FEDERAL RESERVE
press release

For Use at 4:00 p.m. January 20, 1978

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 December 19-20, 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 December 19-20, 1977

1. Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services was growing in the current quarter at about the third-quarter pace, which the Commerce Department had revised upward appreciably to an annual rate of 4.7 per cent. At the same time the rise in average prices, as measured by the fixed-weighted price index for gross domestic business product, appeared to be stepping up somewhat from an annual rate of 5.1 per cent estimated for the third quarter. Staff projections for the year ahead, which were based on assumptions that did not include reductions in Federal income taxes, differed little from those prepared just before the November meeting of the Committee; they suggested that real GNP would continue to grow at a moderate, although gradually diminishing, pace throughout 1978. It was also expected that the rate of increase in prices would remain high and that the unemployment rate would decline gradually.

The staff estimate of continued growth of real GNP in the current quarter at about the third-quarter pace was attributable to expectations of substantially greater expansion in final sales of goods and services in combination with a decline in the rate of business inventory accumulation. With respect to final sales, there were indications of considerable strength in consumer spending for both durable and nondurable goods and in residential construction. It was anticipated, moreover, that growth in business fixed investment would pick up from the reduced rate in the third quarter.

The staff projections for the year ahead reflected expectations that, in real terms, the expansion in business capital outlays would be relatively strong; the growth in consumer spending would remain moderate; the increases in State and local government purchases of goods and services would continue to be sizable; the expansion in residential construction activity would taper off as the period progressed; and the rise in Federal purchases of goods and services would be smaller than over the past year.

In November industrial production expanded 0.5 per cent, compared with 0.3 per cent in October and 0.4 per cent in September. Increases in output were widespread in November, but automobile assemblies were reduced. Capacity utilization in manufacturing was estimated to have remained at about 83 per cent; in both the materials-producing and the advanced processing industries, utilization rates were close to their levels in the second and third quarters. For the materials-producing industries, the rate was about 10 percentage points below the high reached in the previous period of business expansion.

Nonfarm payroll employment rose substantially in November. In particular, gains were large in services and finance, trade, and State and local government. Employment in manufacturing advanced moderately, and the average workweek edged up further to 40.5 hours, the same as in June. The increase in total employment, as measured by the survey of households, was particularly large. The rise in the civilian labor force also was substantial, however, and the unemployment rate, at 6.9 per cent, remained in the narrow range prevailing since April.

The pace of expansion in personal income had increased sharply to an annual rate of more than 16 per cent in October and then slowed to a rate of about 11 per cent in November, according to statistics released since the Committee's meeting in mid-November. In October growth in wage and salary payments had been augmented by raises in pay for Federal civilian and military personnel. Farm income--bolstered by increased price supports for grains and sugar--advanced in both October and November, after having declined for a half year.

The dollar value of retail sales had risen 1.5 per cent in November according to the advance report. Moreover, the estimate of sales for October had been revised upward substantially and was 2.7 per cent above the September level. As a consequence, the average for the first 2 months of the fourth quarter was up almost 4 per cent from the monthly average for the third quarter. Increases in total sales from one quarter to the next had not been that large since the fourth quarter of 1976.

Although the total value of retail sales advanced in November, unit sales of new domestic and foreign autos declined about 5 per cent. Unit sales appeared to have been trending downward since spring. In October and November the average rate was nearly 10 per cent below that in the second quarter.

Private housing starts rose substantially in October to an annual rate of more than 2.2 million units--the highest monthly rate since the current upswing began in early 1975--and then edged down in November to a rate of about 2.1 million units. The average for the 2 months was 5 per cent higher than that for the third quarter.

The latest Department of Commerce survey of business spending plans, taken in late October and November, suggested that spending for plant and equipment would expand at an annual rate of 5.8 per cent in the fourth quarter of 1977 and at rates of 11.4 and 10.2 per cent in the first and second quarters of 1978, respectively. The survey also indicated that such spending would be 13.7 per cent greater in 1977 as a whole than in 1976; the preceding survey of the Department of Commerce had indicated a year-to-year gain of 13.3 per cent.

Manufacturers' new orders for nondefense capital goods, which had advanced sharply in September, increased somewhat further in October to a level 8-1/2 per cent above the monthly average for the third quarter. Contract awards for commercial and industrial buildings--measured in terms of floor space--in October were close to the average for the third quarter, which was up about 10 per cent from the average for the preceding quarter and 30 per cent from that for the third quarter of 1976.

