FEDERAL RESERVE

press release

For Use at 4:00 p.m. September 23, 1977

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 16, 1977.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on August 16, 1977

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 6.4 per cent in the second quarter, according to preliminary estimates of the Commerce Department--was growing less rapidly in the current quarter. At the same time the rise in average prices, as measured by the fixed-weighted price index for gross domestic business product, appeared to be slowing from that of the second quarter, estimated to have been at a 7.0 per cent annual rate. Staff projections suggested that growth in real GNP was likely to remain less rapid over the remainder of 1977, and to slow a little further in 1978. The projections also suggested that the rate of increase in prices would moderate from that in the first half, but would still remain high.

According to the staff projections, rising activity in a number of sectors would contribute to a continuation of the economic expansion over the year. Growth in consumer spending, which had slowed appreciably in the second quarter, was projected to pick up gradually. Relatively strong growth was anticipated in business capital outlays, and inventory investment seemed likely to continue as an expansive factor, although much less so than in the first half of 1977. Increases in Federal purchases of goods and services were expected to remain substantial. Spending by State and local governments was projected to continue rising briskly, in part because of the stimulus of expanded Federal public works and job related grant programs. On the negative side, slow export growth and rising imports seemed likely to exert a drag on economic activity over much of the projection period. And the increase in residential construction activity was expected to level off as the period progressed.

In July industrial production rose by 0.5 per cent, a little less than in June and roughly half of the substantial increase in May. The rate of capacity utilization in manufacturing edged higher, to an estimated 83.7 per cent. The July rise in production reflected sizable increases in the output of consumer durable goods and business equipment. Production of nondurable consumer goods changed little, and steel output declined. Auto assemblies rose slightly, but it was expected that production schedules would be reduced more than usual in August by the beginning of the changeover to the new model year.

Nonfarm payroll employment expanded by more than a quarter of a million in July, half again as much as in June, with factory jobs rising by 70,000. According to the household survey data, however, total employment--after increasing 2-1/4 million between December and June--declined in July, due to a sharp reduction in agricultural jobs. The labor force also contracted in July, almost wholly as a result of reduced participation by teenagers, and the unemployment rate declined 0.2 of a percentage point, returning to the May level of 6.9 per cent.

Personal income had advanced briskly during the first half of 1977 as a result of the large gains in employment. The rise in wage and salary payments slowed in June, but for the second quarter as a whole the increase was the largest since the first quarter of 1976. In July wage and salary payments apparently rose at a moderate rate, and growth in personal income was bolstered by a cost-of-living increase for social security recipients.

Available reports suggested that corporate profits had improved during the second quarter. Although comprehensive data were not yet available, the information at hand implied a second-quarter level of corporate profits that was significantly above the relatively low levels recorded in the third and fourth quarters of 1976 and the first quarter of 1977. As a proportion of GNP, however, corporate profits still remained below their longer-run average and well below previous postwar peaks.

The dollar value of retail sales had increased 0.5 per cent in July, according to the advance report. However, data for June--which had initially indicated no change from May--had been revised to show a decline of 1.3 per cent. For the second quarter as a whole the value of retail sales was now estimated to have risen 1.6 per cent, down from the earlier estimate of 2.1 per cent. In July there were sizable advances in sales at stores in the GAF (general merchandise, apparel, furniture and appliance) grouping. But auto sales fell to an annual rate of 10.8 million units, from the near-record pace of 11.8 million units in June.

Businesses appeared to be making prompt adjustments to evidence of developing imbalances in inventories of nondurable goods. In June the book value of such inventories declined at both manufacturers and wholesalers--at the latter, for the second consecutive month--following large increases earlier in the year. Inventories of durable goods continued to rise at a relatively rapid rate at both manufacturers and wholesalers, but the growth was about in line with the advance in sales.

Private housing starts declined to an annual rate of about 1.8 million units in June, the latest month for which data were available. This was close to the average rate that had prevailed since late 1976. In the second quarter as a whole, single-family starts--at an annual rate of 1.4 million units--were the highest for any quarter on record. Mortgage lending activity had remained strong in recent months; the rate of growth in mortgage debt outstanding was estimated to have been at a record during the second quarter, and it appeared to have risen somewhat further in July.

New orders for nondefense capital goods increased by about 5 per cent in June. Contract awards for commercial and industrial buildings--as measured in terms of floor space--edged off from the high May level; for the second quarter as a whole, however, they were 4.5 per cent above their level in the first quarter.

