FEDERAL RESERVE
press release

For Use at 4:00 p.m. March 3, 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 January 17, 1978.

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 January 17, 1978

1. Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services had grown in the fourth quarter of 1977 at a pace close to that of the third quarter, which the Commerce Department had revised upward to an annual rate of 5.1 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 have stepped up somewhat from the annual rate of 5.0 per cent estimated for the third quarter. Staff projections for the year from the fourth quarter of 1977 to the fourth quarter of 1978--which now were based on assumptions that included reductions next fall in Federal income taxes--suggested a moderately faster expansion than the projections prepared just before the December meeting of the Committee. According to the latest projections, growth in real gross national product (GNP) would be sustained at a good pace throughout 1978. It was also expected that the rise in prices would remain relatively rapid and that the unemployment rate would decline moderately further over the year ahead.

The staff estimates for the fourth quarter of 1977 suggested that final sales of goods and services had risen substantially more than in the third quarter, but that the rate of business inventory accumulation had slowed considerably after a slight rise in the third quarter. With respect to final sales in real terms, gains had been particularly strong in consumer spending for both durable and nondurable goods and in residential construction.

Staff projections for the year ahead reflected expectations that the growth of consumer spending in real terms would moderate during the first quarter from the exceptionally rapid pace in the fourth quarter of 1977 and then would pick up as the year progressed--particularly during the fourth quarter, following the reduction in personal income taxes assumed to take effect on October 1. Business fixed investment was projected to expand moderately, owing in part to stimulative modifications of the investment tax credit that were assumed to be retroactive to the beginning of 1978. It was still anticipated that the rise in residential construction outlays would taper off as the year progressed and that the increase in Federal purchases of goods and services would be smaller than over the past year.

In December industrial production expanded 0.2 per cent, compared with 0.4 per cent in November. However, the December increase was held down by a strike that had caused a reduction of nearly 50 per cent in output of bituminous coal. Auto assemblies were curtailed somewhat but output of other consumer goods and of business equipment continued to rise. For the fourth quarter as a whole, growth in industrial production slowed to an annual rate of about 2-1/4 per cent from about 4-1/4 per cent in the third quarter, reflecting in part the reduction in the rate of business inventory accumulation.

Nonfarm payroll employment continued to rise in December, and after adjustment for strikes, the gain was as large as in November. Employment increases were again substantial in trade, services, and State and local government. In manufacturing too, the gain was sizable, but the average workweek declined, in part because of the curtailment in assemblies of autos. The unemployment rate dropped to 6.4 per cent in December from a (revised downward) rate of 6.7 per cent in November.

The dollar value of retail sales, according to the Census Bureau's advance estimate, had declined a little in December after having risen sharply in the preceding 2 months. For the fourth quarter as a whole sales rose by almost 4 per cent, about equaling the large rise in the fourth quarter of 1976. Unit sales of new domestic and foreign autos increased somewhat in December, returning to about the October level, and sales were almost as high in the fourth quarter as in the third.

Private housing starts, as had been reported before the Committee's December meeting, edged down in November to an annual rate of about 2.1 million units. The average number of starts for October and November was 5 per cent above the third-quarter average, which in turn was the highest of the current expansion.

The latest Department of Commerce survey of business spending plans, taken in late November and December, suggested that spending for plant and equipment would expand 10.1 per cent in 1978. Such spending had increased 13.7 per cent in 1977.

Manufacturers' new orders for nondefense capital goods declined 5 per cent in November, but the October-November average was about 6-1/2 per cent above the third-quarter average. Contract awards for commercial and industrial buildings--measured in terms of floor space--advanced sharply in November after having declined in October. The average for the 2 months was somewhat higher than that for the third quarter.

The index of average hourly earnings for private nonfarm production workers increased relatively little in December, as it had in November. However, from December 1976 to December 1977 the index rose 7.4 per cent, which compared with an increase of 6.9 per cent over the preceding 12 months.

