FEDERAL RESERVE

press release

For Use at 4:00 p.m. November 18, 1977

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 17-18, 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 October 17-18, 1977

1. Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the third quarter had slowed from the pace in the second quarter, estimated by the Commerce Department to have been at an annual rate of 6.2 per cent. The rise in average prices--as measured by the fixed-weighted price index for gross domestic business product--appeared to have moderated appreciably from that of the second quarter, estimated to have been at an annual rate of 7.5 per cent. Staff projections suggested that growth in real GNP would pick up in the fourth quarter and would continue at a moderate, although slightly diminishing, pace in 1978. It was also expected that the rate of increase in prices, while less than that in the first half of 1977, would remain high.

According to staff estimates, the third-quarter slowing of growth in real GNP was attributable mainly to a reduction in the rate of business inventory accumulation, following a large increase in the second quarter, as businesses attempted to prevent an excessive build-up of stocks. It was estimated that growth in final sales of goods and services in real terms had been about the same in the third quarter as in the second.

Staff projections of growth in real GNP over the year ahead reflected expectations that expansion in business capital outlays would be sustained; that increases in State and local government purchases of goods and services would remain large, in part because of the stimulus of increased Federal public works and job-related programs; and that growth in consumer spending would be moderate. It was still anticipated that the expansion in residential construction activity would taper off as the period progressed and that exports of goods and services would continue to exceed imports by a sizable, but not an increasing, amount.

In September industrial production expanded 0.4 per cent, returning to the level reached in July. About one-third of the September rise was attributable to gains in copper and coal mining following the end of strikes, but small increases in output were widespread. Production of steel declined, and automobile assemblies were about unchanged at a relatively high rate. From the second quarter to the third, total industrial production advanced 1.2 per cent, about half as much as from the first quarter to the second.

Capacity utilization in manufacturing in September remained at the August level of 82.9 per cent. In the materials-producing industries, utilization changed little, and at 82.8 per cent for both September and the third quarter as a whole, it remained appreciably lower than at the comparable stage of other recent business expansions.

Total nonfarm payroll employment expanded substantially in September, reflecting in large part continuation of strong growth in the service-producing sector--specifically, in services, retail trade, and State and local government. Payroll employment in manufacturing increased too, recovering most of the decrease of August, but the length of the average workweek of production workers declined for the third consecutive month--reaching 40.0 hours, compared with 40.5 in June. Total employment, as measured by the survey of households, also increased substantially in September. The civilian labor force rose somewhat less than total employment, as a sizable increase in the number of women in the labor force was offset in part by decreases in the number of adult men and of teenagers, and the unemployment rate edged down 0.2 of a percentage point to 6.9 per cent. From April through

September the unemployment rate had fluctuated between 6.9 and 7.1 per cent.

The size of the gain in employment in September suggested an increase in the pace of expansion in wage and salary disbursements. In August such disbursements had increased little.

The dollar value of retail sales had declined 1.2 per cent in September, according to the advance report, after having increased 2.3 per cent over the preceding 2 months. From the second quarter to the third the value of sales had risen 0.3 per cent, considerably less than the rise from the first quarter to the second and, most likely, less than the increase in average prices of the goods and services sold. Unit sales of new autos--domestic and foreign models--declined more than 10 per cent, but the weakness may have been caused by the lateness of the changeover to 1978 models for some domestic makes and by reduced inventories of both foreign cars and 1977 domestic models.

Expansion in the book value of business inventories accelerated in August, after having slowed sharply further in July, but it was still slightly less rapid than the monthly-average rise in the first half of 1977. The build-up of stocks at retail stores was somewhat faster than in July and considerably more rapid than the average increase during the preceding 6 months, reflecting exceptionally high rates of accumulation both at durable goods stores other than automobile dealerships and at nondurable goods stores. In manufacturing, on the other hand, accumulation slowed further in August; in both durable goods and nondurable goods industries, the rate of accumulation was less than that over the first 6 months of the year.

As had been reported before the September meeting of the Committee, private housing starts were at an annual rate of slightly more than 2.0 million units in August, almost as much as in July. The average for the 2 months was 7 per cent above the average for the second quarter, reflecting in large part gains in starts of multifamily units.