The index of average hourly earnings for private nonfarm production workers rose in July at an annual rate of 6-1/2 per cent--close to the average rise over the preceding 18 months. Major collective bargaining settlements in the first half of 1977 provided for first-year wage increases averaging 8.0 per cent, compared with an average of 8.4 per cent under contracts negotiated in 1976. On the other hand, compensation per hour in the private nonfarm business sector rose at an annual rate of about 9.5 per cent in the first half, a little faster than in 1976.

The wholesale price index for all commodities, which had declined in June, was about unchanged in July. Average prices for farm products and foods--after having risen sharply in the early months of 1977--declined for the second successive month. Average prices for industrial commodities continued to advance but at a more moderate pace than in the earlier months of the year.

The consumer price index in June rose 0.6 per cent--about the same as in the preceding 3 months. While the advance for commodities other than foods slowed to 0.2 per cent, the increases for foods and for services edged up to 0.8 per cent.

By the time of this Committee meeting, the average value of the dollar against leading foreign currencies had recovered more than 1 per cent from the low reached on July 25, but it was still below its late-June level. The strengthening of the dollar since late July reflected reaction in the foreign exchange markets to statements by U.S. officials indicating the importance that the United States attaches to maintaining the strength of the dollar, and also to the recent relative rise in interest rates on dollar-denominated assets. The dollar appreciated most sharply against the German mark and the Japanese yen. It depreciated against sterling, however, after authorities in the United Kingdom elected to discontinue their earlier policy of maintaining a target ceiling rate for sterling defined exclusively in terms of the U.S. dollar.

The U.S. trade deficit rose sharply in June, as imports rebounded from the somewhat reduced level in May and exports declined. For the second quarter as a whole, the trade deficit as measured in the international accounts was at an annual rate of $31 billion.

At U.S. commercial banks, total credit expanded slightly faster in July than in June, but the pace in July remained below the average for the first half of the year. Holdings by banks of U.S. Treasury securities declined sharply in July, while their holdings of other securities increased moderately. Total loans rose more rapidly than in any other month since last October, reflecting strength in most major categories. However, business loans grew considerably less than in June, when corporations had borrowed to finance an unusually large volume of Federal income tax payments. Also, the outstanding volume of commercial paper issued by nonfinancial corporations declined slightly in July.

Growth in the narrowly defined money stock (M-1) accelerated to an annual rate of about 18 per cent in July. While much of the increase apparently was temporary, part seemed to reflect rising transactions demands for money. For the 7 months ending with July, M-1 grew at an annual rate of nearly 8 per cent.

Growth in the more broadly defined measures of money (M-2 and M-3) also accelerated sharply in July, to annual rates of about 17 and 16 per cent, respectively. The high rates of expansion in these measures were due primarily to the large increases in M-1, but inflows of the time and savings deposits included in M-2 and M-3 also picked up from their reduced rates in June. For the 7 months ending with July, M-2 and M-3 grew at annual rates of 10 and 11 per cent, respectively.

At its July meeting the Committee had decided that growth in M-1 and M-2 in the July-August period within ranges of 3-1/2 to 7-1/2 per cent and 6-1/2 to 10-1/2 per cent, respectively, would be appropriate. It had judged that these growth rates were likely to be associated with a weekly-average Federal funds rate of about 5-3/8 per cent. The Committee had agreed that if growth rates in the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5-1/4 to 5-3/4 per cent.

Data that had become available in the days immediately following the July meeting suggested that over the July-August period both M-1 and M-2 would grow at rates in the upper parts of their specified ranges. These data were considered especially tentative, however, because unusual patterns in the figures received just after the power failure in New York City suggested that the failure might have introduced statistical distortions. The System Account Manager, therefore, continued to seek a Federal funds rate of about 5-3/8 per cent. Later, however, when new data not only confirmed the initial signs of strength but also suggested that growth in the aggregates would be somewhat above the upper limits of the specified ranges, System operations were directed at achieving a higher Federal funds rate. During the statement week ending August 3, the funds rate averaged 5.80 per cent, approximately equal to the 5-3/4 per cent upper limit of the Committee's range.

Information that became available on August 4 suggested that the growth rates in the aggregates in the July-August period would be well above the ranges specified by the Committee, and on August 5 the Committee voted to increase the upper limit of the range for the funds rate to 6 per cent. It was understood that the Manager would use this additional leeway very gradually and only in the event that the aggregates continued to register values far in excess of the Committee's objectives. When such strength in the aggregates did persist, the Account Manager aimed at a Federal funds rate of about 6 per cent.

