FEDERAL RESERVE
press release

For Use at 4:00 p.m. December 27, 1976

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 November 16, 1976.

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 November 16, 1976

Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services--which had increased at an annual rate of 4.0 per cent in the third quarter, according to preliminary estimates of the Commerce Department--might be expanding at a somewhat slower pace in the current quarter. The rise in average prices--as measured by the fixed-weighted price index for gross domestic business product--appeared to be somewhat faster than in the third quarter, when it had slowed to an annual rate of 4.4 per cent.

A staff analysis suggested that in the fourth quarter a significant reduction in the over-all rate of inventory accumulation might be taking place in response to the increases in inventory/sales ratios that had developed in many lines of manufacturing and trade over the past several months. It appeared that final purchases of goods and services in real terms were expanding at about the third-quarter rate and, with production schedules curtailed, that inventory positions would be brought into better balance.

Staff projections suggested, therefore, that growth in real GNP would pick up somewhat in the first quarter of 1977 and that it would be sustained at about the first-quarter rate well into the new year. On balance, however, the projected rates of growth were slightly less than those of a month earlier. The projected expansion in business fixed investment was scaled down somewhat further, and the anticipated growth in personal consumption expenditures also was reduced a little. On the other hand, the rise in residential construction was now expected to be somewhat stronger.

The staff projections continued to suggest that both Federal and State and local government purchases of goods and services would increase at a moderate pace in the quarters immediately ahead. With respect to the Federal Government, on October 27 the Treasury and the Office of Management and Budget had announced that spending on a unified budget basis had fallen $11.4 billion short of the estimates of last January for the period encompassing the fiscal year ending June 1976 and the third quarter of calendar year 1976--the "transition quarter" resulting from the change from a fiscal year running from July through June to one running from

October through September. In the administration's Mid-Session Review of the 1977 Budget issued in July, it had been assumed that spending in the transition quarter would be augmented by a shift in outlays from fiscal year 1976, making up for the shortfall. However, the assumed shift did not occur. The staff projections for over-all Federal outlays and for growth in real output reflected a judgment--based on an analysis of the types of Federal outlays that had fallen short of earlier expectations--that the shortfall would have only a relatively small carryover effect in the fiscal year beginning October 1976. No allowance was made in the projections for new fiscal policy initiatives.

Retail sales were now estimated to have declined substantially in September. The advance report suggested that sales had increased little in October and that they were no higher than the monthly average in the third quarter. However, sales of new automobiles were adversely affected by a strike at the plants of a major producer; in October auto sales fell to an annual rate of 9.5 million units from 10 million in September. Sales at apparel and general merchandise stores rose sharply in October after having declined in the previous month.

The index of industrial production--which for September had been revised downward to show a small decrease--declined somewhat further in October to a level that was 0.5 per cent below the average for the third quarter. A significant part of the decline in output over the 2 months was accounted for by strikes. In October, however, decreases in output were widespread among industries, including both those making final products and those making materials.

After adjustment for strikes, total payroll employment in nonfarm establishments rose modestly further in October. In manufacturing, however, employment declined even after adjustment for strikes. Since July, total employment, the civilian labor force, and unemployment--as measured by the household survey--had changed little. The rate of unemployment was 7.9 per cent in October, compared with 7.8 per cent in September.

Private housing starts were reported to have declined somewhat in October from an advanced level; indeed, the figure for September was revised to show an even larger increase than had been indicated a month earlier. Thus, the October level of starts, at an annual rate of almost 1.8 million units, was considerably above the third-quarter average. In September, moreover, the dollar volume of mortgage commitments outstanding at savings and loan associations had continued to advance, reaching a new record.

