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 17, 1977.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting 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 solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on May 17, 1977

Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services--which had increased at an annual rate of 5.2 per cent in the first quarter, according to preliminary estimates of the Commerce Department--was expanding at a rapid pace in the current quarter. The rise in average prices--as measured by the fixed-weighted price index for gross domestic business product--appeared to have slowed somewhat from the annual rate of 6.8 per cent estimated for the first quarter.

According to staff estimates, real output was growing at a significantly faster pace in the current quarter than had been projected a month earlier. It now appeared that the expansion in consumer purchases of goods and services would be considerably stronger than had been anticipated, although still not so strong as in the first quarter; that the gain in business fixed investment would be larger than had been expected and that the recovery in net exports of goods and services would be greater, following a much larger decline in the first quarter than had been estimated a month ago.

The staff projections for the second half of 1977 differed little from those made just before the previous meeting, which had incorporated assumptions about Federal fiscal measures that were later enacted or funded. Specifically, the assumptions included the increase in the standard deduction for personal income taxes passed by the Congress on May 16 and the expansion in outlays for public service employment, for local public works, and for countercyclical revenue sharing.

Growth in real GNP for the second half was projected to be substantial, although not so rapid as in the second quarter. It was anticipated that increases in Federal purchases of goods and services would be larger; that expansion of business investment would remain relatively strong; and that investment in inventories would accelerate. At the same time, however, it was expected that growth in consumption expenditures would slow somewhat further; that the pace of the expansion in residential construction would moderate; and that net exports of goods and services would change relatively little from the second-quarter level.

In April, expansion in economic activity remained vigorous. Industrial production rose by 0.8 per cent, following a gain of

1.4 per cent in March. Relatively large increases in output were widespread among both final products and materials. However, assemblies of automobiles declined somewhat, both because of strikes at a few motor vehicle plants and because of efforts to reduce the excessive inventories of small-model cars.

The rate of capacity utilization in April remained at 82 per cent for manufacturing as a whole and increased from 81 to 82 per cent for the materials-producing industries. These utilization rates were about 6 and 10 percentage points, respectively, below the peaks in the previous business expansion, when capacity constraints in a number of materials-producing industries limited growth in output and contributed to upward pressures on prices.

The number of private housing units started in April had not been made public by the time of this meeting. In March, as reported just before the last meeting, starts had risen sharply further to an annual rate of about 2.1 million units--the highest rate in nearly 4 years. For the first quarter as a whole, starts were about the same as for the fourth quarter of 1976 and more than one-tenth above the total for the third quarter.

Sales of new and existing homes combined remained vigorous in March, and nonbank thrift institutions continued to supply a substantial volume of mortgage credit with little change in interest rates, despite reduced inflows of deposits.

Developments in labor markets continued to reflect the strength in economic activity. Payroll employment in nonfarm establishments expanded considerably in April, after a sharp rise in March; the increase since December--amounting to 1.3 million persons--was unusually large for a 4-month period. The unemployment rate declined further in April, by 0.3 of a percentage point, to 7.0 per cent. During the second half of 1976 the rate had fluctuated between 7.8 and 8.0 per cent.

Growth in total personal income accelerated to an annual rate of 20 per cent in March from about 17 per cent in February, reflecting in large measure faster expansion in private wage and salary payments. The employment statistics suggested that wage and salary payments continued to grow in April, although at a less rapid pace than in the two preceding months.

Consumer demands remained strong. In April total retail sales held at the advanced level reached in March and were 2-1/4 per cent above the monthly average for the first quarter. Sales of new automobiles declined somewhat, after having surged upward in March. However, sales of other consumer items rose by about 1 per cent, equaling the gain in the preceding month.

New orders for nondefense capital goods rose as much in March as they had declined in February, and for the first quarter as a whole they were up about 6 per cent from the preceding quarter. Unfilled orders for such goods edged up during the first quarter. Contract awards for commercial and industrial buildings--measured in terms of floor space--shot upward in March, and the total for the first quarter was 8-1/2 per cent above that for the preceding quarter. A private survey, conducted in late March and early April, indicated that businesses were planning to spend significantly more for plant and equipment in 1977 than had been shown by surveys taken in February and in the autumn of 1976.