The wholesale price index for all commodities rose 0.5 per cent in December, considerably less than in October and November. Average prices of farm products and foods advanced only 0.4 per cent in December, compared with an average increase of 1.8 per cent over the preceding 2 months. The 0.5 per cent rise in prices of industrial commodities in December equaled the October-November average.

The consumer price index rose 0.5 per cent in November, somewhat more than in any of the preceding 4 months. Retail prices of foods increased 0.6 per cent, in contrast with an average between 0.1 and 0.2 per cent in the July-October period. The pace of advance in nonfood commodities also picked up, mainly because of increases for new autos, but the rise in prices of services remained at a reduced rate.

In foreign exchange markets the dollar continued under strong downward pressure from mid-December to just after the turn of the year, and during that period its trade-weighted value against major foreign currencies declined about 2-1/2 per cent. On January 4, 1978, it was announced that the Exchange Stabilization Fund of the U.S. Treasury would henceforth be utilized actively, together with the swap network operated by the Federal Reserve System, to check speculation and to help re-establish order in the foreign exchange markets. On January 6 the Board of Governors announced approval of an increase in Federal Reserve discount rates from 6 to 6-1/2 per cent, and in an accompanying press release noted that the recent disorder in foreign exchange markets constituted a threat to orderly expansion of the domestic and international economy. The Board expressed the hope that the need for this increase would prove temporary. It also noted that the condition of the domestic economy was sound and that credit supplies to sustain the economic expansion would remain ample. From January 4 to the time of this meeting the trade-weighted value of the dollar recovered about 1-3/4 per cent.

The U.S. foreign trade deficit declined substantially in November after a sharp increase in October. The dock strike that had halted containerized shipments through Atlantic and Gulf Coast ports between October 1 and November 29 appeared to have depressed recorded exports and imports by similar amounts in November, whereas in October the strike had caused much more of a reduction in recorded exports than imports.

At U.S. commercial banks, total credit contracted slightly in December, but because it had grown rapidly in October and November, expansion for the fourth quarter as a whole remained close to the third-quarter pace. The December halt in growth of bank credit reflected both a sharp slackening in loan expansion and a further contraction in holdings of securities.

While the reduced loan expansion at banks in December stemmed in part from a large net reduction in securities loans, business loan growth also slowed appreciably. Sales of commercial paper expanded by a roughly similar amount, however, so total short-term credit to nonfinancial businesses from these sources rose at about the same pace in December as in November.

The narrowly defined money stock (M-1)[1/] grew at a 7.6 per cent annual rate in December and at a 6.8 per cent annual rate for the fourth quarter as a whole. From the fourth quarter of 1976 to the fourth quarter of 1977, M-1 grew 7.4 per cent, compared with 5.6 per cent in 1976 and 4.4 per cent in 1975.

In the third quarter of 1977 M-1 had grown nearly as fast as nominal GNP so the income velocity of M-1--the ratio of nominal GNP to M-1--had shown little change. It appeared, however, that income velocity had increased significantly in the fourth quarter as a result of both faster growth in GNP and a slower rise in M-1.

1/ M-1 is composed of private demand deposits and currency in circulation.

Growth in M-2[2/] increased somewhat in December from the low November rate. Virtually all of the growth in the time and savings deposit component of M-2 occurred in large-denomination time deposits not subject to ceiling rates; savings deposits remained about unchanged for the second consecutive month and small-denomination time deposits, which had contracted in November, expanded only a little. From the fourth quarter of 1976 to the fourth quarter of 1977, M-2 grew 9.6 per cent, compared with 10.9 per cent in 1976 and 8.3 per cent in 1975.

Deposit growth at nonbank thrift institutions slowed further in December, and M-3[3/] expanded at a 7.5 per cent annual rate--about the same as in November. Most of the December growth in deposits at thrift institutions presumably occurred in longer-maturity instruments on which the effective offering rates still exceeded yields available on Treasury securities of comparable maturity. For 1977 as a whole, M-3 grew 11.6 per cent.

