FEDERAL RESERVE

press release

For Use at 4:00 p.m. October 21, 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 September 20, 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 September 20, 1977

1. Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services--which had expanded at an annual rate of 6.2 per cent in the second quarter, according to revised estimates of the Commerce Department--had grown less rapidly in the current quarter. The rise in average prices--as measured by the fixed-weighted price index for gross domestic business product--appeared to have slowed from that of the second quarter, now estimated to have been at an annual rate of 7.5 per cent. Staff projections suggested that real GNP would grow moderately over the year ahead, although at a slightly lower rate than projected a month earlier. The projections also suggested that the rate of increase in prices, while below that in the first half of 1977, would remain high.

According to staff estimates, the third-quarter slowing of growth in real GNP was accounted for by a sharp cutback in the rate of business inventory accumulation, following a large increase in the second quarter, as businesses attempted to prevent an excessive build-up of stocks. It was estimated that growth in final sales of goods and services in real terms was about the same in the third quarter as in the second.

Staff projections of moderate growth in real GNP over the year ahead reflected expectations that growth in consumer spending would pick up gradually; that expansion in business capital outlays would be sustained; and that increases in State and local government purchases of goods and services would remain large, in part because of the stimulus of increased Federal public works and job-related programs. It was still anticipated that the expansion in residential construction activity would taper off as the period progressed and that slow export growth combined with a somewhat faster rise in imports would exert a drag on domestic economic activity over much of the year ahead.

In August industrial production declined by 0.5 per cent, about as much as it had risen in July. A substantial part of the decline was accounted for by curtailments in automobile assemblies and electric utility power generation, both of which had increased sharply in July, but decreases in output were widespread. Production of iron ore was reduced by a strike.

Capacity utilization in manufacturing also declined in August, for the most part reflecting decreases in the transportation equipment and nonelectrical machinery industries. Utilization in the materials-producing industries edged down to 82.7 per cent. This rate was appreciably lower than at the comparable stage of other recent business expansions, in part because of larger supplies from foreign sources.

In association with the decrease in industrial output, employment in manufacturing fell in August--returning to the level of May--and the length of the average workweek declined for the second successive month. Total nonfarm payroll employment increased moderately, however, as employment outside the manufacturing sector continued to grow. According to the household survey, total civilian employment also rose moderately, but the labor force expanded sharply and the unemployment rate increased 0.2 of a percentage point to 7.1 per cent--the same level as in June. From April through August the unemployment rate fluctuated between 6.9 and 7.1 per cent.

The rise in personal income accelerated in July, as a result of a cost-of-living increase in social security payments, and then slowed in August to about the same rate as in May and June. In August total wage and salary disbursements increased little. Disbursements expanded substantially in government, reflecting gains in State and local payrolls attributable to a rise in Federally sponsored public service jobs, but declined in manufacturing and gained little in other industries.

The dollar value of retail sales had increased 1.7 per cent in August, according to the advance report. The August level of sales was somewhat above the earlier peak reached in March and moderately above the average for the second quarter. Sales gains in August were widespread among types of outlets and were particularly strong at furniture and appliance stores, apparel stores, and gasoline stations. Sales of new automobiles, which had fallen in July, recovered almost to the high rate that had prevailed throughout the second quarter.

The adjustment in inventories proceeded in July, when the book value of nondurable goods stocks actually declined. The increase in the book value of total manufacturing and trade stocks was substantially below the monthly-average increases in the first two quarters of 1977.

Private housing starts rose appreciably in July to an annual rate of nearly 2.1 million units and then edged down in August to a rate slightly above 2.0 million. The average for the 2 months was 7 per cent above the average for the second quarter, in large part because of gains in starts of multifamily units.

The Department of Commerce survey of business plans taken in late July and August suggested that spending for plant and equipment would be 13.3 per cent greater in 1977 than in 1976; the survey taken in May had suggested a year-to-year gain of 12.3 per cent. The latest survey implied average increases of somewhat less than 3 per cent in the third and fourth quarters of the year, compared with 3-1/2 per cent in the first two quarters.

