



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 September 19, 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 September 19, 1978

1. Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services had been growing moderately in the current quarter, but the rate of expansion appeared to be somewhat below the average annual rate of about 4 per cent estimated by the Commerce Department for the first two quarters of the year. The rise in average prices--as measured by the fixed-weight price index for gross domestic business product--slowed considerably from the exceptional pace in the second quarter, but the rise was still relatively rapid.

Staff projections for the period from the current quarter through the second quarter of 1979 were little changed from those of a month earlier. They continued to suggest that output would grow moderately over the period and that the rate of inflation would be rapid, although considerably below the average pace in the first two quarters of 1978. The unemployment rate was expected to change little from its August level.

In August the index of industrial production increased an estimated 0.5 per cent, close to the moderate gains in the preceding 3 months but well below the large increases in March

and April. Nonfarm payroll employment rose further in August, but the gain was about half the monthly increase in the preceding 3 months. In manufacturing, employment declined somewhat and the average workweek continued to change little at a relatively high level. The unemployment rate fell 0.3 of a percentage point to 5.9 per cent, a rate slightly below the average in the first 7 months of the year.

Total private housing starts edged down in July. At an annual rate of nearly 2.1 million units, however, starts were close to the pace in the second quarter of 1978 and in the second half of 1977.

The latest Department of Commerce survey of business plans, taken in late July and August, suggested that spending for plant and equipment would be 12.3 per cent greater in 1978 than in 1977, a somewhat larger increase than had been indicated 3 months earlier. Businesses spent more in the second quarter of 1978 than had been anticipated, and the latest survey still implied less expansion in spending over the second half of the year than over the first half.

The dollar value of total retail sales rose in August, but the increase followed a decline now indicated for July; on balance sales had changed little since April. Unit sales of new

automobiles, which had declined in July, recovered in August almost to the advanced pace of the second quarter.

The index of average hourly earnings for private nonfarm production workers rose little in August following a substantial increase in July; over the first 8 months of the year the index advanced at an annual rate of about 8 per cent, somewhat more than it had during 1977. Declines in prices of food products contributed to a moderation in the rise of the consumer price index in July and to a slight reduction in average prices of producer finished goods in August; both price measures had risen at very rapid rates in the first half of the year.

The trade-weighted value of the dollar against major foreign currencies, which had declined sharply in early August, subsequently recovered against a background of uncertain conditions in exchange markets. The recovery was triggered early in the inter-meeting period by expressions of concern by U.S. officials, and was reinforced by subsequent increases in U.S. short-term interest rates and the announcement of expanded gold sales by the U.S. Treasury. However, the dollar weakened in late August, when it was announced that the U.S. trade deficit had increased sharply in July, and at the time of this meeting the dollar was somewhat below its level at the end of July.

After a surge in July, total credit at U.S. commercial banks expanded at a substantially slower rate in August, mainly because of large declines in bank holdings of U.S. Treasury securities and in security loans. Growth in business loans accelerated further but remained well below the average rate in the first half of 1978. Outstanding commercial paper of nonfinancial businesses contracted slightly, following a sharp expansion in June and July.

Growth of the narrowly defined money supply (M-1), which had been at an average annual rate of about 5-3/4 per cent in June and July, picked up in August to a rate of about 7-3/4 per cent, roughly the same as the average in the first two quarters of the year.^{1/} Weekly data suggested a further pickup in September. Inflows of the interest-bearing deposits included in M-2 and M-3 also accelerated somewhat in August, reflecting primarily substantial flows of funds into large-denomination time deposits at banks and into the 6-month money market certificates at nonbank thrift institutions. As a result, growth in the broader monetary aggregates was relatively rapid.

At its meeting on August 15 the Committee had decided on ranges of tolerance for the annual rates of growth in M-1 and

^{1/} Revised measures of the monetary aggregates, reflecting new benchmark data for deposits at nonmember banks and certain technical adjustments, were available to the Committee at the time of this meeting and were published on September 21, 1978. On the basis of these revised figures, the annual rate of growth in M-1 was about 8-3/4 per cent in August and about 8 per cent on the average in the first two quarters of the year.

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M-2 over the August-September period of 4 to 8 per cent and 6 to 10 per cent, respectively. The Committee had agreed that early in the coming inter-meeting period operations should be directed toward a Federal funds rate of around 8 per cent. 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.

Immediately following the August 15 meeting the Manager of the System Open Market Account began to seek bank reserve conditions consistent with an increase in the weekly-average Federal funds rate to around 8 per cent. Later in August, incoming data suggested that growth in M-1 would be at the upper limit of the range specified by the Committee and that growth in M-2 would be close to the upper limit of its range. Accordingly, the Manager sought reserve conditions consistent with a further increase in the Federal funds rate to 8-1/4 per cent, the upper limit of the 7-3/4 to 8-1/4 per cent range specified for the inter-meeting period.