New orders for nondefense capital goods--which had declined in August for the first time in 1976--advanced in September to a level that, in real terms, was about 15 per cent higher than in December 1975. Unfilled orders continued to change little and remained at a level well below that at the end of 1975. Construction contracts for commercial and industrial buildings, measured in terms of floor space, dropped in September after having edged down in both July and August. Total contracts in the third quarter, while down from the preceding quarter, were still well above those of the first quarter. Private surveys of business plans for 1977 suggested that expenditures for plant and equipment would be significantly higher than in 1976, even after allowance for the average rise in prices of capital goods anticipated by the survey respondents.

The index of average hourly earnings for private nonfarm production workers advanced at an annual rate of 7 per cent in October, about the same as from the second to the third quarter;

the rise, while slightly higher than in the first two quarters of 1976, remained somewhat below the rapid rate of increase during 1975. In the third quarter of 1976 productivity in the private business sector of the economy continued to improve at a good pace, and the annual rate of increase in labor costs per unit of output was 3.8 per cent--the same as in the preceding quarter.

The acceleration of the rise in average wholesale prices of industrial commodities that had begun in June--after 5 months at a reduced rate of increase--continued in October, when the index rose 1 per cent. Increases were largest for fuels and power; for transportation equipment--reflecting prices set on new models of automobiles and trucks; and for lumber and wood products. The wholesale price index for all commodities rose less rapidly in October than in September, however, because of a decline in average prices of farm products and foods.

The consumer price index rose at an annual rate of about 5 per cent in September, compared with an average rate of 6 per cent in the months of April through August. Average retail prices of foods were stable in September, and average prices of other commodities and of services increased a little less than in the previous month.

The average value of the dollar against leading foreign currencies remained steady over the 4 weeks between the October and November meetings of the Committee. The dollar declined slightly against the German mark and associated currencies in the European "snake" arrangement, but it rose against the pound sterling and the Italian lira. On October 27 Mexico again allowed the peso to float downward against the dollar; after a depreciation of about 20 per cent, the Bank of Mexico stabilized the peso at a rate 50 per cent below the level that had been maintained for 22 years prior to the beginning of September.

The U.S. foreign trade deficit, which had diminished in August, widened again in September as imports expanded while exports changed little. From the second to the third quarter the rise in imports was substantial, due to especially large increases in fuels, other industrial supplies, and consumer goods. The increase in exports was much less, and the deficit in the third quarter was about double the average for the first two quarters of 1976.

In October total credit at U.S. commercial banks showed the largest monthly rise since mid-1974, reflecting a sizable increase in loans. Expansion in business loans was sharp--substantially exceeding a modest contraction in outstanding commercial paper of nonfinancial businesses.

The narrowly defined money stock (M-1), after changing little in September, was estimated to have expanded at a 14-1/2 per cent annual rate in October. However, data for early November suggested that growth in that month would be much slower. Over the 12 months ending in October M-1 grew at a rate of 5.7 per cent.

The October resurgence of growth in M-1 was reflected in an acceleration of expansion in the broader monetary aggregates, M-2 and M-3. Inflows of the types of time and savings deposits included in the broader aggregates continued strong, as yields on competing market securities remained below the rates offered on such deposits. Over the 12 months ending in October, M-2 and M-3 grew at rates of 10.7 and 12.6 per cent, respectively.

System open market operations since the October meeting had been guided by the Committee's decision to seek bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead. Over the inter-meeting period, the Federal funds rate had remained close to 5 per cent.

On October 21, 2 days after the October meeting, incoming data suggested that over the October-November period rates of growth in both M-1 and M-2 would be at about the upper limits of the ranges specified by the Committee. Therefore, it appeared likely that any reduction in the Federal funds rate in that week--pursuant to the Committee's consensus at the October meeting--would have to be quickly reversed. In those circumstances the Committee concurred in Chairman Burns' recommendation of October 21 that the Manager be instructed to continue to aim during that week for a Federal funds rate at about the prevailing level of 5 per cent.

