



FEDERAL RESERVE

press release

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The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on August 15, 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 August 15, 1978

Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services was growing moderately in the current quarter, although the rate of expansion appeared to be a little below the average pace in the first two quarters of the year. The rise in prices--as measured by the fixed-weighted price index for gross domestic business product--seemed to have slowed appreciably from the second-quarter rate but was still well above the rise in other recent quarters.

Staff projections for the year ending in the second quarter of 1979 were little changed from a month earlier. They continued to suggest that output would grow at a moderate pace, with the unemployment rate projected to decline slightly from its July level. The rate of inflation was expected to remain rapid, but to moderate considerably from its pace in the second quarter of 1978.

In July the index of industrial production increased an estimated 0.5 per cent, equal to the gains now indicated for May and June but well below the rapid advances in March and April. Total nonfarm payroll employment rose in July at close to the

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May-June pace, after exceptional gains in March and April. In manufacturing, employment rose slightly in July while the average workweek was unchanged. The over-all unemployment rate jumped 0.5 of a percentage point, following a decline of 0.4 of percentage point in June; the July level of 6.2 per cent was about the same as the average in the first 5 months of the year.

In June, private housing starts exceeded an annual rate of 2 million units for the fourth consecutive month. Starts averaged 2.1 million units in the second quarter, about the same as in the second half of 1977 and well above the rate for the first quarter of 1978.

Total retail sales changed little in July for the third consecutive month following exceptional gains earlier in the year. Unit sales of new automobiles fell somewhat in July from the very rapid pace in the second quarter, while dollar sales of other durable goods rose considerably further.

The index of average hourly earnings for private non-farm production workers increased at an annual rate of nearly 10 per cent in July; over the first 7 months of the year the index had risen at an annual rate of close to 9 per cent, considerably above its advance in 1977. The rise in average prices of producer goods moderated somewhat in July as prices

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of consumer foods declined after moving up rapidly in most earlier months of the year. In June the consumer price index for all urban consumers continued to rise at a rapid pace; over the first half of the year the index advanced at an annual rate of more than 10 per cent.

In foreign exchange markets the trade-weighted value of the dollar had declined nearly 6 per cent further since mid-July to a level about 10 per cent below the 1978 peak in May. The downward pressure on the dollar appeared to reflect widespread concern about the outlook for inflation in the United States and the persistence of large imbalances in the international payments positions of the United States and some of its major trading partners. The U.S. trade deficit, however, had declined in the second quarter from an extraordinarily high rate in the first quarter.

Following a substantial slowdown in June, the expansion in total credit at U.S. commercial banks accelerated in July to a pace close to the unusually rapid growth experienced in April and May. Expansion in bank loans was very strong in July and included growth in all major loan categories. Banks also made sizable additions to their holdings of U.S. Treasury and other securities. While growth in business loans was above the reduced

pace in June, it remained well below the average rate in the first half of the year. Outstanding commercial paper of non-financial businesses continued to expand rapidly in July.

Growth of the narrowly defined money supply (M-1) remained moderate in July. Growth in M-2 and M-3 also continued moderate, as substantial inflows of funds into large-denomination time deposits at banks and into the new money market certificates at nonbank thrift institutions were partly offset by weakness in savings and small-denomination time deposits.

At its meeting on July 18 the Committee had decided that the ranges of tolerance for the annual rates of growth in M-1 and M-2 during the July-August period should be 4 to 8 per cent and 6 to 10 per cent, respectively. The Committee had agreed that during the coming inter-meeting period operations should be directed toward maintaining the weekly-average Federal funds rate within a range of 7-3/4 to 8 per cent. It was also agreed that if, with approximately equal weight given to M-1 and M-2, growth rates of the aggregates appeared to be close to or beyond the limits of the indicated ranges, the objective for the funds rate was to be raised or lowered in an orderly fashion within its specified range.

Following the July 18 meeting the Manager of the System Open Market Account sought bank reserve conditions consistent with a weekly-average Federal funds rate somewhat above 7-3/4 per cent. Data that became available throughout the inter-meeting interval suggested that growth in the monetary aggregates over the July-August period would be well within the Committee's ranges and the Manager continued to seek conditions consistent with a Federal funds rate within a range of 7-3/4 to 8 per cent. The average rate during the inter-meeting period was about 7-7/8 per cent.