In markets for short- and medium-term securities, interest rates generally rose by 3/8 to 1/2 of a percentage point over the inter-meeting period. Yields on corporate and municipal bonds, however, showed little change over the period, and those on Treasury bonds posted only small advances.

During the 4 weeks of the inter-meeting period the U.S. Treasury raised about $4.0 billion of new money in securities markets, including $3.0 billion obtained in connection with its mid-August refinancing. Issues offered in the refinancing consisted of $3.0 billion of 3-year notes, $2.25 billion of 7-year notes, and $1.0 billion of (reopened) 29-1/2 year bonds.

In July the volume of new publicly offered corporate bonds was slightly larger than in June and was above the monthly average for the second quarter. Offerings by industrial issuers--which had been exceptionally low in June--were at their highest level since December 1976, while new issues by utilities were below their advanced second-quarter pace. The volume of new State and local government bonds dropped more than seasonally during July, following a record supply of new issues both in June and for the second quarter as a whole. The heavy volume of new municipal offerings in recent months included a large number of advance refundings, as well as issues offered earlier than originally planned, apparently in the expectation that interest costs would rise later in the year.

Average prices of common stocks traded on the New York Stock Exchange declined during the inter-meeting period--in the case of one widely used index, to the lowest level since early 1976. Indexes of issues traded on the American Stock Exchange and over the counter also declined somewhat during the period, but they remained near their highest levels since 1973.

In markets for home mortgages, average interest rates on new commitments for conventional loans were relatively stable in the weeks just prior to this meeting, following small advances in late June and early July. Meanwhile, yields in the secondary market for home mortgages generally edged higher.

In the Committee's discussion of the economic situation, the members agreed that the expansion was likely to continue for some time. Several members suggested that the apparent moderation in economic growth from the rapid pace of the first half of the year was an essentially healthy adjustment; continued expansion at the earlier pace might well have led in time to a reacceleration of inflation and created price distortions that would have brought the expansion to an early end. It was observed that the economy was experiencing few imbalances at present and that needed adjustments in business inventories were being made promptly. The view was widespread among members that the upward trend of business capital investment would persist and very likely would strengthen.

While the members agreed that the economic expansion was likely to continue, they differed regarding its probable profile over the quarters ahead. Specifically, several members thought that the rate of economic growth was likely to be slower in the second half of 1977, and faster in the first half of 1978, than suggested by the staff projections. With respect to the second half of 1977, these members thought that spending on consumer goods and housing would rise less than indicated, and they found it difficult to identify offsetting sources of strength. For the longer run, however, they believed that economic growth would be fostered by sustained increases in business capital outlays and in spending by Federal and State and local governments. It was suggested that such a pattern might well be associated with a slower rate of price advance than that projected by the staff.

Other members of the Committee indicated that, while they expected more strength in the economy in the second half of 1977 than their colleagues did, they were not persuaded that the rate of growth would rise after the turn of the year. In this connection they identified several potential problems. One was the possibility that the recent upcreep in unit costs of production relative to selling prices might continue, with a consequent further narrowing of profit margins. It was noted that when this process had developed in the past, an economic downturn had typically occurred within 1 to 2 years. Other potential problems mentioned were the recent rapid increase in consumer credit and the evidence of speculation in some real estate markets. One member of the Committee, in commenting on the erosion of profit margins, observed that businesses did not appear to be pressing as actively as they might to hold labor costs down, fearing the impact of strikes and assuming that inflation would continue.

In the discussion of the outlook for business investment, it was noted that outlays were falling short of what might have been expected on the basis of past cyclical expansions, even in industries where the need for increased plant and equipment spending was clearly evident. A number of members expressed the view that narrow profit margins were tending to constrain investment spending. One member offered the hypothesis that a more typical increase in such spending might continue to be delayed until profit margins were widened by increases in product prices as capacity limits were approached. Among other factors mentioned as inhibiting investment was the unusual degree of uncertainty prevailing in business circles, particularly with respect to public policy on such matters as inflation control, energy, and tax reform.

Several members of the Committee cited the recent declines in stock prices as evidence of uncertainties about the prospects for corporate profits. In the discussion Committee members identified other factors they believed might help to account for some of the weakness in stock prices. One was the restructuring of investment portfolios being undertaken by many institutional investors to increase emphasis on fixed-rate instruments. Another was efforts by stockholders to realize accumulated capital gains, as a precaution against the possible enactment of legislation limiting the special tax treatment of capital gains.