Data becoming available during the following week continued to suggest unexpected strength in growth of the monetary aggregates. In response to an inquiry from the Manager concerning the appropriate interpretation of the Committee's instructions, Chairman Burns noted that at the meeting held on October 19 the Committee had agreed upon a policy course that contemplated a slight easing of money market conditions, and that the objective for the weekly-average Federal funds rate would have been reduced to about 4-7/8 per cent had there not been indications of surprising strength in the monetary aggregates. Accordingly, the Chairman advised that in his judgment any significant increase in the Federal funds rate at that time from the prevailing level of 5 per cent would be inconsistent with the Committee's intent. No member of the Committee expressed the view that a rise in the Federal funds rate would be appropriate.

Market interest rates fluctuated in a narrow range during the inter-meeting period. On balance, most rates edged higher, as strength in the published weekly data for the monetary aggregates apparently dispelled market expectations that the early October decrease of 1/4 of a percentage point in the Federal funds rate would be followed by a further decline. However, the prime rate charged by commercial banks--which generally responds with a lag to changes in market rates--was reduced 1/4 of a percentage point to 6-1/2 per cent.

Corporate financing in markets for longer-term bonds expanded substantially in October, reaching the largest volume since June. Utilities stepped up the pace of their financing;

finance companies were again active issuers; and several large industrial firms added to the over-all supply of new securities. In addition, takedowns of privately placed obligations of corporations apparently continued at a record pace.

Around mid-October underwriters of publicly offered corporate bonds encountered buyer resistance on several aggressively priced new issues, and a number of syndicates with sizable unsold balances were forced to terminate restrictions on the prices at which they would sell the issues. By the month-end, however, after new issues began to be priced to provide somewhat higher yields and most of the expanded monthly volume of new offerings had been placed, the tone of the bond market improved.

In markets for State and local government bonds, the volume of new issues was also large in October. Although yields in these markets backed up around midmonth, along with those in other markets, spreads between higher- and lower-rated municipal issues narrowed somewhat. Large purchases of higher-yielding, longer-term issues by property-liability insurance companies, commercial banks, and newly authorized mutual funds of municipal bonds contributed to the narrowing of risk premiums.

The U.S. Treasury was a sizable borrower in the period between the October and November meetings of the Committee. It raised $1.3 billion of new money through the sale of 2-year notes in late October and $2.5 billion in conjunction with its November refinancing. In the refunding the Treasury auctioned $3.3 billion of 3-year notes at an average rate of 6.36 per cent; $3.0 billion of 7-year notes at an average rate of 7.02 per cent; and $1.0 billion of reopened 23-1/4 year bonds at an average rate of 7.9 per cent.

Activity in the mortgage market appeared to have remained strong in October. Acquisitions of mortgages by savings and loan associations continued at a rapid pace, and the volume of new issues of GNMA-guaranteed securities was large. Between the October and November meetings of the Committee, average interest rates on new commitments for long-term conventional home mortgages at savings and loan associations had moved down 10 basis points.

Credit demands for the remainder of the year were expected to be generally moderate both at banks and in the securities markets. Corporations appeared to be scheduling fewer new bond issues than they had in the early part of the year. It was not clear whether this reflected reduced over-all financing requirements, or a slackening of efforts to restructure balance sheets, or simply a change in borrowers' expectations with regard to the level of interest rates in the future.

The U.S. Treasury's needs for new money during the rest of the year appeared to have been fully discounted by the market. With respect to State and local government issues, market participants were anticipating a continued sizable volume of longer-term debt offerings, as many issuers were taking the opportunity to fund short-term debt and to re-activate earlier plans for long-term borrowing. Demands for such securities, however, appeared to be generally strong.

In their discussion of the economic situation, members of the Committee were in agreement that the sluggishness or "pause" in the growth of real output was continuing. As at the mid-October meeting, no member suggested that a recession was likely. Some members noted elements of strength in the current situation that gave promise of near-term revival in the pace of expansion, and some indicated a belief that growth in economic activity in the quarters just ahead would exceed the modest rates suggested by the staff projections. However, some members expressed the view that prospects had deteriorated further over the past month, or at least that uncertainties about the outlook had increased. It was also noted that the economy might be subjected to another increase in the price of imported oil. Concern was again expressed that growth in the near term would be inadequate to make much if any progress in reducing the unemployment rate. Inflation also continued to be a source of concern, in part because of its potentially adverse effect on business outlays for fixed capital and on consumer outlays.