New orders for nondefense capital goods, which had increased about 5 per cent in June, were indicated by the partial sample estimate to have fallen about 10 per cent in July. Much of the rise and subsequent decline was accounted for by orders for commercial aircraft, apparently for export. The level of new orders in July was well below the average for the second quarter and about equal to the average for the first quarter. Manufacturers' shipments of nondefense capital goods expanded in July, and unfilled orders for such goods leveled off after having risen during the preceding 6 months. Contract awards for commercial and industrial buildings--measured in terms of floor space--declined in July and were moderately below the average for the second quarter.

The index of average hourly earnings for private nonfarm production workers, which had increased substantially in July, according to revised data, advanced little in August. Over the first 8 months of 1977 the index rose at an annual rate of 6.8 per cent; over the 12 months of 1976, the index had risen 6.9 per cent.

The wholesale price index for all commodities, which had declined in June and changed little in July, was about unchanged again in August. Average prices of farm products and foods declined sharply for the third successive month and were back down to about the level of December 1976. Average prices of industrial commodities continued to rise at a more moderate pace than in the latter part of 1976 and the first 4 months of 1977.

The consumer price index rose 0.4 per cent in July, considerably less than in any month in the first half of 1977. Retail prices of foods changed little, after having increased about 7 per cent over the preceding 6 months. Average prices of nonfood commodities also changed little in July, in part because of reductions for gasoline and used cars, but prices of services continued to rise at an annual rate of about 10 per cent.

The weighted-average exchange rate for the dollar against leading foreign currencies recovered further over the inter-meeting period and returned to the level of late June. During the period the Swedish krona was devalued by

10 per cent and was withdrawn from the European "snake" arrangement; the Norwegian and Danish kroner were devalued by 5 per cent within that arrangement. Upward pressure on sterling intensified, and the Bank of England intervened in the market to maintain the exchange rate for the pound against the dollar.

The U.S. foreign trade deficit declined in July from the record level of June and was about equal to the average for the second quarter. Imports of petroleum and products fell, following an increase of about 20 per cent in June. Inflows of capital, both private and foreign official, were sizable in July.

At U.S. commercial banks, growth in total credit accelerated during August to a rate somewhat above the average for the first 7 months of 1977. Growth in total loans remained at the advanced pace of July while bank holdings of U.S. Treasury securities declined much less than in July and holdings of other securities continued to increase moderately. Expansion of business loans picked up from the reduced rate in July. Outstanding commercial paper issued by nonfinancial businesses increased in August, but by somewhat less than it had declined in July.

Growth in the narrowly defined money stock (M-1) slowed to an annual rate of about 5-1/2 per cent in August from the July rate of more than 18 per cent. Nevertheless, growth over the 2-month period, at an annual rate of almost 12 per cent, was more rapid than the advanced rate of the second quarter.

Growth in the more broadly defined measures of money, M-2 and M-3, also slowed during August--to annual rates of 6.4 and 11.2 per cent, respectively--mainly because of deceleration of growth in the demand deposit and currency components common to all three measures of money. Expansion of the bank time and savings deposits included in the broader aggregates also slowed substantially, but inflows of deposits to nonbank thrift institutions remained strong. Over the July-August period, M-2 and M-3 grew at annual rates of 11.6 and 13.7 per cent, respectively.

At its August meeting the Committee had decided that during the August-September period growth in M-1 and M-2 within ranges of 0 to 5 per cent and 3 to 8 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 6 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 5-3/4 to 6-1/4 per cent.

Data that had become available in the weeks immediately following the August FOMC meeting suggested that over the August-September period M-1 was growing at a rate in the upper half and M-2 at a rate near the midpoint of their respective ranges. Accordingly, the System Account Manager continued to seek a Federal funds rate of around 6 per cent. Near the end of the inter-meeting period, growth in M-1 for the 2-month period appeared to be exceeding the upper limit of its range and growth in M-2 appeared to be in the upper half of its range. Therefore, the Manager sought a firming in the Federal funds rate to around 6-1/8 per cent, and the rate averaged close to that level in the 5 days just prior to this meeting of the Committee.

During the initial weeks of the inter-meeting period, market interest rates declined somewhat from the levels that had prevailed in mid-August. But in early September, when it became evident that growth in the monetary aggregates had not receded so much in August as market participants had anticipated and that the Federal funds rate was remaining above 6 per cent, other market interest rates turned up. Over the inter-meeting period, short-term rates posted net advances ranging up to about 1/4 of a percentage point. Long-term rates, however, changed little on balance. Early in the inter-meeting period major commercial banks raised their prime rate on business loans 1/4 of a percentage point to 7 per cent, and in the second week of September most of them raised the rate to 7-1/4 per cent.