2/ M-2 includes M-1 and commercial bank time and savings deposits other than large-denomination certificates of deposit.
3/ M-3 includes M-2 and deposits at nonbank thrift institutions (savings and loan associations, mutual savings banks, and credit unions).

At its December 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 the 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 6-1/2 per cent, so long as M-1 and M-2 appeared 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. However, members also 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.

The Committee also had included in 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 had been 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.

With the monetary aggregates apparently expanding at rates well within the Committee's specified ranges, the Manager of the System Account continued to aim for a Federal funds rate of around 6-1/2 per cent in the last weeks of December and the first statement week of January. Due to technical factors, however--including the usual money market churning around year-end--Federal funds actually traded at rates somewhat above this level. The Manager in early January also shaded his Federal funds rate objective slightly upward because of downward pressures on the dollar in foreign exchange markets. On January 9, following the January 6 increase in Federal Reserve discount rates to 6-1/2 per cent, the Federal Open Market Committee concurred in the Chairman's recommendation to raise the inter-meeting range for the Federal funds rate to 6-1/2 to 7 per cent and to instruct the Manager to aim for a rate of around 6-3/4 per cent over the next few days. In the days remaining until this meeting, the funds rate averaged 6.75 per cent.

During the initial weeks of the inter-meeting period other short-term interest rates showed little net change, while longer-term rates tended to move higher. After the discount rate action and the increase in the funds rate to 6-3/4 per cent, short-term market rates adjusted sharply upward, with the largest net increases--ranging from 35 to 45 basis points--occurring on Treasury bills. Bond yields also rose somewhat further over this period but significantly less than bill rates.

Auctions of 2-year notes and 15-year bonds netted the U.S. Treasury $2.7 billion of new money during the inter-meeting period--including $600 million of 2-year notes sold directly to foreign official institutions on a noncompetitive basis. For the fourth quarter as a whole, net Treasury sales of marketable debt to the public totaled nearly $19 billion, a substantial share of which was purchased by foreign official institutions.

The volume of bonds offered publicly by nonfinancial corporations in December was somewhat less than in previous months, as industrial firms reduced their flow of new issues. Financial concerns continued to borrow heavily in long-term debt markets, however.

Offerings of State and local government bonds expanded contraseasonally in December, raising the total for the fourth quarter almost to the high level of the third quarter. Most of the December rise was attributable to advance refunding issues.

Net mortgage lending in the fourth quarter appeared to be running close to the record third-quarter rate. Savings and loan associations managed to sustain an unusually high level of lending--notwithstanding their slower deposit inflows--by increasing their borrowings, particularly from Federal home loan banks. Such borrowing rose $2.6 billion during the quarter, the largest expansion in more than 3 years.

In the Committee's discussion of the economic situation, most members agreed that the staff's projection of the growth rate in real GNP over the full year 1978 was reasonable. However, there was some difference of opinion regarding the probable profile of the expansion during the course of the year. Specifically, a number of members thought that growth might be faster in the first half of 1978 and slower in the second half than had been projected.

In this connection, it was suggested that in the early part of 1978 production would be stimulated by business efforts to restore inventories depleted by the surge in sales that had occurred in the fourth quarter of 1977. It was observed, however, that if production increased as expected and growth in sales slowed, the consequent inventory build-up could lead to a need for correction and hence to slower growth in output later in the year. There was some feeling also that the proposed reductions in Federal income taxes might have less stimulative effect in the fourth quarter than expected by the staff, and it was noted that payroll taxes for social security and unemployment insurance were scheduled to rise at the beginning of 1979. One member was of the opinion that a number of forces, including the depreciation of the dollar that had occurred in foreign exchange markets, would induce a faster rise in prices than the staff had anticipated and that inflation would tend to slow the expansion in activity as the year progressed. However, none of the members who expressed concern about the growth of real GNP late in the year anticipated that the economy would move into a recession during 1978.