The index of average hourly earnings for private nonfarm production workers rose at an annual rate of 6.8 per cent in April, about the same as the average increase during 1976; over the first quarter the rise had accelerated to a rate of 7.3 per cent, in large part because of an increase in the minimum wage at the beginning of 1977. Major collective bargaining settlements in the first quarter provided for first-year increases in wages averaging 7.6 per cent, compared with an average of 8.4 per cent for the first-year adjustments under contracts negotiated during 1976. However, compensation per hour for all persons in the nonfarm business sector of the economy rose at an annual rate of about 10 per cent in the first quarter, up from 7 per cent in the preceding quarter and from an average of about 8 per cent over the four quarters of 1976. The rise reflected not only the increase in the minimum wage but also an increase in taxes on employers for social security and unemployment insurance.

The wholesale price index rose 1.1 per cent in April, marking the third consecutive month of increases of about 1.0 per cent. The index had risen 0.5 per cent on the average during the 6 months ending in January. The acceleration in the latest 3 months was attributable to sharp increases in prices of farm products and foods. At the same time, however, there were sizable advances among industrial commodities; the average for such commodities rose 2.0 per cent over the 3-month period.

The consumer price index increased 0.6 per cent in March--less than in January and February but still somewhat more than the average during the second half of 1976. In March price increases averaged 0.6 per cent for foods, 0.4 per cent for nonfood commodities, and 0.8 per cent for services.

The average value of the dollar against leading foreign currencies changed little on balance over the inter-meeting period. The dollar rose against the Japanese yen, but it declined against the currencies associated in the European "snake" arrangement. The change in the dollar/yen rate reflected a sharp decline in short-term interest rates in Japan and market reaction to a decision by the U.S. Customs Court requiring the imposition of countervailing duties on imports of electronic products from Japan. Despite its recent weakening, the yen was nearly 6 per cent higher against the dollar than it had been at the end of 1976.

The U.S. foreign trade deficit, already large in January and February, was still larger in March. The deficit for the first quarter as a whole was almost twice that for the final quarter of 1976, as imports rose 10 per cent and exports were virtually unchanged. Among imports, increases in the first quarter were largest for fuels, foods, automobiles from Canada, and consumer durable goods other than autos. The net outflow on bank-reported capital transactions declined sharply in the first quarter.

At U.S. banks, growth in total credit accelerated during April from the already brisk pace of the first quarter. All major loan categories expanded significantly further, and holdings of tax-exempt securities increased sharply for the first time since November. A sizable part of bank acquisitions of such securities consisted of tax-anticipation notes--particularly those issued by New York State--but banks in most areas of the country increased their holdings of long- as well as of short-term municipal issues. Bank holdings of U.S. Government securities declined.

In April the strength in business credit at banks was concentrated at smaller institutions. The relative weakness of business loan demand at large banks apparently reflected a preference of large corporations to cover their increased requirements for short-term financing at the lower interest costs prevailing in the commercial paper market. As a result, commercial paper issued by such corporations rose by the largest amount in 2-1/2 years.

Growth in the narrowly defined money stock (M-1) accelerated to a record annual rate of nearly 20 per cent in April. Temporary influences contributed to this rapid growth, and data for early May indicated some shrinkage in money balances. In addition, however, the rapid expansion in economic activity appeared to have been raising transactions demands for money. Over the 12 months ending in April, M-1 grew about 6-1/2 per cent.

Inflows of the time and savings deposits included in M-2 and M-3 continued to moderate in April. However, the large increase in M-1 produced a marked acceleration of growth in the broader aggregates in that month. Over the 12 months ending in April, M-2 grew about 10-1/2 per cent and M-3 about 12-1/4 per cent.

At its April meeting the Committee had decided that growth in M-1 and M-2 in the April-May period at annual rates within ranges of 6 to 10 per cent and 8 to 12 per cent, respectively, would be appropriate. It had judged that these growth rates were likely to be associated with a weekly-average Federal funds rate of about 4-3/4 per cent. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4-1/2 to 5-1/4 per cent.

Data that had become available in the days immediately after the April meeting suggested that over the April-May period both M-1 and M-2 would grow at rates well within their specified ranges, although it appeared that growth in April would be strong. Accordingly, the Manager of the System Open Market Account sought to maintain the Federal funds rate at about 4-3/4 per cent or a shade higher. By late April, however, incoming data suggested that over the 2-month period M-1 was likely to grow at a rate considerably above the upper limit of its specified range and that M-2 was likely to grow at a rate close to the midpoint of its range. In those circumstances System operations in late April and early May were conducted with a view to raising the Federal funds rate toward 5-1/4 per cent, the upper limit of its specified range.