Stock prices declined further during the intermeeting period. Just prior to the September meeting, several major indexes of stock prices reached their lowest levels since the end of 1975 and early 1976.

On August 29 the Board of Governors of the Federal Reserve System announced its approval of action by directors of five Federal Reserve Banks raising the discount rate from 5-1/4 to 5-3/4 per cent, effective August 30; on August 30 and September 1 increases at the remaining Reserve Banks were approved. In announcing the approval, the Board stated that its action was intended as a technical move for the purpose of bringing the discount rate into better alignment with other short-term interest rates and that the action was taken to reduce the incentive for member banks to borrow from the Federal Reserve. Daily-average borrowings had risen from $323 million in July to $1,084 million in August; in the week ending August 24, they had reached $1,665 million. In the week ending September 14, daily-average borrowings were down to $337 million.

During the inter-meeting period the U.S. Treasury raised $6.3 billion of new money, including $1.5 billion in conjunction with a regular rollover of $1.9 billion of maturing 2-year notes and $3.0 billion through a new offering in the regular cycle of 4-year notes. Also, the Treasury sold $1.8 billion of short-dated, cash-management bills, which it refinanced at maturity by adding to the regular weekly bill auctions. This marked the Treasury's first sizable use of the bill market for new money since late 1976.

Gross offerings of new State and local government bonds increased substantially in August. Part of the large volume consisted of offerings that had originally been scheduled for September and then were advanced to August. Advance refunding of outstanding municipal issues rose to a record level.

The volume of new publicly offered corporate bonds declined in August, in large part for seasonal reasons. As in July, the bulk of the new offerings were from lower-rated issuers, reflecting the continuing reduction of risk premiums for such securities. Downward pressure on risk premiums in the public market apparently reflected some continuing spillover of funds from the private placement market--where the supply of investable funds being provided by insurance companies and pension funds remained large.

Growth in mortgage credit also remained strong in August. Mortgage loans outstanding at commercial banks continued to rise at a rapid pace, and new issues of GNMA-guaranteed, mortgage-backed securities increased further. At savings and loan associations the record volume of mortgage commitments outstanding at the end of July suggested that mortgage holdings had risen substantially further. Nevertheless, the liquidity position of these associations remained comfortable, reflecting the strong growth in deposits and large inflows of funds from mortgage repayments.

In the Committee's discussion of the economic situation and outlook, the members agreed--as they had at the August meeting--that the expansion was likely to continue for some time, and most of them expected that real GNP would grow at about the moderate pace projected by the staff. However, some members expressed doubts about the vigor of the expansion. One member reiterated a view that he had expressed at the August meeting, to the effect that growth was likely to fall short of the rate projected for the balance of this year and then to exceed the projected rates in the first half of 1978.

It was suggested during the discussion that recent developments bore some resemblance to those in 1976. Last year, it was recalled, progressive diminution in the quarterly rates of growth in real GNP had fostered concern that the expansion might be coming to an end and had given rise to recommendations for a stimulative fiscal program. It was noted, however, that the 1976 slowing had been caused by an inventory adjustment; final sales of goods and services had been strong throughout the year. It was observed that a similar adjustment of inventories had begun in the third quarter of this year and that once again the expansion in real final sales had been maintained while growth in total real GNP had slowed.

In view of the continued strength in final takings, it was suggested that the recent cutbacks in production and in employment in some activities were likely to be temporary. It was also observed that the performance of the recent unemployment statistics might have been affected by inadequate seasonal adjustments.

In the discussion, members offered reasons for expecting greater or less strength in business activity over the next year or so than suggested by the staff projections. Thus, some doubts were expressed that growth in consumer spending would pick up as much as projected and, in particular, that over the year ahead sales of new automobiles would increase further from the currently advanced levels. These doubts were attributed in part to the surge in spending for durable goods and the substantial rise in consumer debt that had already occurred. It was also suggested that expansion in consumer spending might be dampened by the adverse effect that the decline in stock prices had had on wealth. On the other hand, it was noted that rising real estate values had tended to increase consumers' wealth, and that the liquidity of real estate holdings--while less than that of market securities--had been increasing as a result of the greater ease with which homeowners could refinance first mortgages and obtain second mortgages. The comment was made that many second mortgages were being undertaken for the purpose of refinancing outstanding instalment debt.

