments.

> To implement this policy, while taking special account of the effects of possible bank regulatory changes, developments in credit markets, and international developments, the Committee seeks to achieve bank reserve and money market conditions that will support more moderate growth in monetary aggregates over the months ahead.

> Votes for this action: Messrs. Burns, Hayes, Brimmer, Bucher, Coldwell, Daane, Eastburn, Mayo, Mitchell, and Sheehan. Votes against this action: Messrs. MacLaury and Robertson.
> Absent and not voting: Mr. Winn. (Mr. Mayo voted as Mr. Winn's alternate.)

Mr. MacLaury dissented from this action because he had become increasingly disturbed by the rapid rates of growth in the aggregates, given the prospective strength of the economy, and he felt that the Committee's current operating procedures did not assure that money market conditions would be permitted to tighten sufficiently to slow this excessive monetary growth in the near future.

Mr. Robertson dissented because of his belief that with the existing potentiality for increased inflationary pressures, the Committee was not doing enough to curb the rate at which reserves were being fed into the banking system by the Federal Reserve and to slow down the rate of growth in the monetary aggregates. In his view, the failure to do so might result in a new groundswell of inflation later on.