Several reasons were given for thinking that the outlook for growth in economic activity had weakened during the past month. On the basis of estimated retail sales figures through October, it appeared that consumer purchases had been inadequate to prevent inventories from becoming excessive in a number of industries. While there were signs that consumer buying had picked up in recent weeks, there was a possibility that the improvement represented earlier-than-usual Christmas shopping--perhaps spurred by early promotions of such goods--and that it would be followed by disappointing figures later in the season. In any case, it was suggested, the disappointing performance of sales and the accompanying build-up of inventories now had lasted long enough to have secondary effects: In the past few months output in some industries had been reduced and real nonfarm personal income had not grown much. In these circumstances, expansion in capital spending might lag behind the pace indicated by surveys of business spending plans or might actually lose momentum altogether as businessmen awaited more positive signs of strength in the economy. The state of confidence--as reflected by the decline in stock prices--was regarded as a source of concern.

It was noted that, in part because of the shortfall in Federal outlays in recent quarters, the Federal budget on the high-employment basis had shifted from deficit to surplus and thus had been exerting a restrictive effect on the economy at a relatively early stage of the current business expansion. However, it was suggested that the likelihood of a tax reduction now had to be taken into account in assessing the outlook, although any reduction probably would not actually come until next spring.

It was suggested in the discussion that during the next few months the attitudes and decisions of consumers and businessmen would be influenced in a significant way by their assessments of the economic policies of the new administration. Some businessmen were reported to be concerned that steps taken to stimulate economic expansion might soon be followed by imposition of some form of price and wage controls.

The likelihood of an uptrend in Federal spending, whether or not a significant part of the recent shortfall was made up, was one of several reasons cited for expecting that before long growth in over-all economic activity would accelerate. In addition, particular attention was called to the good rise in the number of housing starts and to the continuing strength in new orders for nondefense capital goods. Members reported, moreover, that retail sales in some areas were doing well and that since mid-October the volume of freight being moved had risen after a slow period. And it was suggested that as the new administration was formed and provided additional information as to how it planned to deal with particular economic problems, uncertainties would diminish and businessmen and consumers would become more optimistic about the future.

At its telephone meeting on November 8 the Committee had agreed that from the third quarter of 1976 to the third quarter of 1977, average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: M-1, 4-1/2 to 6-1/2 per cent; M-2, 7-1/2 to 10 per cent; and M-3, 9 to 11-1/2 per cent. The associated range for growth in the bank credit proxy was 5 to 8 per cent. It was agreed that the longer-term ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It also was understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for annual periods.

In the discussion of current policy at this meeting, members of the Committee in general favored some easing in money market conditions in the period immediately ahead, so long as growth in the monetary aggregates did not appear to be unduly rapid. A number of members felt that any such easing should be slight; they suggested a near-term reduction in the weekly average Federal funds rate to about 4-7/8 per cent from its prevailing level of about 5 per cent. In the judgment of these members liquidity positions were adequate for the needs of the economy. In particular, they noted that nonfinancial corporations were able to meet a large part of their financing needs with internally generated funds, that savings and loan associations were experiencing enormous inflows of funds, and that underlying demands for loans at commercial banks were weak. In these circumstances, it was suggested, the benefits of a move toward easier conditions would be negligible. Moreover, anything more than a slight easing so late in the business expansion could cause difficulties later on. Also, against the background of the recent rate of increase in prices and the rapid monetary growth in October, anything more than a slight easing might be interpreted as a lessening of the Federal Reserve System's concern about the continuing problem of inflation.