The index of average hourly earnings for private nonfarm production workers increased relatively little in November following a sharp rise in October. The rate of increase over the first 11 months of 1977 was about 7-1/2 per cent, compared with a rise of about 7 per cent over the 12 months of 1976.

The wholesale price index for all commodities rose sharply in November for the second successive month. Average prices of farm products and foods, which had advanced 1.3 per cent in October, increased 2.3 per cent further to a level 4.8 per cent higher than in November 1976. For industrial commodities, the rise slowed to 0.4 per cent from 0.6 per cent in October and 0.8 per cent in September. Over the

12 months ending in November, the increase in the industrial commodity average was 6.5 per cent.

The consumer price index rose 0.3 per cent in October, marking the fourth consecutive month of moderate increases. From June to October retail prices of foods advanced only about 0.5 per cent, in contrast with a rise of nearly 7 per cent over the first 6 months of the year. The rise in average prices of commodities other than foods continued in October at about the reduced pace of the third quarter, and the advance in prices of services slowed somewhat.

The dollar had been under considerable selling pressure in foreign exchange markets throughout the inter-meeting period, and its trade-weighted value had declined more than 3 per cent further even though central banks purchased a substantial amount of dollars. All major currencies rose against the dollar over the period, and appreciations amounted to 9 per cent for the Swiss franc, 6 per cent for the German mark, and 2 per cent for the Japanese yen. The persistent pressure on the dollar reflected uncertainty about U.S. economic policies, especially with respect to energy, as well as continuing concern in the markets about the deficit in U.S. foreign trade and about the weakness in economic activity in other industrial countries relative to that in the United States.

The U.S. foreign trade deficit increased sharply in October. However, the widening of the deficit was attributable to the 2-month dock strike that was terminated at the end of November. Because of statistical procedures, the strike depressed recorded exports more than recorded imports.

At U.S. commercial banks, expansion of total credit in November was close to the fast pace in October. Bank loans continued to grow at a rapid rate, and the strength was broadly distributed among major loan categories. As in October, banks reduced their holdings of Treasury securities somewhat more than they added to their holdings of other securities.

Commercial banks in the aggregate financed the November increase in loans entirely through managed liabilities. Negotiable CD's at weekly reporting member banks increased $4.5 billion over the month, and other large time deposits not subject to rate ceilings expanded $5.0 billion. The total increase of $9.5 billion for the month was a record for large-denomination time deposits.

The narrowly defined money stock (M-1) contracted slightly in November, following a large increase in October. For October and November combined, growth in M-1 was at an annual rate of 5 per cent, and for the 11 months ending with November, it was at an annual rate of about 7-1/4 per cent.

Growth in M-2 slowed to an annual rate of 4-1/2 per cent in November. The increase in the interest-bearing component was concentrated in the large-denomination time deposits that are not subject to interest rate ceilings. The total of savings deposits and small-denomination time deposits, which are subject to rate ceilings, declined slightly. Throughout November, rate ceilings on all but the longest maturities of bank time accounts were significantly below the yields available on competing market securities. Over the first 11 months of 1977, M-2 grew at an annual rate of about 9-1/4 per cent.

At nonbank thrift institutions, inflows of funds slowed further in November. Growth in M-3 was reduced to an annual rate of about 7-1/4 per cent, from 12-1/2 per cent in October. Over the first 11 months of the year M-3 grew at an annual rate of about 11-1/4 per cent.

At its November meeting the Committee had decided that operations in the period immediately ahead should be directed toward maintaining about the prevailing money market conditions, provided that monetary aggregates appeared to be growing at approximately the rates then expected. Specifically, the Committee sought to maintain the weekly-average Federal funds rate at about its current level--which was 6-1/2 per cent--so long as M-1 and M-2 appeared to be growing over the November-December period at annual rates within ranges of 1 to 7 per cent and 5 to 9 per cent, respectively. However, the members also had agreed that if growth in the aggregates appeared to approach or move beyond the limits of their specified 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.

Throughout the period between the November and December meetings, incoming data suggested that growth in M-1 and M-2 would be well within the ranges that had been specified by the Committee. Accordingly, the Manager of the System Open Market

Account sought to maintain reserve conditions consistent with a Federal funds rate of 6-1/2 per cent.