At its July meeting the Committee had agreed that from the second quarter of 1977 to the second 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, 7 to 9-1/2 per cent; and M-3, 8-1/2 to 11 per cent. The associated range for the rate of growth in commercial bank credit was 7 to 10 per cent. It was agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings.

In considering policy for the period immediately ahead, members of the Committee noted that growth in the monetary aggregates was expected to slow markedly in August and September. Because of the sharp increases in July, however, expansion in the third quarter as a whole--particularly in M-1--would be relatively rapid. It was observed that considerably slower growth rates would be needed in subsequent quarters if monetary growth for the year ending with the second quarter of 1978 was to be kept within the ranges that the Committee had decided upon in July.

While the views of members on appropriate short-run policy did not differ greatly, a number of members placed particular stress on the need to resist further sizable increases in the monetary aggregates, noting that continued rapid growth would foster inflationary expectations and weakening of confidence within the business community. Other members put more emphasis on the sizable increase that had occurred since late April in the Federal funds rate and other short-term interest rates, and some expressed reluctance to seek further tightening in the money market at a time when growth in economic activity was showing signs of moderating. These members suggested that, in the absence of unusual behavior in the monetary aggregates, it would be desirable to maintain relatively stable conditions in the money market for the time being.

The members agreed that, in view of the July bulge in the monetary aggregates, no easing of money market conditions should be sought in the coming interval even if growth rates in the aggregates during the August-September period appeared to be quite low. For M-1, most members favored a growth range for the August-September period of 0 to 5 per cent or 0 to 6 per cent; a few preferred slightly higher ranges. For M-2, most members favored a range of 3 to 8 per cent.

All members of the Committee favored directing inter-meeting operations initially toward the objective of maintaining the Federal funds rate at about the prevailing level of 6 per cent. Views differed somewhat with respect to the degree of leeway for operations during the inter-meeting period in the event that the aggregates appeared to be deviating significantly from the midpoints of the specified ranges, but most members preferred ranges for the funds rate of 5-3/4 to 6-1/4 per cent or 5-3/4 to 6-1/2 per cent. Some members suggested that more weight than usual should be placed on money market conditions in the directive to be issued to the Federal Reserve Bank of New York, but a majority preferred to continue to stress the monetary aggregates.

At the conclusion of the discussion the Committee decided that growth in M-1 and M-2 over the August-September period at annual rates within ranges of 0 to 5 per cent and 3 to 8 per cent, respectively, would be appropriate. It was understood that in assessing the behavior of these aggregates the Manager should continue to give approximately equal weight to the behavior of M-1 and M-2.

It was the Committee's judgment that such growth rates were likely to be associated with a weekly-average Federal funds rate of about 6 per cent. The members agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 5-3/4 to 6-1/4 per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that real output of goods and services is growing less rapidly in the current quarter than in the second quarter. In July industrial output rose a little less than in June. The rise in payroll employment in nonfarm establishments was substantial. According to the household survey data, total nonagricultural employment was unchanged and the unemployment rate edged down to 6.9 per cent, the same as in May. The dollar value of total retail sales rose somewhat, after 2 months of decline. The wholesale price index for all commodities was about unchanged in July; average prices of farm products and foods declined sharply further, and average prices of industrial commodities continued to rise at a more moderate pace than in the early months of 1977. The index of average hourly earnings has continued to advance at about the same pace that it had on the average during 1976.
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> The weighted average exchange rate for the dollar against leading foreign currencies has recovered more than 1 per cent from the low point reached in late July. In June the U.S. foreign trade deficit rose sharply, and the deficit was larger for the second quarter as a whole than for the first.
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> The increase in M-1 was exceptionally large in July. Inflows to banks of the time and savings deposits included in the broader monetary aggregates strengthened, and growth in M-2 and M-3 also accelerated sharply. Business short-term borrowing moderated from

the rapid pace in June. Interest rates on short- and intermediate-term market instruments have risen appreciably in recent weeks, while yields on longer-term bonds have changed little.

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 July 19, 1977, the Committee agreed that growth of M-1, M-2, and M-3 within ranges of 4 to 6-1/2 per cent, 7 to 9-1/2 per cent, and 8-1/2 to 11 per cent, respectively, from the second quarter of 1977 to the second quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in M-1 and M-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the August-September period to be within the ranges of 0 to 5 per cent for M-1 and 3 to 8 per cent for M-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly-average Federal funds rate of about 6 per cent. If, giving approximately equal weight to M-1 and M-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 5-3/4 to 6-1/4 per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.