Other members were more optimistic about the economic outlook. One noted that at this time of the year forecasters almost invariably expressed more uncertainty about the prospects for the second half than for the first half. Another indicated that he expected the expansion to be sustained by a gradual improvement in business and consumer confidence. This member and others also stressed the stimulative effects of the prospective tax reduction, and one noted that if necessary the reduction could be larger than presently contemplated.

These differences of view were generally associated with different expectations for major sectors of the economy. Thus, one member expressed the opinion that residential construction activity would remain at a high level during 1978, in part because individuals were tending to perceive homeownership as an effective hedge against inflation. At the same time, this member noted that the recent spurt in consumer spending had been financed in considerable measure by credit; he did not expect the rapid expansion to continue, and he thought it would be an unhealthy development if it did. Another member said he anticipated an appreciable decline in the rate of housing starts during the year, and a third expressed concern about the possible consequences for housing activity if thrift institutions should cut back significantly on new mortgage commitments because of the record volume already outstanding and because of increased uncertainty about the pace of deposit inflows. The latter member also doubted that consumer purchases of new automobiles would be sustained at the levels of 1976 and 1977 for another year, as projected by the staff, especially in view of the downtrend in sales that appeared to have been under way since last spring.

With respect to business fixed investment, the results suggested by the recent Commerce Department survey of business spending plans for 1978 were described as disappointing. It was also observed, however, that a more favorable outlook for capital investment was presented by such indicators as new orders for nondefense capital goods, construction contracts for commercial and industrial buildings, formations of new businesses, and newly approved capital appropriations, and that over the years such measures had provided better indications of future business fixed investment than had surveys of spending plans. It was noted that the administration's tax program would include new incentives for business fixed investment, and one member suggested that such investment was likely to be stimulated by rising rates of capacity utilization, such as those being forecast for the coming year. However, another member offered the hypothesis that the need for new plants in this country was being reduced by a trend toward remodeling and re-equipping existing structures and by a tendency for multinational corporations to rely on their plants abroad for needed capacity.

It was observed during the discussion that the course of business fixed investment depended on the state of business confidence in general and on profit expectations in particular. Some members reported that they had recently detected some deterioration of business confidence, but others felt that the state of confidence had remained unchanged or had improved. One member remarked that businessmen had long been deeply disturbed about the persistence of inflation, and that recently some who followed monetary developments closely had begun to question the System's determination to slow the rates of growth of the monetary aggregates. One member observed that the recent behavior of the stock market--including the low levels to which price/earnings ratios had fallen--was not indicative of the kind of business confidence that normally would be accompanied by rising investment. Another member remarked that low price/earnings ratios probably reflected in part the realization by investors that reported earnings overstated real earnings as a result of the use of conventional accounting procedures in a period of inflation. It also was suggested that in making investment decisions businessmen were now insisting on shorter expected "payout" periods than they had earlier because they perceived the risks to be greater.

Serious concern continued to be expressed about the dollar's weakness in foreign exchange markets, although it was noted that the dollar had recovered somewhat over the past 2 weeks. The observation was made that the conventional theory concerning depreciation of a currency did not apply to the dollar because of its special role in international trade and finance. Specifically, it was suggested that depreciation of the dollar tended to weaken confidence here and abroad and to cause postponement of decisions to spend or to invest in new facilities; that the counterpart of the dollar's depreciation--appreciation of foreign currencies--adversely affected exports of other major countries and generated risks of stagnation or recession in economic activity; and that this negative impact on aggregate demand abroad could have adverse effects on the U.S. foreign trade balance that greatly outweighed the favorable effects of the improved competitiveness of U.S. products in markets here and abroad. As at the December meeting, 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 meeting in October 1977 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 had also been 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. However, no further modification was made at this meeting.

In the Committee's discussion of policy for the period immediately ahead, a number of members suggested that any significant easing of money market conditions would be undesirable at this time because of the weakness of the dollar in foreign exchange markets and--in the view of some--because of the cumulative growth rates in the monetary aggregates over recent months. Each of the three members who had dissented from the decision of January 9 to seek a higher Federal funds rate indicated that he would not now advocate a rollback since that decision had been implemented and absorbed by the financial markets. At the same time, there was little sentiment for further firming actions in the coming inter-meeting period unless the monetary aggregates appeared to be growing at rapid rates.