Some concern was expressed about the sluggishness of economic activity in other major industrial countries, particularly in Europe, and about its effect on net exports and thus on domestic economic activity. However, the view was also expressed that in some major countries the foundation for improvement in activity was being laid by a slowing of the rise in wages and prices, a reduction of growth in money supplies, and a strengthening of external positions.

Business fixed investment was described as a sector whose contribution to over-all economic growth might well be greater than projected, as businessmen responded to further growth in economic activity and increases in capacity utilization. Moreover, business confidence was said to have increased somewhat, although it was still being adversely affected by uncertainties concerning Government tax and energy policies. It was suggested that the contribution to over-all economic growth from Federal Government expenditures also could be greater than projected.

Concern was expressed about the outlook for both unemployment and prices. It was remarked that even if real GNP grew at a moderate pace over the next year, little progress would be made in reducing the unemployment rate--which was still significantly above the level that might be regarded as "full employment," even if that level were judged for structural reasons to be considerably higher than in the past. Moreover, one member observed, recent experience had shown that high unemployment did not greatly reduce the rate of inflation, and the staff projections did suggest persistence of both a rapid rate of inflation and a high rate of unemployment. To a few members, those prospects for unemployment and prices indicated that active public discussion of some form of an incomes policy would be appropriate. Others observed that an incomes policy both workable and likely to have fairly wide support had not yet been devised, and also that an effort to institute such a policy probably would have an adverse effect on business fixed investment. One member expressed the view that the longer-run outlook for unemployment and inflation called for a shift in the policy mix toward a firmer monetary policy--to limit growth of liquidity--and an easier fiscal policy.

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 their discussion at this meeting of policy for the immediate future , Committee members differed in their views on the appropriate response to the recent rapid growth in the monetary aggregates. It was noted that growth in M-1 and M-2 had not slowed so much in August as had been expected and that it apparently was picking up somewhat in September--making it likely that the rates of monetary expansion in the third quarter would be high relative to the Committee's longer-run ranges. Some members thought that the Committee's primary objective in the period immediately ahead should be to resist continued rapid expansion in the aggregates, in light of the implications of such expansion for inflation and inflationary expectations. On the other hand, some members advocated avoiding substantial increases in interest rates at present, in light of their doubts about the economic outlook. It was also noted that the recent high rate of growth in M-1 might represent a return to a more typical relationship between that rate and the growth rate in nominal GNP--following a period in which the demand for money had been held down by changes in financial practices--and accordingly that it might not warrant the kind of policy response that would be appropriate under other circumstances. Most members, however, were of the opinion that the Committee could not afford to ignore either the uncertainties in a generally favorable economic outlook or the recent high rates of monetary growth, and they favored finding some middle ground.

These differences in members' views were reflected in their preferences for operating specifications for the period immediately ahead. For the annual rate of growth in M-1 over the September-October period, most members favored a range with a lower limit of 2 or 3 per cent and an upper limit of 7 or 8 per cent. For M-2, most favored a range of 4 to 8 or 4 to 9 per cent. However, one member, who advocated maintaining relatively stable money market conditions, preferred ranges of 2 to 9 per cent for M-1 and 5-1/2 to 9-1/2 per cent for M-2. Another member favored a range of 0 to 5 per cent for M-1.

With respect to the Federal funds rate, a variety of views were expressed as to both the objective toward which operations should be directed initially and the degree of leeway that should be provided during the inter-meeting period in the event that the aggregates appeared to be deviating significantly from the midpoints of the specified ranges. Most members favored directing operations initially toward a funds rate of 6-1/8 per cent--the prevailing level--or 6-1/4 per cent, but some sentiment also was expressed for a higher initial objective. In view of the rapid monetary growth over recent months, the members in general believed that it would be desirable to avoid any significant decline in the weekly-average Federal funds rate from its current level, and almost all favored 6 per cent for the lower limit of the range. The view was expressed that a weekly-average Federal funds rate above 6-1/2 per cent should not be sought before the Committee had had an opportunity for further consultation, and a majority favored 6-1/2 per cent as the upper limit for the range. There was, however, considerable sentiment for an upper limit of 6-3/4 per cent.