The latest Department of Commerce survey of business plans, taken in late July and August and published in early September, suggested that spending for plant and equipment would be 13.3 per cent greater in 1977 than in 1976. The survey implied somewhat less expansion in spending in the second half of the year than in the first half.

Manufacturers' new orders for nondefense capital goods picked up somewhat in August after having declined sharply in July; the average for the 2 months was well below that for the second quarter and about equal to that for the first quarter. However, the machinery component of such orders--generally a better indicator of underlying trends in demand for business equipment--was at an appreciably higher rate in July-August than in the second quarter. Over-all shipments of nondefense capital goods continued to expand in August, and unfilled orders for such goods edged down. Contract awards for commercial and industrial buildings--measured in terms of floor space--rose sharply in August, and the July-August average was about 8 per cent above the average for the second quarter.

The index of average hourly earnings for private nonfarm production workers advanced at a moderate pace in September. Over the first 9 months of 1977 the index had risen at an annual rate of about 7 per cent, the same as the increase over the 12 months of 1976.

The wholesale price index for all commodities, which had declined in June and then had shown little change in July and August, rose moderately in September. Average prices of farm products and foods changed little following 3 months of large decreases, and prices of industrial commodities rose more than in the immediately preceding months. Among industrial commodities, sizable increases were recorded for lumber and wood products, certain fuels, some types of machinery, and roofing and insulation materials.

The consumer price index in August, as in July, rose considerably less than in any month of the first half of 1977. Retail prices of foods changed little over the July-August period, after having risen about 6-1/2 per cent over the preceding 6 months. The increase in prices of nonfood commodities was relatively small in September for the third consecutive month, and the rise in prices of services was significantly less than the average increase in the preceding 7 months.

In foreign exchange markets, pressure on the dollar emerged at the end of September--following 2 months of recovery from the depreciation that had occurred in early summer--in reaction mainly to statements by U.S. Government officials concerning the large deficits in both foreign trade and the current accounts that were in prospect for 1977 and were projected for 1978. From late September to mid-October the trade-weighted average value of the dollar depreciated about 1-1/2 per cent, reflecting declines against all major currencies except the Canadian dollar; the largest declines were against the Japanese yen and the Swiss franc. Over the period, moreover, foreign central banks intervened in the exchange markets to purchase a substantial amount of dollars.

The U.S. foreign trade deficit widened in August. The monthly-average deficit for July and August was somewhat greater than that for the second quarter.

At U.S. commercial banks, growth in total credit was small in September following substantial expansion in the preceding 2 months. In September bank holdings of U.S. Treasury securities declined considerably further. Total loans expanded, but by less than in July and August. Real estate loans continued to grow at a rapid pace, but business loans increased less than in any month earlier in the year.

The small increase in business loans at banks in September was accompanied by a decrease of about the same amount in the outstanding volume of commercial paper issued by nonfinancial corporations. For the third quarter as a whole, business credit expansion through these two sources slowed to an annual rate of 6 per cent--the lowest since the summer of 1976.

The narrowly defined money stock (M-1) grew at an annual rate of 7-3/4 per cent in September, up from the August pace of 5-1/2 per cent. Data for early October suggested further acceleration. M-1 grew at an annual rate of 9-1/4 per cent from the second quarter to the third, and by about 7-1/4 per cent from the third quarter of 1976 to the third quarter of 1977.

Growth in the more broadly defined measures of money, M-2 and M-3, also stepped up in September--to annual rates of 8 and 12 per cent, respectively, from rates of about 6-1/2 and 11-1/2 per cent in August. These more rapid rates resulted almost entirely from the acceleration of expansion in the demand deposit and currency components common to all three measures of money. Expansion in the time and savings deposit component of M-2 changed little in September from the reduced rate of August; and inflows of deposits at nonbank thrift institutions, included in M-3, remained near the strong pace of August. From the third quarter of 1976 to the third quarter of 1977, M-2 and M-3 grew about 11 and 12-1/2 per cent, respectively.

At its September meeting the Committee had decided that during the September-October period growth in M-1 and M-2 within ranges of 2 to 7 per cent and 4 to 8 per cent, respectively, would be appropriate. The Committee had established 6 to 6-1/2 per cent as the range for variation in the weekly-average Federal funds rate for the period until the next meeting. The 6-1/4 per cent midpoint of the range was slightly above the rate of 6-1/8 per cent prevailing in the days just before that meeting. 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 their ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within its indicated range.