In early September, available data suggested that both M-1 and M-2 would grow at rates significantly above the

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upper limits of their respective ranges. With the Federal funds rate already at its upper limit, the Committee decided on September 8, at a telephone conference meeting, 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. In the days remaining before this meeting the funds rate fluctuated around 8-3/8 per cent.

The rise in the Federal funds rate during the inter-meeting period was accompanied by appreciable increases in rates on other short-term market instruments. Yields on long-term securities, however, generally edged down. In mid-September commercial banks raised the rate on loans to prime business borrowers from 9-1/4 to 9-1/2 per cent.

On August 18 the Board of Governors announced an increase in Federal Reserve discount rates from 7-1/4 to 7-3/4 per cent. In announcing the increase, the Board stated that the action had been taken in view of recent disorderly conditions in foreign exchange markets as well as the continuing serious domestic inflationary problem.

Conditions in residential mortgage markets, which had tightened significantly during the first half of the year and

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then stabilized, apparently had eased somewhat in recent weeks. Interest rates on new commitments for conventional home mortgage loans at savings and loan associations edged down during the inter-meeting interval, and yields in the secondary mortgage market declined moderately.

In the Committee's discussion of the economic situation and outlook, the members generally concurred with the staff's view that real output of goods and services would grow at a moderate pace over the period from the second quarter of 1978 to the second quarter of 1979. At the same time, a number of members anticipated a little less growth than the staff projected and one anticipated a little more. The observation was made that even a slight shortfall in growth of output from the rate projected by the staff implied an upward drift in the unemployment rate.

All members of the Committee expected a continuation of a rapid rate of inflation over the period to the second quarter of 1979--in the view of several members, even more rapid than the pace projected by the staff. As at other recent meetings, it was observed that in 1979 pressures for large increases in wage rates would be strong. It was also noted that in the near future the administration was expected to announce a new anti-inflation program and that the way in which such a program was

perceived by businessmen and consumers could have a considerable impact on attitudes and expectations.

Although the members differed little in their assessments of the most likely rate of growth in output over the next few quarters, some of them called attention to elements of potential weakness or strength in the current situation that could contribute to a different outcome. One member observed, for example, that the business expansion, having endured for a long time by historical standards, was exhibiting some signs of potential weaknesses that were to be expected at this stage. On the other hand, this member also saw some indications of a pickup in business activity in other industrial countries that might be of sufficient magnitude to raise demands for U.S. exports significantly--thereby enhancing growth in output in this country, strengthening the dollar in foreign exchange markets, and contributing generally to improvement in confidence.

A second member saw little, if any, evidence of the major cyclical imbalances that characteristically developed during business expansions and brought on downturns in activity. Therefore, the expansion appeared likely to continue. However, the very high rate of inflation at present was seen as the main threat to a sustained expansion.

Another member, noting that a recent survey had pointed to some deterioration in business assessments of prospects for their own companies as well as for the economy as a whole, suggested that business investment spending in 1979--especially for fixed capital, but also for inventories--could prove to be disappointing. And with respect to fiscal policy, a member observed that the Federal budget on the high employment basis had recently swung in the direction of restraint, and that the stimulative impact of the prospective reduction in Federal taxes would depend heavily on final decisions concerning both its composition and its timing.

The one member who anticipated slightly faster growth than the staff projected for the period through the first half of 1979 expressed concern about certain developments that could have adverse consequences further in the future. Specifically, the current high rate of construction of commercial buildings and of apartment houses could lead to an excessive supply of such facilities and to a consequent drop in construction. At about the same time, in this member's view, a sharp cyclical downswing in credit-financed buying of certain consumer durable goods might develop.

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.

In the discussion of policy for the period immediately ahead, considerable concern was expressed about recent rates of monetary growth. It was observed that for an extended period of time M-1 had been growing at rates in excess of the longer-run range adopted by the Committee and that a slowing of growth was necessary in pursuit of the Committee's objective of resisting inflationary pressures while encouraging continued moderate economic expansion. Most members believed that some additional firming in money market conditions during the next few weeks was needed to help assure a slowing in growth of money over the months ahead, although they differed with respect to the degree of firming that they thought the Committee ought to contemplate.

In this connection, the comment was made that current levels of interest rates were not exerting as much restraint on credit flows as might be supposed. Thus, it was observed, interest rates adjusted for expected rates of inflation were not high and might even be negative. Moreover, the degree of nonprice rationing of credit, particularly credit for housing, had been reduced by such structural changes in the financial system as the introduction of the 6-month money market certificates.

Two members, stressing the magnitude of the increases in interest rates that had already occurred, proposed that for the time being operations be directed toward maintaining the money market conditions currently prevailing. It was argued that, in light of the recent slowing of the expansion in economic activity and of uncertainties in the economic outlook, such a "pause" would afford the Committee an opportunity to evaluate additional evidence on the current situation, including the effects of the recent increases in interest rates. It was observed that, historically, growth in output had never been held at about its trend rate for very long and that further increases in interest rates at this time might slow growth to a rate below trend or might even provoke an actual downturn.