Market interest rates on most short- and long-term securities had declined 10 to 30 basis points since mid-July. The fall in rates apparently reflected a shift in expectations that was influenced by the recent pattern of moderate growth in the monetary aggregates, a smaller rise in the Federal funds rate than many had anticipated, and signs of some slowing in economic expansion. Declines in Treasury bill rates were also encouraged by sizable investments by foreign central banks of dollars obtained in currency support operations.

Conditions in mortgage markets, which had tightened significantly during the first half of the year, had stabilized in recent weeks. Interest rates on new commitments for

conventional mortgage loans at savings and loan associations had changed little during the inter-meeting period, while yields in the secondary market for home mortgages had declined in line with reductions in most other market rates.

In the Committee's discussion of the economic situation, there was general agreement that the outlook for economic activity had changed little since the July meeting, and that in the year ending with the second quarter of 1979 output of goods and services was most likely to grow at about the moderate pace projected by the staff. This judgment was qualified by the recognition that the weakness of the dollar in foreign exchange markets might have unfavorable repercussions on the domestic economy.

Committee members who differed with the staff economic projection all expected average growth to be a little less than the staff figure. A few members, while anticipating somewhat greater growth than the staff was projecting for the last half of 1978, continued to believe that growth in 1979 would slow more abruptly.

Several members noted that although economic growth had moderated recently, the pattern of expansion appeared to be well-balanced. In their judgment none of the key economic sectors was exhibiting either serious sluggishness or

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unsustainably rapid growth; there was little evidence of developing capacity constraints and inventory surpluses were not a problem.

One negative element in this pattern, which seriously concerned all members of the Committee, was the unexpectedly high recent rate of inflation in prices and wages and the related possibility that an appreciable slowing of inflation would prove more difficult to achieve than previously had been anticipated. It was observed in this connection that the declining value of the dollar in foreign exchange markets was contributing significantly to inflation in the United States. Nearly all the Committee members expected price increases for the year ahead to be more rapid than the staff was projecting.

One member suggested that although the economy appeared to be fairly well-balanced by the usual standards, there were potential problem areas: He identified the heavy reliance of consumers on credit to finance their spending; growing, if still limited, capacity constraints and materials shortages; and, of particular concern to him, the likely inflationary effects of impending wage settlements. Because of these generally strong inflationary pressures, he thought the risks of an early end to the expansion had become greater.

Other members of the Committee suggested that an important change in the outlook since the July meeting was an apparent stiffening in the resolve of labor leaders to hold out in forthcoming contract negotiations for sizable wage settlements. One member also cited apparent efforts by some businessmen to accelerate increases in wages and prices because of their concern that controls might be imposed.

Committee members differed little in their estimates of the likely unemployment rate in the second quarter of 1979. Those estimates were all relatively close to the average rate thus far in 1978. It was suggested that productivity would show little increase over the projection period.

At its meeting in July the Committee had agreed that from the second quarter of 1978 to the second quarter of 1979 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, 7-1/2 to 10 per cent. The associated range for the rate of growth in commercial bank credit was 8-1/2 to 11-1/2 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.

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In the discussion of policy for the period immediately ahead, most members expressed a preference for some slight firming of money market conditions. Several members emphasized the need to restrain the expansion of the monetary aggregates, especially in light of current and prospective inflationary pressures. It was suggested that an indication at this time of the System's continued determination to resist inflation would have a favorable impact on confidence, both in the domestic economy and in foreign exchange markets. With regard to the latter, the members were seriously concerned about the weakness of the dollar. They recognized that interrelated governmental actions would be needed to make progress in this area.

No sentiment was expressed at this meeting for an easing of money market conditions. On the other hand, it was suggested that a sharp move toward restraint under present circumstances might incur an undue risk of precipitating a recession. Two members preferred to retain current money market conditions for the time being.