In association with the stability in the Federal funds rate, short-term market interest rates changed little during the inter-meeting period, although a minor realignment in relationships occurred. Rates on Treasury bills declined, reflecting in large part substantial foreign purchases of such securities, while yields on private short-term instruments edged up. Rates on longer-term securities rose somewhat during the period.

The U.S. Treasury raised $10.2 billion of new money during the inter-meeting period, including $1.3 billion in its regular weekly bill auctions, $3.0 billion through 139-day, cash-management bills, and $5.9 billion through 1-year bills and 2- and 4-year notes. Moreover, the Treasury planned to auction $3 billion of 2-year notes on the Wednesday after this meeting and $1.5 billion of 15-year bonds in the following week.

Gross public offerings of corporate bonds in November were close to the October volume, and private placements of bonds were estimated to have remained large. Total gross issues of corporate securities increased as stock offerings--primarily by public utility firms--reached the highest level in nearly 2 years.

Gross offerings of new bonds by State and local governments declined somewhat more than seasonally in November. Advance refundings accounted for about one-fifth of the November total--the same proportion that had prevailed during the first 10 months of the year--although the volume was apparently reduced by a Treasury announcement on November 5 of an intention to issue new regulations restricting certain types of advance refunding issues. Demands for municipal securities continued to be strong from commercial banks, from property-casualty insurance companies, and from individuals through municipal bond investment companies.

The volume of mortgage lending in November apparently remained near the record pace of other recent months. The increase in mortgage loans at commercial banks was larger than in October and near the high monthly-average gain in the third quarter. Outstanding mortgage commitments at savings and loan associations rose to a new record in October. In November these institutions apparently maintained a high level of mortgage lending activity, and they continued to float additional issues of mortgage-backed bonds and to increase their borrowings from the Federal home loan banks. By month-end, outstanding advances from those banks had reached their highest level since early 1975. The average interest rate on new commitments for conventional home mortgages at savings and loan associations changed little in late November and early December.

In the Committee's discussion of the economic situation, the members were in agreement that the expansion in activity was likely to continue throughout the year ahead. A number of members expressed the view that growth in real GNP during 1978 would be as strong as or stronger than that suggested by the staff projections. Other members foresaw substantial strength for the period immediately ahead--in response to the recent pick-up in final sales and consequent adjustment of inventory positions--but less strength later in

1978. It was noted, however, that the administration was planning to propose a substantial reduction in taxes on individual and business incomes in the new year, and that such reductions--depending upon their nature and timing--could have a significant effect on the course of activity.

Although the prospective reductions in taxes were seen as supportive of the rate of expansion in over-all activity, there was some concern about their implications for the mix of policies affecting aggregate demand and, consequently, for business fixed investment over the longer term. It was observed that long-term interest rates were relatively low, after allowing for the prevailing rate of increase in prices; but it was also observed that enlarged deficits in the Federal budget might be accompanied by increases in interest rates as the year progressed. It was suggested, moreover, that the rate of inflation could prove to be higher than expected and could, therefore, hamper the progress of the expansion.

As at other recent meetings, members expressed different assessments of the outlook for business capital spending. A few felt that expansion in such spending would be at least as strong as suggested by the staff projections--which, in turn, were stronger than implied by the surveys of expenditures for the early part of 1978. One of these members suggested that, in a variety of ways, the recent decline in the value of the dollar against other major currencies had increased the attractiveness of investment in industrial facilities in the United States. On the other hand, some members felt that the staff projections of capital outlays were on the optimistic side. In the opinion of one of these, manufacturers had been able to achieve new efficiencies in their production facilities which added significantly to capacity without requiring large expenditures for additional structures.

With respect to the housing market, it was suggested that a number of forces were at work that might make activity in 1978 fall short of the rates projected by the staff. On the other hand, the thought was expressed that demands might continue to be buoyed by consumer perceptions of homeownership as an effective hedge against inflation.

One member suggested that the expansion in residential construction activity had been sustained at a fast pace, despite the high and rising prices for housing, by such temporary influences as the rapid increase in homeowners' equity and a backlog of demands accumulated earlier during a period of reduced construction activity, whose force might now be spent; consequently, demands for housing in the period ahead might be more closely related to such fundamental factors as family formation and growth in disposable income. It was suggested also that construction activity in some areas might be impeded by elements of the Government's energy program and by moratoria on new hook-ups for utilities, although building activity in the inner cities might be stimulated.