In accordance with the Committee's decision, the Manager of the System Open Market Account began immediately after the September meeting to seek bank reserve conditions consistent with a Federal funds rate of around 6-1/4 per cent. Data that were becoming available at the same time suggested that over the September-October period M-1 and M-2 would grow at rates at or above the upper limits of the ranges specified by the Committee, and the estimates of these growth rates were raised further on the basis of the data that became available in subsequent weeks. Therefore, the Manager sought a gradual firming in the Federal funds rate to 6-1/2 per cent, the upper limit of its specified range. In the three business days prior to this meeting of the Committee, the funds rate averaged 6-1/2 per cent.

Interest rates in securities markets also rose during the inter-meeting period. Increases ranged from 30 to 65 basis points in markets for short-term securities and up to 20 basis points in markets for long-term instruments. Major banks raised the rate on loans to prime business borrowers from 7-1/4 to 7-1/2 per cent.

As market rates of interest rose, member bank borrowings at Federal Reserve Banks expanded. In the 5 days preceding the Committee meeting, borrowings averaged nearly $1.6 billion, up from a daily average of $337 million in the statement week ending September 14.

Stock prices drifted down further over the inter-meeting period, and several major indexes of stock prices reached their lowest levels since the end of 1975. The reduced prices of common stocks, in combination with a record number of dividend increases announced so far this year, raised the average yield of dividends to an unusually high level by historical standards.

The U.S. Treasury raised $3.3 billion of new money during the inter-meeting period. For the third quarter as a whole, its cash borrowing totaled $17 billion--excluding $2.5 billion of temporary borrowing from the Federal Reserve System at the end of the quarter. Of the $17 billion, $2.8 billion was provided through sales of special nonmarketable Treasury securities to State and local governments that were making temporary investments of the proceeds from advance refundings.

Gross offerings of new bonds by State and local governments remained substantial in September, reflecting a continued large volume of advance refundings. Primarily because of such refundings, State and local government offerings of long-term securities in the first 9 months of 1977 exceeded the record volume of sales in all of 1976.

Gross public offerings of corporate bonds remained strong both in September and in the third quarter as a whole. Total external financing by nonfinancial corporations in the third quarter appeared to have been substantially greater than the gap between capital outlays and internally generated funds. In those circumstances, such a large volume of financing suggested that some firms were encouraged by the levels of prevailing yields to borrow in advance of their current needs. The proceeds of such borrowings may have been used to enlarge holdings of liquid assets as well as to reduce short-term debt.

Growth in mortgage credit in September apparently remained near the strong pace registered earlier in the third quarter. Expansion in mortgage loans at commercial banks slightly exceeded the sizable July-August average, and new issues of GNMA-guaranteed, mortgage-backed securities were down only moderately from the August record volume. At savings and loan associations, outstanding mortgage loan commitments had risen appreciably in August to a new record level. At the same time, inflows of funds to these institutions during September were apparently sufficient to permit them to acquire a sizable volume of spot loans in addition to financing takedowns of outstanding mortgage commitments.

In the Committee's discussion of the economic situation, the members agreed that the expansion in activity was likely to continue for some time to come. They differed, however, in their assessments of the prospective vigor of the expansion. Most indicated no disagreement with the staff projections suggesting that growth in real GNP would pick up in the fourth quarter and would continue at a moderate--if slightly diminishing--pace in 1978, although the view was expressed that uncertainties about the current situation and outlook had increased in recent months. One of the members suggested that the private economy had demonstrated great vitality since the start of the current business upswing, as evidenced by growth of nearly 7 million persons in total employment. He believed that the expansion could well pick up speed again if the tax proposals being developed by the administration were practical and included, in particular, measures designed to foster a higher rate of business capital expenditures. Another member who regarded the staff projections as reasonable nevertheless thought that any deviation was more likely to be in the direction of shortfalls. A third member felt that the economy had not displayed any significant weaknesses and that its performance was likely to be as favorable as, or more favorable than, that projected by the staff.