There were only small differences among most Committee members in their preferences for operating specifications for the period immediately ahead. They were nearly unanimous in favoring a return to basing decisions for open market operations between

meetings primarily on the behavior of the monetary aggregates. In its previous directive the Committee had called for giving greater weight than usual to money market conditions.

For the annual rate of growth in M-1 over the August-September period, most members favored ranges of 4 to 8 per cent or 5 to 9 per cent, but two members also found acceptable a range of 3 to 8 per cent and one preferred a lower range of 3 to 7 per cent. For M-2 most members advocated ranges of 6 to 10 per cent or 6-1/2 to 10-1/2 per cent and one proposed a range of 6 to 11 per cent. One member preferred narrower ranges for both M-1 and M-2 that would be relatively close to the 12-month ranges adopted by the Committee; for M-1 he suggested a range of 5-1/2 to 7-1/2 per cent and for M-2 a range of 6-1/2 to 8-1/2 or 9 per cent. Other members, while preferring wider 2-month ranges, also felt that those ranges should more or less encompass the 12-month ranges in order to facilitate achievement of the Committee's objectives.

Most of the members favored directing open market operations toward a Federal funds rate of about 8 per cent shortly after today's meeting, but two members urged some delay in order to assess further information on the monetary aggregates and developments in foreign exchange markets. One member preferred to continue aiming initially for a Federal funds rate of around 7-7/8 per cent in light of

uncertainties about the economic outlook and the related performance of the monetary aggregates.

With respect to the inter-meeting range for the Federal funds rate, all but two members favored 7-3/4 to 8-1/4 per cent; one preferred 8 to 8-1/4 per cent and another 7-3/4 to 8-1/2 per cent. The latter member felt that more leeway should be provided for raising the rate in the event that the monetary aggregates appeared to be growing rapidly in relation to the Committee's preferences for the August-September period. However, a majority of the members indicated that they did not want to see the Federal funds rate exceed 8-1/4 per cent without further assessment of new developments and the opportunity for consultation among the members.

At the conclusion of the discussion the Committee decided that ranges of tolerance for the annual rates of growth in M-1 and M-2 over the August-September period should be 4 to 8 per cent and 6 to 10 per cent, respectively. With regard to the Federal funds rate, the Manager was instructed to seek a rate of around 8 per cent early in the period following today's meeting. Subsequently, if the 2-month growth rates of M-1 and M-2 appeared to be significantly above or below the midpoints of the indicated ranges, the objective for the funds rate was to be raised or lowered in an orderly

fashion within a range of 7-3/4 to 8-1/4 per cent. 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 its directive a reference to developments in foreign exchange markets as well as the usual reference to conditions in domestic financial markets. The purpose of the added instruction was to provide the Manager with some flexibility to adjust the nature and timing of his operations in light of possible pressures on the dollar in foreign exchange markets.

As is 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 moderately in the current quarter, although the pace is a little less than the average for the first two quarters of the year. In July retail sales remained at about the advanced level reached in April. Industrial production and nonfarm payroll employment continued to expand at lower rates than in the early spring months. The unemployment rate,

which had dropped 0.4 of a percentage point in June, jumped 0.5 of a percentage point in July to 6.2 per cent, about the average rate in the first 5 months of the year. Average prices of goods and services have continued to rise rapidly, although producer prices of foods and foodstuffs declined in July. The advance in the index of average hourly earnings has been somewhat faster so far in 1978 than it had been on the average during 1977.

"Since mid-July the trade-weighted value of the dollar against major foreign currencies has declined sharply further. The U.S. trade deficit was lower in the second quarter than the very high rate of the first quarter.

"Growth in M-1 remained moderate in July. Inflows of the interest-bearing deposits included in M-2 and M-3 picked up, owing to substantial flows into large-denomination time deposits at banks and into the new money market certificates at nonbank thrift institutions. Nevertheless, expansion in the broader aggregates also remained moderate in July. Most market interest rates have declined appreciably on balance in recent weeks.