On May 6 the Committee voted to increase the upper limit of the range for the Federal funds rate from 5-1/4 to 5-1/2 per cent, with the understanding that the Manager would use the additional leeway only if new data becoming available before May 17, the date for this meeting, suggested that the aggregates were strengthening significantly further on balance. Such additional strength did not develop in that period, and the Manager continued to aim for a funds rate of around 5-1/4 per cent. In the final days of the period, the rate actually fluctuated between 5-1/4 and 5-3/8 per cent.

Short-term market interest rates rose generally by 1/2 to 5/8 of a percentage point during the inter-meeting period. The rate on 3-month commercial paper rose from 4-3/4 to 5-3/8 per cent, and near the end of the period most major banks increased their prime interest rate on business loans from 6-1/4 to 6-1/2 per cent. Upward pressures on short-term rates were tempered by a significant reduction during the period in the outstanding volume of Treasury bills.

Yields also rose somewhat in the longer-term markets, but--as in the short-term markets--upward pressures were moderated by Treasury operations. In its mid-May refinancing the Treasury reduced its outstanding debt by about $400 million. Moreover, it announced that it planned to reduce the debt by an additional

$450 million when $2.0 billion of 2-year notes matured later in the month.

In the corporate bond market, rate pressures were tempered by a significant drop in public offerings of new issues in April. Private placements of corporate issues were estimated to have remained large, but insurance companies continued to bid aggressively for privately placed securities. Bond offerings by State and local governments also were large in April.

Net mortgage lending during the first quarter of 1977 was near the record rate of the previous quarter, and the volume apparently remained large in April. Issues of GNMA-guaranteed, mortgage-backed securities in April were close to the strong pace of the first quarter, and mortgage loans outstanding at commercial banks also continued to grow at a rapid rate. In March, the latest month for which data were available, mortgage commitments outstanding at savings and loan associations rose further to another new high. Average interest rates on new commitments for conventional home mortgages continued to edge higher in April, and yields in the secondary mortgage market for FHA/VA loans changed little on balance over the month.

It appeared likely that the Treasury would be able to make additional reductions in the volume of bills outstanding over the rest of the current quarter but that it would need to raise a large volume of new money later in the year. At the same time, business demands for credit--especially for short-term credit--were expected to remain relatively large as a result of continuing improvement in economic activity. Projections of consumer expenditures implied a sustained high rate of growth in consumer credit and mortgage debt.

At its April meeting the Committee had agreed that from the first quarter of 1977 to the first quarter of 1978 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: M-1, 4-1/2 to 6-1/2 per cent; M-2, 7 to 9-1/2 per cent; and M-3, 8-1/2 to 11 per cent. The associated range for growth in the bank credit proxy was 7 to 10 per cent. It was agreed that the longer-term ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It also was understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for annual periods.

With respect to the economic situation and outlook, members of the Committee generally were of the view that the expansion in business activity was quite strong. In particular, they expected over-all growth to remain substantial for a number of quarters ahead.

While not disagreeing with that view, a few members indicated that they would not exclude the possibility that growth in output would prove to be slower than generally expected. Two of these members focused on the possibility that a slowing of growth in consumption expenditures might be accompanied by inadequate expansion in other sectors. Specifically, it was suggested that substantial increases in business investment in fixed capital and inventories were not assured in the current business expansion, which was now in its third year and rather old by historical standards. It was also noted in this context that, according to statistics released a day or two ago, the level of inventories at the end of March had been higher than assumed, and that in the spring of 1976 inventory demands had weakened rather promptly after the rise in retail sales had slowed. One member expressed concern that inventory demands might be unsustainably high in the quarters immediately ahead, leading first to relatively rapid growth in over-all activity and then to a slowing down.

Other members felt that if anything the probabilities favored expansion at a faster rather than at a slower rate than generally expected. It was suggested that business confidence in the outlook for economic activity appeared to have increased considerably. One member expressed the opinion that there was nothing particularly abnormal about the current business expansion, despite the pick-up in the rate of increase in prices and the existence of various uncertainties.

The recent acceleration in the rate of price rise was a source of concern. One member remarked that the sustainability of the expansion could be threatened by intensified upward pressures on labor costs and prices. The observation was made that the administration's proposals for increases in social security taxes on employers beginning in 1979 would raise unit labor costs substantially. It was felt that the prospects of such increases--especially in conjunction with certain features of the proposed energy policy--had contributed to business uncertainties.

It was reported in the discussion that there had been a considerable volume of speculation in real estate in some parts of the country, accompanied by rapidly rising prices. While speculation was described as being greatest in residential properties on the West Coast--with turnovers at rising prices financed by credit from banks and savings and loan associations--it was also reported to be occurring in farm land in some other areas of the country. It was observed that, heretofore, the present business expansion had been free of the sort of speculation that had the potential to cause problems later on.