Other members leaned toward a somewhat greater near-term reduction in the Federal funds rate, to 4-3/4 per cent. Among these, some were inclined to question whether liquidity positions could be considered adequate, especially in view of the sluggish performance of the economy. While the various measures of liquidity of nonfinancial corporations had improved over the past year or so, they still appeared to be less favorable than they had been at this stage of earlier business cycles in the postwar period. In this context it was observed that nominal long-term interest rates were still high by postwar standards and that--the rate of inflation notwithstanding--current levels of interest rates tended to discourage some business managers from undertaking or enlarging commitments to make capital investments and consumers from undertaking commitments to buy houses. Modest downward pressure on short-term interest rates, it was argued, would be communicated in some degree to longer-term rates as managers of the portfolios of financial institutions lengthened the average maturities of those portfolios in an effort to maintain a satisfactory over-all return.

In considering the ranges of growth rates for the monetary aggregates to be specified for the November-December period, the members took account of the indications that growth in November was likely to be relatively slow for M-1 and relatively rapid for M-2. For M-1, most members favored a range of 3 to 7 per cent or 2-1/2 to 6-1/2 per cent. For M-2, most members favored a range of 9-1/2 to 13-1/2 per cent or 9 to 13 per cent.

A number of divergent views were expressed with respect to the range to be specified for the weekly-average Federal funds rate in the inter-meeting period. Members proposed ranges that varied in width from 4-1/4 to 5-1/4 per cent at one extreme to 4-3/4 to 5 per cent at the other, and a number suggested retention of the range of 4-1/2 to 5-1/4 per cent specified at the previous meeting. Some of those members advocating the narrower ranges favored placing greater emphasis on money market conditions in the domestic policy directive to be issued to the Federal Reserve Bank of New York than had been the case in the directive issued at the meeting a month earlier. Others, however, preferred to retain language similar to that adopted in October, which placed more emphasis on the behavior of the aggregates in guiding operations.

At the conclusion of the discussion the Committee decided to seek bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead. Specifically, the Committee concluded that growth in M-1 and M-2 over the ~~October-November~~ November-December period at annual rates within ranges of 3 to 7 per cent and 9-1/2 to 13-1/2 per cent, respectively, would be appropriate. It was understood that, in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of M-1 and of M-2.

It was agreed that until the next meeting the weekly-average Federal funds rate might be expected to vary in an orderly way within a range of 4-1/2 to 5-1/4 per cent. It was also agreed that the Manager should aim to reduce the Federal funds rate to about 4-7/8 per cent within the next week and to about 4-3/4 per cent within the following week--provided that growth in the monetary aggregates did not appear to be strong relative to the specified ranges--and to decide on subsequent objectives on the basis of incoming data for the monetary aggregates. 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 may be falling somewhat below the third-quarter rate. In October retail sales increased little following a decrease in September. Industrial production and employment in manufacturing declined, in part because of strikes. After adjustment for strikes, total payroll employment

in nonfarm establishments rose somewhat further. According to household survey data, the unemployment rate edged up from 7.8 to 7.9 per cent. The wholesale price index for all commodities rose less rapidly in October than in September as average prices of farm products and foods declined; however, average prices of industrial commodities rose sharply further. The advance in the index of average wage rates over recent months has remained somewhat below the rapid rate of increase during 1975.

The average value of the dollar against leading foreign currencies has remained steady in recent weeks, declining slightly against the German mark and associated European currencies but rising against the pound sterling and the lira. In September the U.S. foreign trade deficit widened again, and the third-quarter deficit was about double the average of the first two quarters of 1976.

M-1, which was about unchanged in September, expanded sharply in October. Growth in M-2 and M-3 accelerated as inflows of the time and savings deposits included in these broader aggregates continued exceptionally strong. Interest rates have fluctuated in a narrow range in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.

Votes for this action: Messrs. Burns, Volcker, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, Winn, and Guffey. Votes against this action: None. Absent and not voting: Mr. Balles. (Mr. Guffey voted as alternate for Mr. Balles.)