"In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster monetary and financial conditions that will resist inflationary pressures while encouraging continued moderate economic expansion and contributing to a sustainable pattern of international transactions. At its meeting on July 18, 1978, the Committee agreed that these objectives would be furthered by growth of M-1, M-2, and M-3 from the second quarter of 1978 to the second quarter of 1979 at rates within ranges of 4 to 6-1/2 per cent, 6-1/2 to 9 per cent, and 7-1/2 to 10 per cent, respectively. The associated range for bank credit is 8-1/2 to 11-1/2 per cent. These ranges are subject to reconsideration at any time as conditions warrant.

"In the short run, the Committee seeks to achieve bank reserve and money market conditions that are broadly consistent with the longer-run ranges for monetary aggregates cited above, while giving due regard to developing conditions in domestic and international financial markets more generally. Early in the period until the next regular meeting, System open market operations shall be directed at attaining a weekly-average Federal funds rate slightly above the current level. Subsequently, operations shall be directed at maintaining the weekly-average Federal funds rate within the range of 7-3/4 to 8-1/4 per cent. In deciding on the specific objective for the Federal funds rate the Manager shall be guided mainly by the relationship between the latest estimates of annual rates of growth in the August-September period of M-1 and M-2 and the following ranges of tolerance: 4 to 8 per cent for M-1 and 6 to 10 per cent for M-2. If, giving approximately equal weight to M-1 and M-2, their rates of growth appear to be significantly above or below the midpoints of the indicated ranges, the objective for the funds rate shall be raised or lowered in an orderly fashion within its range.

"If the rates of growth in the aggregates appear to be above the upper limit or below the lower limit of the indicated ranges at a time when the objective for the funds rate has already been moved to the corresponding limit of its range, 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. Miller, Volcker, Baughman, Coldwell, Eastburn, Gardner, Jackson, Wallich, and Winn. Votes against this action: Messrs. Partee and Willes.

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Mr. Partee dissented from this action because he favored a 2-month range of tolerance for growth in M-1 that was somewhat higher than the range advocated by the majority. He did not believe that a further move toward firmer money market conditions was warranted unless monetary expansion proved to be distinctly on the high side, especially in view of the marked slowing in real economic growth that now appeared to be in progress.

Mr. Willes dissented because he favored a more vigorous effort to curb the expansion of the monetary aggregates in light of current and expected inflationary pressures in the domestic economy and the weakness of the dollar in foreign exchange markets. He preferred to specify a 2-month range of tolerance for M-1, below the range agreed upon by the majority.

Subsequent to the meeting, on September 8, the Committee held a telephone conference meeting pursuant to its decision on August 15 to consult further if the rates of growth in the monetary aggregates appeared to be above or below the limits of the Committee's ranges of tolerance for the August-September period and the Federal funds rate had already moved to the corresponding limit of its range. The latest staff projections suggested that M-1 and M-2 would grow at annual rates of 9.0 and 11.3 per cent, respectively, over the August-September period; the ranges of

tolerance established at the August 15 meeting were 4 to 8 per cent for M-1 and 6 to 10 per cent for M-2. The Manager had been aiming for a funds rate of about 8-1/4 per cent, the top of the range that the Committee had specified at its August meeting, and the average rate in each of the two latest statement weeks was at about that level.

Against this background, the Committee decided to raise the upper limit of the range for the Federal funds rate to 8-1/2 per cent and to instruct the Manager to aim promptly for a weekly-average Federal funds rate of about 8-3/8 per cent. It was understood that the funds rate might be raised to the upper limit of the range if new data suggested that the aggregates were strengthening further, or be reduced slightly if such data suggested significant weakening from current projections.

On September 8, 1978, the Committee modified the domestic policy directive adopted at its meeting of August 15, 1978, by increasing the upper limit of the 7-3/4 to 8-1/4 per cent range specified for the Federal funds rate to 8-1/2 per cent and by calling for operations directed at raising the weekly-average Federal funds rate promptly to 8-3/8 per cent.

Votes for this action: Messrs. Miller, Volcker, Coldwell, Eastburn, Gardner, Jackson, Kimbrel, Partee, Willes, and Winn. Votes against this action: None. Absent and not voting: Messrs. Baughman and Wallich (Mr. Kimbrel voted as alternate for Mr. Baughman.)