A few members expressed doubts that the demand for automobiles would measure up to the staff projections, which suggested that sales would be sustained in 1978 at about the fast pace of 1977. The observation was made that sizable cut-backs in assemblies, should they be made necessary by slippage in sales, might not be effected until the spring. It was also suggested, however, that some decline in the rate of sales was a reasonable expectation and, in view of the excessive expansion in consumer credit recently, a welcome development.

In commenting on unemployment, one member questioned whether the over-all rate might not be about as low as could be expected, given the rapid growth in the labor force. He suggested that the high rate of unemployment was a structural problem that could not be solved with monetary policy instruments; in his view, growth in real GNP at any rate above the longer-run average would be satisfactory. Another member observed that a particularly troublesome aspect of the situation was that the large increase in employment during the current business expansion had not lowered the unemployment rate for blacks, especially for black teenagers. It was observed that the increase in the minimum wage that would become effective at the beginning of the new year would contribute to that problem, and it was suggested that in the coming year serious attention might again be given to proposals for a youth differential in the minimum wage.

In the Committee's discussion, serious concern was expressed about the recent weakness of the dollar in foreign exchange markets. While it was noted that depreciation of the dollar might in time contribute to improvement in the U.S. trade balance, it was pointed out that it contributed to the rate of inflation in this country and weakened business confidence both here and abroad. Excessive appreciation of foreign currencies, it was suggested, could have adverse effects on over-all economic activity abroad and, consequently, on the U.S. trade balance. The observation was made that the position of the dollar would be strengthened by adoption in this country of an effective energy program, of a tax policy conducive to business investment here, and of a more effective attack on inflation, as well as by pursuit abroad of faster rates of economic growth.

At its October meeting the Committee had agreed that from the third quarter of 1977 to the third 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 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. The associated range for the rate of 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.

In the Committee's discussion of policy for the period immediately ahead, the members took note of the slowdown in the growth of the monetary aggregates in recent weeks and of the uncertainties in financial markets usually associated with the year-end. Against that background and in light of the performance of the economy, it was observed that increases in short-term interest rates were probably not warranted at this time. On the other hand, it was suggested, the weakness of the dollar in foreign exchange markets argued against declines in such rates. Accordingly, most members were in favor of the maintenance of prevailing conditions in the money market for the time being and of continuing to give greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting of the Committee. However, some members indicated a preference for basing operating decisions in the period ahead primarily on the behavior of the monetary aggregates.

The members did not differ greatly in their preferences for ranges of growth for the monetary aggregates over the December-January period. Most of them favored ranges of 2-1/2 to 8-1/2 per cent and 6 to 10 per cent for the annual rates of growth in M-1 and M-2, respectively. However, there was some sentiment for a slightly lower and some for a slightly higher range for M-1. And one member who preferred to base operations on the behavior of the monetary aggregates believed that System operations should be directed toward a firming in money market conditions if it appeared that over the 2-month period M-1 would grow at a rate in excess of 6-1/2 per cent.

At the conclusion of the discussion the Committee decided that operations in the period immediately ahead should be directed toward maintenance of prevailing money market conditions, as represented by the current level of the Federal funds rate. However, the members agreed that if growth in the aggregates should appear to approach or move beyond the limits of their specified 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 December-January period, the Committee specified ranges of 2-1/2 to 8-1/2 per cent and 6 to 10 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.

The Committee decided to include in the next to last paragraph of its directive to the Federal Reserve Bank of New York the following sentence: "In the conduct of day-to-day operations, account shall be taken of emerging financial market conditions, including the unsettled conditions in foreign exchange markets." This instruction was added to provide the Manager with somewhat greater flexibility, in part because of the Committee's view that pressures on the dollar in foreign exchange markets might appropriately influence the nature and timing of domestic open market operations from day to day.

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 in the current quarter at about the pace in the third quarter. The dollar value of total retail sales, which had increased sharply in October, rose considerably further in November. Industrial production continued to expand, and employment increased substantially. However, the unemployment rate, at 6.9 per cent, remained in the narrow range prevailing since April. The wholesale price index for all commodities rose sharply in November for the second successive month, reflecting another large increase in average prices of farm products and foods. However, the rise in average prices of industrial commodities was less rapid than in the preceding 2 months. The index of average hourly earnings has advanced at a somewhat faster pace so far this year than it had on the average during 1976.
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> The dollar has been under considerable pressure in foreign exchange markets in recent weeks, and its trade-weighted value against major foreign currencies has declined more than 3 per cent further since mid-November. In October the U.S. foreign trade deficit widened sharply, primarily as a result of the dock strike at many U.S. ports.