On the other hand, several members felt that the performance of the economy was likely to be less favorable than projected and, consequently, that there might be little further progress in reducing the rate of unemployment from its high level. One of these members observed that the projections for a number of sectors of activity appeared to be on the high side and that shortfalls were likely to occur in at least some cases. Another of these members suggested, however, that a rate of growth in real GNP of less than 5 per cent--which was being widely forecast on the assumption of the existing fiscal policy--was likely to lead to some new measures of fiscal stimulus, although uncertainty existed about the amount of time required to legislate new measures and about their probable effectiveness. Another member expressed the view that, compared with the staff projections, growth was likely to be weaker in the fourth quarter of 1977, to be stronger in the first half of 1978, and to be weaker again in the second half of 1978.

Members differed somewhat in their appraisals of the outlook for major categories of expenditures. With respect to business fixed investment, little disagreement was expressed with the staff projection that expansion would be sustained over the year ahead. It was observed that new orders for machinery had been strong; that a revival in large-scale industrial and commercial building projects had begun earlier this year; and that new businesses were being formed at an increasing rate. However, the view was also expressed that business confidence had deteriorated somewhat--owing to the rather indifferent performance of profits, to the decline in stock prices, and to widespread uncertainty concerning a number of Government policies--and it was noted that some private surveys of plans for 1978 did not suggest any great strength in business capital spending. Concerning inventories, it was observed that businesses were likely to continue pursuing conservative policies, that the recent increase in stocks at retail stores had occurred as sales had leveled off, and that any appreciable increase in inventory investment in the period ahead might reflect involuntary accumulation and thus be indicative of weakness rather than strength in the over-all situation.

Several members expressed skepticism concerning the staff projection of some further expansion in housing starts from recent levels and of somewhat higher starts in 1978 as a whole than in

1977. In that connection, it was suggested that starts might be limited by supplies of insulating and other building materials as much as by any easing in demands. On the other hand, the view was expressed that certain factors affecting starts of multifamily units had become more favorable and that increases in such starts might sustain the total, although it was recognized that on the average less construction activity was involved in multifamily than in single-family units. With respect to financing, it was observed that the availability of funds for mortgages remained good. Moreover, it was suggested that thrift institutions apparently had become less exposed than in the past to diversions in savings flows in response to higher market rates of interest, mainly reflecting a lengthening in the maturity structure of their liabilities.

A few members viewed the staff projection of moderate growth in real consumer spending as optimistic. One of these expressed doubt that purchases of new automobiles would increase further from the advanced rate of the past year or so. Another observed that expansion in disposable income was likely to fall short of that required to validate the projection, especially if, as widely expected, the savings rate recovered from the reduced levels of recent quarters.

Some members expressed doubt about the expansion in exports projected for the year ahead, which was large enough in real terms to offset the projected rise in imports; thus they viewed the foreign trade sector as a source of weakness in prospects for growth in total real GNP. Concern was also expressed that at some point continuation of a large current-account deficit could have adverse psychological effects in exchange markets, although it was recognized that the deficit could be financed without repercussions--especially if relative interest rates remained favorable and price performance in the United States did not deteriorate. One member suggested that even if interest rate relationships were not especially favorable, capital might still flow in because of improving profits of U.S. enterprises.

It was suggested that the performance of prices could be somewhat better than that portrayed by the staff projection. Specifically, it was thought that further improvement in supplies of foodstuffs might result in continued downward pressure on prices, and that worldwide demands for industrial raw materials were unlikely to be strong enough to drive their prices up to any significant degree. It was also noted, however, that the underlying rate of inflation remained high and that the rate of increase in unit labor costs in the private business sector of the economy was unlikely to be reduced in the coming year. One member indicated concern about the structural inflation that appeared to have a life of its own; he referred specifically to the increase in the salary structure for Federal employees that had taken effect in early October, to recent increases in wage rates in the private sector, to pending legislation raising the minimum wage, and to pressures for import quotas. The judgment was expressed that the administration apparently was not being effective in pursuing its anti-inflation policy.

Finally in the discussion of the economic situation, it was reported that declines in prices of agricultural commodities had led to declines in prices of farmland in a few States for the first time in many years. It was noted, moreover, that banks were finding it necessary to restructure an increasing number of loans to finance agricultural operations because of the farmers' inability to repay them on time.