Consistent with these views, most members expressed a preference for continuing to give greater weight than usual to money market conditions in conducting operations in the period until the next meeting of the Committee. However, a few favored basing operating decisions primarily on the behavior of the monetary aggregates, particularly if growth rates appeared to be higher than desired. While there was general agreement that operations should be directed initially toward maintaining the current Federal funds rate of about 6-3/4 per cent, various suggestions were made with respect to the range in which the funds rate might be varied if the growth rates in the monetary aggregates appeared to be deviating markedly from expectations. Thus, some members favored retaining the present range of 6-1/2 to 7 per cent, but others were inclined to raise the lower limit to 6-5/8 or 6-3/4 per cent; some in the latter group also suggested raising the upper limit.

In addition, there were some differences of view with respect to the specifications for growth in M-1 over the January-February period, relating to both the width and the level of the range. A number of members suggested that the range be narrowed from the spread of 6 percentage points used in the last few directives to one of 5 or 4 points, while others were willing to retain the wider range. Suggestions for the lower limit of the M-1 range varied from 1-1/2 to 3-1/2 per cent and those for the upper limit varied from 7 to 8-1/2 per cent. For M-2 the majority of members favored a range of 5 to 9 per cent, although one advocated a substantial reduction in the lower limit and another was inclined to reduce both limits slightly.

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 the current 6-3/4 per cent 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 6-1/2 to 7 per cent. It was understood that very strong evidence of weakness in the monetary aggregates would be required before operations were directed toward reducing the Federal funds rate from its current level. For the annual rates of growth in M-1 and M-2 over the January-February period, the Committee specified ranges of 2-1/2 to 7-1/2 per cent and 5 to 9 per cent, respectively. It also agreed that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of M-1 and of M-2.

The Committee decided to retain in the directive the sentence calling for account to be taken of "emerging financial market conditions, including the unsettled conditions in foreign exchange markets" in the conduct of day-to-day open market operations. As already noted, this instruction had been included in the previous directive in part because of the Committee's view that the nature and timing of operations might appropriately be influenced by pressures on the dollar in foreign exchange markets.

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 in the fourth quarter was close to the pace in the third quarter. The dollar value of total retail sales declined in December, but the gain from the third to the fourth quarter was substantial. Industrial production expanded somewhat further in December, although the rise was limited by a strike in coal mining. Employment increased appreciably, and the unemployment rate declined from 6.7 per cent to 6.4 per cent. The wholesale price index for all commodities rose considerably less in December than

in the preceding 2 months, reflecting a much smaller increase in average prices of farm products and foods. Prices of industrial commodities advanced at about the average pace in the preceding 2 months. The index of average hourly earnings advanced slightly faster during 1977 than it had during 1976.

Exchange market pressure on the dollar has continued in recent weeks. On January 4 it was announced that the Exchange Stabilization Fund would be utilized actively together with the swap network operated by the Federal Reserve System to help re-establish order in the foreign exchange markets. On January 6 an increase in Federal Reserve discount rates from 6 to 6-1/2 per cent was announced. The trade-weighted value of the dollar against major foreign currencies declined about 2-1/2 per cent further from mid-December to the early days of January but subsequently recovered about 1-3/4 per cent.

M-1--which had declined slightly in November--rose in December. Growth in M-2 remained relatively slow, as inflows to banks of time and savings deposits other than negotiable CD's were sharply curtailed. Inflows to nonbank thrift institutions slowed somewhat further. Market interest rates edged up in late December, and rates--particularly for short-term securities--rose substantially further in the early weeks of January.

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 January-February period at annual rates within ranges of 2-1/2 to 7-1/2 per cent and 5 to 9 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 6-1/2 to 7 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, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None. Absent and not voting: Mr. Jackson.