M-1--which had expanded substantially in October--declined slightly in November, and M-2 increased relatively little. The total of savings deposits and small-denomination time deposits at commercial banks declined somewhat, but growth in large-denomination time deposits accelerated sharply further as credit demands remained strong. Inflows to nonbank thrift institutions slowed further in November. Market interest rates have changed relatively little since mid-November.

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 October 18, 1977, the Committee agreed that 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 the current level, so long as M-1 and M-2 appear to be growing over the December-January period at annual rates within ranges of 2-1/2 to 8-1/2 per cent and 6 to 10 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. In the conduct of day-to-day operations, account shall be taken of emerging financial market conditions, including the unsettled conditions in foreign exchange markets.

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, and Wallich. Vote against this action: Mr. Roos.

Mr. Roos dissented from this action because he believed that the upper limit of the December-January range for growth in M-1 specified by the Committee allowed for the possibility of too rapid growth in that aggregate, particularly in view of the rate at which it had grown so far this year. In his opinion, growth in M-1 over the December-January period at a rate in excess of 6-1/2 per cent would require an excessively restrictive policy later, if the Committee's long-range growth path was to be achieved.

Subsequent to the meeting, on January 9, 1978, the Committee voted to raise the range for the Federal funds rate to 6-1/2 to 7 per cent and to instruct the Manager to raise the rate to 6-3/4 per cent over the next few days. This action was taken upon recommendation of Chairman Burns.

During the preceding 2 weeks the Federal funds rate had averaged a little over 6-5/8 per cent, or above the midpoint of the range of 6-1/4 to 6-3/4 per cent established at the December meeting. Year-end money market pressures had affected the rate, but most recently the Manager had not discouraged some rise above the midpoint of the range in view of unsettled conditions in foreign exchange markets. Available data had suggested that over the December-January period M-1 and M-2 would grow at rates within the ranges specified at the December meeting.

On January 6, just before the Chairman recommended this action, the Board of Governors had approved action by directors of two Federal Reserve Banks raising the discount rate from 6 to 6-1/2 per cent. In announcing the increase in the discount rate, the Board had issued the following press release:

"The recent disorder in foreign exchange markets constitutes a threat to orderly expansion of the domestic and international economy. In view of this, the Board of Governors of the Federal Reserve System today approved an increase in the discount rate from 6 per cent to 6-1/2 per cent.

"The Board expressed the hope that the need for the increase will prove temporary. The Board further indicated that the condition of the domestic economy is sound and that credit supplies to sustain economic expansion will remain ample.

"In making the change, the Board acted on requests from directors of the Federal Reserve Banks of New York and Chicago, increasing the discount rates of those Banks to 6-1/2 per cent, effective Monday, January 9. The discount rate is the interest rate that is charged member banks when they borrow from their district Federal Reserve Banks."

On January 9, 1978, the Committee modified the domestic policy directive adopted at its meeting of December 19-20, 1977, by raising the range for the Federal funds rate to 6-1/2 to 7 per cent and by instructing the Manager to raise the rate to 6-3/4 per cent over the next few days.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Mayo, Roos, and Wallich. Votes against this action: Messrs. Lilly, Morris, and Partee. Absent and not voting: Mr. Jackson.

Messrs. Lilly, Morris, and Partee voted against this action because they did not believe that the performance of the domestic economy justified an increase in interest rates at this time. Mr. Morris believed, in addition, that the proper response to present conditions in the foreign exchange markets was more aggressive intervention, not a higher level of domestic interest rates.

2. Authorization for foreign currency operations

Paragraph 1D of the Committee's authorization for foreign currency operations authorizes the System Open Market Account to maintain an over-all open position in all foreign currencies not exceeding $1.0 billion, unless a larger position is expressly authorized by the Committee. On January 6, 1978, the Committee authorized an increase in the limit to $1.5 billion. The Foreign Currency Subcommittee (consisting of Messrs. Burns, Gardner, Volcker, and Wallich) recommended the increase of $500 million in the limit in view of the recent scale of operations and the continuing unsettled condition of the foreign exchange markets. It was announced on January 4, 1978, that the Exchange Stabilization Fund of the U.S. Treasury would henceforth be utilized actively together with the $20 billion swap network operated by the Federal Reserve System to check speculation and to help reestablish order in the foreign exchange markets.