At this meeting the Committee reviewed its 12-month ranges for growth in the monetary aggregates. At its July meeting the

Committee had specified the following ranges for growth over the period from the second quarter of 1977 to the second quarter of 1978: M-1, 4 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 commercial bank credit was 7 to 10 per cent. The ranges being considered at this meeting were for the period from the third quarter of 1977 to the third quarter of 1978.

In the discussion of the appropriate ranges for growth in the monetary aggregates over the year ahead, it was suggested that the Committee make clear its continuing determination to bring the ranges down gradually to levels compatible with general price stability, while at the same time assuring that growth in the aggregates would be sufficient to facilitate an orderly expansion of economic activity. In such a framework it was further suggested that the Committee indicate that its basic goal was to contribute to the satisfactory performance of the economy and that it would not sacrifice or compromise that goal in the interest of seeking to attain predetermined rates of monetary growth.

In the discussion, attention was drawn to the behavior of the monetary aggregates and to certain developments in financial markets. Specifically, it was noted that over the year from the third quarter of 1976 to the third quarter of 1977 growth in M-1 had exceeded by a sizable margin the upper limit of the range that the Committee had set at its meeting in early November 1976, whereas on other recent occasions when the Committee had reconsidered its longer-run ranges it could look back to periods of a year when growth in M-1 had fallen within, or below the lower limit of, its range. Growth in M-2 and M-3 over the year to the third quarter of 1977 also had exceeded the upper limits of the ranges adopted in early November 1976, and growth in all three aggregates over the period had exceeded their longer-run ranges for the first time since the Committee had begun to adopt such ranges. However, it was also noted that, although growth in M-1 had been at a faster rate in the first 9 months of 1977 than during 1976, growth in M-2 and M-3 had been slower; and that M-1 had begun to grow rapidly only over the two most recent quarters.

With respect to financial market developments, it was noted that short-term interest rates in general had risen about 200 basis points since the beginning of the year--with a substantial part of that rise having occurred in the third quarter. However, it was pointed out, long-term rates had not changed much on balance since the beginning of the year, although they had increased somewhat in recent weeks. Also, the decline in stock prices was interpreted as signaling that investors were uneasy about the profitability of corporations and about the performance of the economy.

Uncertainty was expressed about the underlying causes of the expansion of the demand for money (narrowly defined) in the second and third quarters and about the implications of that expansion for policy. It was suggested that various changes in financial technology that had been resulting in substitution of income-earning deposits for demand deposits had become less powerful and, consequently, that increasing demands for transactions balances in the latest two quarters had had a greater effect on growth in M-1. One member suggested that the demand for money had also been raised recently by increased uncertainty of various kinds--about conditions in the job market, about prices of securities, about foreign exchange rates, and about other elements in the economic situation--and that this had contributed to the apparent decline in the income velocity of M-1 in the third quarter. In his view, however, the decline in velocity more fundamentally reflected the sluggishness of economic expansion in the third quarter, and a pick-up in the pace of expansion once again might be accompanied by a sharp rise in velocity.

Because of the uncertainty about the underlying causes of the recent expansion in the demand for M-1 and about the prospects for its velocity, some members indicated that they now had less confidence in the behavior of the monetary aggregates as guides to monetary policy than they might have had earlier. It was felt, moreover, that those uncertainties made it particularly important to emphasize that the Committee's basic goal was to contribute to the satisfactory performance of the economy rather than to pursue predetermined rates of monetary growth.

In commenting on the ranges for growth in the monetary aggregates over the period from the third quarter of 1977 to the third quarter of 1978, most members concurred in the view that the objective of continuing the gradual process of bringing the longer-run ranges for growth in the monetary aggregates down to rates compatible with general price stability would best be served at this time by retaining the existing range of 4 to 6-1/2 per cent for M-1 and making some reduction in the ranges for M-2 and M-3. Proposals to achieve the latter included reducing the upper limits of the ranges by 1/2 of a percentage point, reducing the lower as well as the upper limits by that amount, and reducing both limits by 1 percentage point.