2. Authorization for foreign currency operations

Paragraph 1D of the Committee's authorization for foreign currency operations authorizes the Federal Reserve Bank of New York for 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 had authorized an open position of \$1.5 billion.

At this meeting the Committee authorized an open position of \$1.75 billion. This action was taken in view of the scale of recent and potential Federal Reserve operations in the foreign exchange markets undertaken pursuant to the Committee's foreign currency directive.

> Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None. Absent and not voting: Mr. Jackson.

3. Authorization for domestic open market operations

At this meeting the Committee amended, effective immediately, the authorization for domestic open market operations by adding the following paragraph, designated paragraph 4:

> In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, (a) for System Open Market Account, to sell U.S. Government securities to such foreign and international accounts on the bases set forth in paragraph 1(a) under agreements providing for the resale by such accounts of those securities within 15 calendar days on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph 1(c), repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account

and foreign and international accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None. Absent and not voting: Mr. Jackson.

Since mid-1974 the Federal Reserve Bank of New York had made available to its foreign official accounts a facility for making repurchase agreements (Rp's) involving U.S. Government and Federal agency securities. The facility not only provided a service for foreign central banks but also added a useful dimension of flexibility to System open market operations. In arranging Rp's for foreign official accounts the New York Bank had--depending on the System's operating objectives at the moment--either served as an agent in arranging the transactions with the market or made the transactions with the System Open Market Account (SOMA). Arrangements of the former type were not under the jurisdiction of the Federal Open Market Committee; those of the latter type were authorized by the Committee under the general authority to buy or sell U.S. Government or agency securities for SOMA contained in paragraph 1(a) of the authorization for domestic open market operations.

In May 1977 the New York Bank had learned of an Internal Revenue Service (IRS) ruling on the treatment of Rp's by a taxpayer that suggested that a tax liability might be incurred in connection with income earned by some foreign official accounts on Rp's with the market. At the same time it did not appear probable that a tax liability would be incurred in the case where Rp's were arranged between foreign official accounts and some entity of the Federal Reserve System. Accordingly, after Committee discussion, the New York Bank ceased acting as agent for foreign official accounts in making Rp's with the market, and it requested an IRS determination of the tax consequences of Rp's made for foreign official accounts with various entities. The IRS subsequently ruled that income received by foreign central banks on Rp's made with SOMA, or with the Federal Reserve Bank of New York acting as a principal, was exempt from Federal income tax.

In light of that ruling, the Committee amended its authorization for domestic open market operations to authorize the New York Bank to arrange foreign official account Rp's with the Bank as a principal, and to make corresponding Rp's with the market, again with the Bank acting as principal. It was understood that such "back-to-back" arrangements would be undertaken under circumstances similar to those in which, before May 1977, the Bank had served as agent in arranging foreign official account Rp's with the market. While the authority for the New York Bank to make foreign official account Rp's with SOMA had been viewed as contained in paragraph 1(a) of the authorization, for the sake of clarity and completeness the Committee decided to include language explicitly authorizing such transactions in the new paragraph 4, along with the authority for the New York Bank to act as a principal in "back-to-back" Rp transactions.

Subsequent to this meeting, on February 15, 1978, Committee members voted to increase from $3 billion to $4 billion the limit on changes between Committee meetings in System Account holdings of U.S. Government and Federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective immediately, for the period ending with the close of business on February 28, 1978.

> Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Mayo, Morris, Partee, and Roos. Votes against this action: None. Absent and not voting: Messrs. Lilly and Wallich.

This action was taken on recommendation of the System Account Manager. The Manager had advised that large-scale sales of Treasury securities since the January meeting--required mainly to counter the effect of seasonal declines in required reserves and currency in circulation--had reduced the leeway for further sales to $780 million, and that it appeared likely that the leeway would shortly be reduced further, to $300 million or less, as a result of the completion of an anticipated transaction with a foreign account. The Manager also noted that the current inter-meeting period had been lengthened by a change in the date of the next meeting from February 22 to February 28, and that projections suggested the need for further reserve-absorbing operations during the interval ending with the latter date.