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With respect to operating specifications for the period immediately ahead, the most frequently proposed ranges for the annual rate of growth in M-1 over the September-October period were 4 to 8 per cent and 5 to 9 per cent; a narrower range of 6 to 8 per cent was also suggested. A few members proposed somewhat higher ranges--in at least one case, because the lower ranges in combination with the strong growth indicated for September implied more of a moderation of growth in October than appeared likely. One member advocated a lower range. For M-2, the most common range suggested was 6 to 10 per cent. Some members advocated somewhat higher ranges, indicating, in a few cases, a willingness to accept the continuing effects that the introduction of the 6-month money market certificate was having on expansion of time deposits at commercial banks.

Most of the members favored directing open market operations toward an increase in the Federal funds rate to about 8-1/2 per cent shortly after this meeting. In general, these members favored an inter-meeting range of 8-1/4 to 8-3/4 per cent, but two of them were willing to accept, and another advocated, an upper limit of 9 per cent. One member proposed directing open market operations toward an increase in the funds rate to 8-3/4 per cent early in the period and setting an inter-meeting

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range of 8-1/2 to 9-1/4 per cent. And the two members who indicated a preference for maintenance of the prevailing money market conditions suggested an inter-meeting range of 8-1/4 to 8-1/2 per cent.

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 September-October period should be 5 to 9 per cent and 6-1/2 to 10-1/2 per cent, respectively. With regard to the Federal funds rate, the Manager was instructed to seek a rate of around 8-1/2 per cent early in the period until the next regular 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 8-1/4 to 8-3/4 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.

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 has grown moderately in the current quarter, although the pace is somewhat below the average for the first two quarters of the year. In August the dollar value of total retail sales rose, after having declined in July, but remained close to the level reached in April. Industrial production continued to expand at about the moderate pace of the preceding 3 months, and nonfarm payroll employment rose somewhat further. The unemployment rate declined from 6.2 to 5.9 per cent, slightly below the average rate in the first 7 months of the year. Since midyear average prices of goods and services have risen less rapidly than earlier, in large part because of declines in prices of foods. 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."

"After a sharp decline in early August, the trade-weighted value of the dollar against major foreign currencies has recovered against a background of uncertain conditions in exchange markets. In late August it was announced that the U.S. trade deficit had increased sharply in July."

"Growth in M-1 picked up in August to about the average rate in the first two quarters of the year. Inflows of the interest-bearing deposits included in M-2 and M-3 also accelerated somewhat, and expansion in the broader aggregates was relatively rapid. Short-term market interest rates have risen appreciably since mid-August, but longer-term rates generally have edged down further. On August 18 an increase in Federal Reserve discount rates from 7-1/4 to 7-3/4 per cent was announced."

"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 8-1/4 to 8-3/4 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 September-October period of M-1 and M-2 and the following ranges of tolerance: 5 to 9 per cent for M-1 and 6-1/2 to 10-1/2 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, Partee, Mrs. Teeters, and Mr. Winn. Votes against this action: Messrs. Wallich and Willes.

Messrs. Wallich and Willes dissented from this action because they favored more vigorous measures to curb the rates of growth in the monetary aggregates. They believed that such measures were essential to deal with the problem of inflation and that they could be undertaken without a significant risk of precipitating a recession. In their view, current levels of interest rates adjusted for expected rates of inflation were not high.

2. Authorization for domestic open market operations

At this meeting, 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 October 17, 1978.

Votes for this action: Messrs. Miller, Volcker, Baughman, Coldwell, Eastburn, Gardner, Jackson, Partee, Mrs. Teeters, Messrs. Wallich, Willes, and Winn. Votes against this action: None.

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This action was taken on the recommendation of the Management of the System Account. The Management had advised that large-scale purchases of Treasury and Federal agency securities over the coming inter-meeting interval might be needed to counter the effect on member bank reserves of a projected increase in Treasury balances at the Reserve Banks arising from corporate tax receipts in mid-September.

Subsequent to this meeting, on October 10, 1978, the Committee voted to approve an additional increase of \$1 billion, to \$5 billion, in the limit on changes between Committee meetings in 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 October 17, 1978.

Votes for this action: Messrs. Miller, Volcker, Baughman, Coldwell, Eastburn, Gardner, Jackson, Partee, Mrs. Teeters, Messrs. Wallich, Willes and Winn. Votes against this action: None.

This action was taken on recommendation of the Management of the System Account. The Management had advised that, even though the Committee had voted at its September 19 meeting to raise the limit from \$3 billion to \$4 billion, large-scale purchases of Treasury and Federal agency securities had reduced the leeway for

further purchases during the inter-meeting period to about \$335 million. It now appeared likely that additional purchases would be required as currency in circulation and other factors were absorbing reserves while Treasury balances continued at a high level, in part because of purchases of special Treasury securities by foreign central banks in association with their recent intervention in the foreign exchange markets.