In support of the proposal to make some downward adjustment in the ranges for M-2 and M-3, several members observed that the rise in short-term interest rates that had already occurred would tend to reduce flows of funds into time and savings deposits (exclusive of money market CD's), so in the period ahead growth in M-2 and M-3 was likely to slow in relation to growth in M-1. However, it was expected that flows into the thrift accounts would still be substantial and would be consonant with the maintenance of a high rate of residential construction activity.

Several reasons were advanced for retaining the existing range for M-1. It was suggested that any change in that range at this time would imply a degree of knowledge that, in view of the changes that were taking place in the demand for money, was not present. The observation was also made that until it became clear that the recent slowing in economic growth would not proceed further, the Committee should avoid making any change in the range for M-1 that might be construed as a measure of tightening. One member expressed the view that if changes in financial technology were in fact having less effect on the demand for money than they had for some time, the existing range for M-1 now would represent a somewhat more restrictive policy than it had before. And it was suggested that any reduction in the upper limit of the range for M-1 following the excessive rates of growth over the past two quarters might be interpreted as implying an aggressive policy for the short run or as implying policy objectives that were not attainable.

Some sentiment was expressed for reducing the upper limit of the range for M-1 by 1/2 of a percentage point. It was suggested that, in view of the magnitude of recent overshoots in growth of M-1, such a reduction would underscore the System's determination to work gradually toward a rate of growth consistent with general price stability and thus might have a positive effect on economic activity by tending to encourage business and consumer spending.

Two members advocated some widening of the longer-run range for M-1, because of uncertainty about changes in the demand for money and, thus, about the income velocity of M-1; it was noted that at times in the past the Committee had adopted ranges as wide as 3 percentage points. One of these members expressed the view that even if the rise in velocity picked up again in the period ahead, it was unlikely to be as rapid as it had been earlier, and he recommended raising the upper limit of the range for M-1 by 1/2 of a percentage point. At the same time, he recommended a reduction of a full percentage point in the lower limit of the range. The other member advocated an increase of 1/2 of a percentage point in the upper limit of the range for M-1 and no change in the lower limit; he also advocated a widening of the ranges for M-2 and M-3.

At the conclusion of its discussion the Committee decided to retain the existing range for M-1 and to reduce both the upper and lower limits of the ranges for M-2 and M-3 by 1/2 of a percentage point. Thus the new ranges, which applied to the period from the third quarter of 1977 to the third quarter of 1978, were 4 to 6-1/2 per cent for M-1, 6-1/2 to 9 per cent for M-2, and 8 to

10-1/2 per cent for M-3. The associated range for growth in commercial bank credit was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It was also understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for the year ahead.

> The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the third quarter of 1977 to the third quarter of 1978: M-1, 4 to 6-1/2 per cent; M-2, 6-1/2 to 9 per cent; and M-3, 8 to 10-1/2 per cent.
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> > Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, and Roos. Vote against this action: Mr. Wallich.

Mr. Wallich dissented from this action because--believing that abnormal gains in the income velocity of M-1 had come to an end, at least temporarily--he preferred to raise the upper limit of the range for M-1 to 7 per cent. At the same time, he would have widened the range by reducing the lower limit to 3 per cent.

As to policy for the period immediately ahead, members of the Committee were in relatively close agreement with respect to their preferences for ranges of growth for the monetary aggregates over the October-November period. Most of them favored ranges of 3 to 8 per cent and 5-1/2 to 9-1/2 per cent for the annual rates of growth in M-1 and M-2, respectively. A few members indicated that slightly lower growth ranges would also be acceptable.

Somewhat greater differences of view were expressed concerning the Federal funds rate. A number of members favored directing operations initially toward maintaining the current rate of around 6-1/2 per cent, but some preferred to raise the rate to around 6-5/8 per cent and one felt that a prompt move to 6-3/4 per cent was needed. Differing views were also indicated with regard to the amount of leeway that should be provided in conducting operations during the inter-meeting period as new information became available on the performance of the monetary aggregates. The members were agreed that little or no decline in the Federal funds rate should be contemplated under foreseeable circumstances, but views were divided with respect to the upper limit that should be set for the rate; several members recommended a ceiling of 6-3/4 per cent while others preferred a ceiling of 7 per cent. Some members in favor of the lower ceiling indicated that they would be prepared to accept a higher rate if the performance of the economy and the monetary aggregates during the inter-meeting period differed significantly from their expectations.