As to policy for the period immediately ahead, members of the Committee thought that relatively slow growth in monetary aggregates over the May-June period would be appropriate in order to compensate at least in part for the exceptionally rapid growth in April. In considering the ranges of growth to be specified for the 2-month period, they took account of a staff analysis that suggested that the extremely large expansion in M-1 in April appeared to have raised the money stock sufficiently to accommodate much of the public's need for additional transactions balances in the second quarter and, consequently, that monetary growth was likely to be slow.

The members did not differ a great deal in their preferences for ranges of growth in the monetary aggregates over the May-June period. For M-1, most of them favored a range of 0 to 4 per cent for the annual rate of growth over the 2-month period. Some sentiment was expressed for slightly different ranges: -1 to 4 per cent, 0 to 5 per cent, and 1 to 5 per cent. For M-2, most members favored a range of either 3 to 7 per cent or 4 to 8 per cent, but those who favored the wider ranges for M-1 preferred comparably wider ranges for M-2.

Differences of view were somewhat greater concerning the Federal funds rate, and they turned in large part on the degree of leeway that should be provided for operations during the inter-meeting period in the event that the aggregates appeared to be deviating significantly from the midpoints of the specified ranges. In view of the rapid monetary growth in April, several members suggested that it would be desirable in the coming period to avoid any significant decline in the weekly-average Federal funds rate from its current level of 5-1/4 to 5-3/8 per cent even if growth in the aggregates appeared to be significantly below the midpoints of the specified ranges. Other members were prepared to accept a decline in the funds rate to 5 per cent under those circumstances.

Most Committee members did not wish to see a rise in the weekly-average Federal funds rate above 5-3/4 per cent during the inter-meeting period--at least not without further consultation. In addition to advocating an upper limit of 5-3/4 per cent for the inter-meeting range, these members generally favored maintaining the funds rate at the outset of the period in the area of 5-1/4 to 5-3/8 per cent or permitting it to rise only slightly. In support of constraining the upper limit to 5-3/4 per cent, it was suggested that a further rise of 50 to 60 basis points--roughly the magnitude of the increase since the April meeting--was likely to have more significant repercussions on financial markets and that considerable uncertainty existed about the underlying strength of the monetary aggregates. A few members of the Committee suggested an upper limit of 6 per cent for the funds rate range and an initial objective of 5-1/2 or 5-5/8 per cent, because they viewed the economic situation as quite strong and they thought such a course would be helpful in restraining excessive growth in the aggregates later on.

At the conclusion of the discussion the Committee decided that growth in M-1 and M-2 over the May-June period at annual rates within ranges of 0 to 4 per cent and 3-1/2 to 7-1/2 per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of M-1 and M-2.

In the judgment of the Committee, such growth rates of the aggregates were likely to be associated with a weekly-average Federal funds rate of about 5-3/8 per cent. The Committee agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5-1/4 to 5-3/4 per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic 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 growing at a rapid rate in the current quarter. In April industrial output and employment continued to expand at a substantial pace, and the unemployment rate declined from 7.3 to 7.0 per cent. Total retail sales remained at the advanced level reached in March. The wholesale price index for all commodities rose substantially in April for the third consecutive month; increases again were particularly sharp among farm products and foods, and they remained sizable for industrial commodities.

The average value of the dollar against leading foreign currencies has changed little on balance over the past month. The U.S. foreign trade deficit widened further in March; for the first quarter as a whole, the deficit was twice as large as for the preceding quarter.

The increase in M-1, which had been moderate in the first quarter, was exceptionally large in April. Inflows of the time and savings deposits included in the broader aggregates were slower than earlier in the year, but because of the rapid expansion in M-1, growth in M-2 and M-3 accelerated. Business short-term borrowing expanded sharply while corporate financing in the capital markets was reduced. Market interest rates have risen in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will encourage continued economic expansion and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.

At its meeting on April 19, 1977, the Committee agreed that growth of M-1, M-2, and M-3 within ranges of 4-1/2 to 6-1/2 per cent, 7 to 9-1/2 per cent, and 8-1/2 to 11 per cent, respectively, from the first quarter of 1977 to the first quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in M-1 and M-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the May-June period to be within the ranges of 0 to 4 per cent for M-1 and 3-1/2 to 7-1/2 per cent for M-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly average Federal funds rate of about 5-3/8 per cent. If, giving approximately equal weight to M-1 and M-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 5-1/4 to 5-3/4 per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.