At the conclusion of the discussion the Committee agreed that growth in M-1 and M-2 over the September-October period at annual rates within ranges of 2 to 7 and 4 to 8 per cent, respectively, would be appropriate. It was understood 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 that operations should be directed initially toward a weekly-average Federal funds rate of 6-1/4 per cent. The members agreed that if growth rates 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 6 to 6-1/2 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 has grown less rapidly in the current quarter than in the second quarter. In August industrial output declined by about as much as it had risen in July. Employment increased moderately but the labor force rose more and the unemployment rate edged up to 7.1 per cent, the same as in June. The dollar value of total retail sales, which had turned up in July, rose appreciably in August. The wholesale price index for all commodities was about unchanged; average prices of farm products and foods declined sharply for the third successive month, and average prices of industrial commodities continued to rise at a more moderate pace than in the early months of 1977. So far this year the index of average hourly earnings has advanced at about the same pace as it had on the average during 1976.

The weighted average exchange rate for the dollar against leading foreign currencies has recovered further in recent weeks, returning to the level of late June. In July the U.S. foreign trade deficit was at about the second-quarter rate, and there were sizable net inflows of foreign private and official capital.

Growth in M-1 and M-2 slowed in August from the exceptionally rapid rates in July. Expansion of both demand deposits and time and savings deposits at banks slackened. Growth in M-3 also slowed, although inflows to nonbank thrift institutions remained strong. Business short-term borrowing increased somewhat from the reduced pace in July, but remained below the volume of preceding months. Short-term interest rates, which had risen appreciably in early August, most recently have advanced somewhat further. Yields on longer-term market securities, however, have changed little on balance in recent months. Federal Reserve discount rates were increased from 5-1/4 to 5-3/4 per cent in late August and early September, and member bank borrowings receded from the high levels of the latter part of August.

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 September-October period to be within the ranges of 2 to 7 per cent for M-1 and 4 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 6-1/4 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 mid-points of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 6 to 6-1/2 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, Mayo, and Partee. Votes against this action: Messrs. Lilly, Morris, Roos, and Wallich.

Messrs. Lilly and Wallich dissented from this action because it allowed for somewhat more firming in money market conditions than they thought was appropriate at present in view of their judgment that the economic situation was not very strong. They also felt that the rapid monetary growth over recent months might represent an increase in the public's demand for money in relation to growth in GNP of a kind that should be accommodated. Mr. Lilly believed, in addition, that further tightening in money market conditions would not be effective in dealing with the underlying structural inflation.

Messrs. Morris and Roos dissented on the ground that the policy adopted by the Committee represented an inadequate response to the rapid rates of monetary growth over recent months, which in their view were not compatible with a healthy economy over the longer run. Mr. Roos felt that, if the Committee did not take action now that would assure a reduction in the rate of growth in M-1, the rate of inflation would accelerate and more drastic action would need to be taken later on.

2. <u>Authorization for domestic open market operations</u>

On September 30, 1977, Committee members voted to increase from $2 billion to $3 billion the limit on Federal Reserve Bank holdings of special short-term certificates of indebtedness purchased directly from the Treasury, specified in paragraph 2 of the authorization for domestic open market operations, effective immediately.

> Votes for this action: Messrs. Burns, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Partee, Roos, Wallich, Eastburn, and Timlen. Votes against this action: None. (Messrs. Eastburn and Timlen voted as alternates for Messrs. Morris and Volcker, respectively.)

This action was taken on the recommendation of Chairman Burns. The Chairman had advised the Committee that the current temporary debt ceiling of $700 billion would expire at midnight on September 30, 1977; that unless congressional action to extend the temporary ceiling were completed before that time, the ceiling would revert to its permanent level of $400 billion; and that under the temporary ceiling, the Treasury had leeway to borrow an additional amount between $2 billion and $3 billion and had requested that the System stand ready to purchase that day directly from the Treasury such amounts of special short-term certificates of indebtedness as the Treasury might be able to issue under the temporary ceiling.