A majority of the members were in favor of giving greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting. In that connection some cited the uncertain implications of the growth of the monetary aggregates in recent months. However, a number of members expressed a preference for continuing to have operating decisions in the period ahead based primarily on the behavior of the monetary aggregates; in their view such operations should be adjusted promptly if the aggregates appeared to be deviating significantly from the midpoints of the specified ranges.

At the conclusion of the discussion the Committee decided that operations in the period immediately ahead should be directed toward maintaining prevailing money market conditions, as represented by a weekly-average Federal funds rate of about 6-1/2 per cent. However, the members agreed that if growth in the aggregates should appear to approach or move beyond the limits of their specified ranges, th ranges, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 6-1/4 to 6-3/4 per cent. With respect to the annual rates of growth in M-1 and M-2 over the October-November period, the Committee specified ranges of 3 to 8 per cent and 5-1/2 to 9-1/2 per cent, respectively. It was also agreed that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of M-1 and M-2.

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 growth in real output of goods and services slowed in the third quarter, mainly because of a reduction in the rate of inventory accumulation. In September industrial production expanded, returning to about the level reached in July, and employment increased substantially. The unemployment rate edged down to 6.9 per cent, but remained near the level prevailing since April. The dollar value of total retail sales declined after having risen appreciably

in July and August. The wholesale price index for all commodities, which had declined on balance since May, advanced in September; average prices of farm products and foods changed little following 3 months of sharp decreases, and average prices of industrial commodities rose more than in the immediately preceding months. So far this year the index of average hourly earnings has advanced at about the same pace as it had on the average during 1976.

Pressure on the dollar in foreign exchange markets emerged at the end of September, and the dollar has declined against most major foreign currencies and particularly against the Japanese yen. In August the U.S. foreign trade deficit widened; the July-August average was somewhat above the second-quarter rate.

M-1 and M-2 expanded somewhat more in September than in August, and increased substantially further in early October. Inflows to banks of time and savings deposits increased little in September from the reduced rate in August, while inflows to nonbank thrift institutions remained strong. Short-term interest rates have risen further in recent weeks, and yields on longer-term market securities have increased.

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.

Growth of M-1, M-2, and M-3 within ranges of 4 to 6-1/2 per cent, 6-1/2 to 9 per cent, and 8 to 10-1/2 per cent, respectively, from the third quarter of 1977 to the third quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

At this time, the Committee seeks to maintain about the prevailing money market conditions during the period immediately ahead, provided that monetary aggregates appear to be growing at approximately the rates currently expected, which are believed to be on a path reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, the Committee seeks to maintain the weekly-average Federal funds rate at about 6-1/2 per cent, so long as M-1 and M-2 appear to be growing over the October-November period at annual rates within ranges of 3 to 8 per cent and 5-1/2 to 9-1/2 per cent, respectively. If, giving approximately equal weight to M-1 and M-2, it appears that growth rates over the 2-month period are approaching or moving beyond the limits of the indicated ranges, the operational objective for the weekly-average Federal funds rate shall be modified in an orderly fashion within a range of 6-1/4 to 6-3/4 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, Partee, Roos, and Wallich. Vote against this action: Mr. Morris.

Mr. Morris dissented from this action because he was convinced that the Committee should take more aggressive action to curb excessive growth in the monetary aggregates, which in his opinion would not be conducive to a healthy, long-term expansion in the economy. He also believed that short-term interest rates could rise somewhat further without significantly damaging short-term prospects for economic activity.

2. Authorization for domestic open market operations

Committee members voted to reduce from $3 billion to $2 billion the limit on Federal Reserve Bank holdings of special short-term certificates of indebtedness purchased directly from the Treasury, specified in paragraph 2 of the authorization for domestic open market operations, effective immediately.

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

This action was taken on the recommendation of Chairman Burns. On September 30, 1977, when the temporary debt ceiling was due to expire at midnight, Committee members had voted to raise the limit on System holdings of directly purchased certificates of indebtedness from $2 billion to $3 billion, and the Treasury had issued a $2.5 billion certificate to the Federal Reserve Bank of New York. The Treasury had retired the certificate on October 4, following approval of legislation increasing the debt ceiling, and the need for the higher limit had passed.