FEDERAL RESERVE
press release

For Use at 4:00 p.m. May 19, 1978

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 April 18, 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 April 18, 1978

Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services had been small in the first quarter of 1978, owing in part to the unusually severe weather and the lengthy strike in coal mining, but that economic activity was rebounding in the latter part of the period. Staff projections suggested that the first-quarter shortfall in growth from the rate expected earlier would be about made up in the current quarter and that over the year ahead output would grow at a moderate pace.

The rise in average prices--as measured by the fixed-weighted price index for gross domestic business product--appeared to have stepped up considerably in the first quarter from the annual rate of 5.4 per cent estimated for the fourth quarter of 1977, reflecting for the most part reduced supplies of meats and increases in payroll taxes and in minimum wages at the beginning of the year. The staff's latest projections of the rise in prices, which were somewhat higher than those made 4 weeks earlier, suggested that the rate over the year ahead would remain well above that in the fourth quarter of 1977. It was also anticipated that the unemployment rate would move downward gradually over the period.

In the first quarter, according to the latest staff estimates, growth in real GNP had slowed much more than had been anticipated a month earlier--mainly because an expected improvement in net exports of goods and services apparently had failed to develop but also because adverse weather had impeded residential, business, and public construction more than had been thought previously. It was still estimated that consumer expenditures for goods in real terms, after having grown rapidly in the fourth quarter of 1977, had declined in the first quarter of 1978. Altogether, final sales in real terms had slowed much more than growth in output, and the rate of business inventory accumulation had picked up from the sharply reduced pace in the preceding quarter.

The staff projections suggested that consumer spending for goods in real terms and both private and public construction would rebound in the second quarter, that the rate of inventory accumulation would increase somewhat further, and that net exports of goods and services would improve moderately. It was anticipated that in the remaining two quarters of the year real consumption expenditures and real business fixed investment would expand moderately but that the foreign trade position would change little and that residential construction would begin to edge down in response to the less favorable mortgage market conditions that had been developing recently.

In March the index of industrial production increased 1.4 per cent, following a rise of 0.3 per cent in February and a decline of 0.8 per cent in January. Thus, the index for March was about 1 per cent above that for December, although the average for the first quarter of 1978 was about the same as that for the fourth quarter of 1977.

Nonfarm payroll employment rose sharply further in March, and gains were widespread among industry groups. In manufacturing, the increase was sizable for the fourth successive month, and the average workweek recovered to the November-December level. The unemployment rate edged up 0.1 of a percentage point to 6.2 per cent, as the civilian labor force expanded substantially after having been unchanged in February.

Total retail sales in February, according to revised estimates, had recovered much more of the January drop than had been reported earlier, and they expanded substantially further in March. Nevertheless, total sales were about the same in the first quarter as in the fourth quarter of 1977. Unit sales of new automobiles, domestic and foreign combined, rose sharply in March, carrying the first-quarter total up to the level of each of the two preceding quarters.

The index of average hourly earnings for private nonfarm production workers rose at an annual rate of about 9 per cent from December to March, compared with a rate of about 8 per cent over the preceding 3 months. The acceleration in the first quarter resulted in large part from the increase in minimum wages at the beginning of the year.

The wholesale price index for all commodities rose 1 per cent in March, the same as in February, reflecting further large increases in prices of farm products and foods. In February the consumer price index for all urban consumers had continued to advance at a faster pace than in the second half of 1977, owing to large increases in retail prices of foods and in rates for natural gas and electricity.

The U.S. foreign trade deficit increased significantly in February, as the value of imports rose sharply while the value of exports changed little. After the trade statistics had been announced on March 31, the trade-weighted value of the dollar declined nearly 1 per cent. In the week preceding this meeting, however, the dollar recovered to about the same level as that 4 weeks earlier.

The rate of expansion in total credit at U.S. commercial banks during March was close to that in February. Growth in loans, particularly business loans and real estate loans, accelerated. At the same time banks reduced their holdings of Treasury securities--resuming the pattern of net liquidation of investments that had been interrupted by substantial acquisitions of Treasury securities in February. Over the first quarter, total bank credit grew at an annual rate of about 10-1/2 per cent, compared with 8-1/2 per cent in the second half of 1977. Business loans (net of bankers acceptances) increased in March at an annual rate of 23 per cent, approaching the rapid pace recorded in the first half of 1974.

Outstanding commercial paper of nonfinancial businesses rose sharply in March, almost offsetting the sizable decreases in the preceding 2 months. Public utilities accounted in large part for both the rise in March and the earlier declines.

The narrowly defined money supply (M-1), which had declined in February, rose moderately in March, and in the first quarter--on a quarterly-average basis--it expanded at an annual rate of 5 per cent. From the first quarter of 1977 to the first quarter of 1978, M-1 grew about 7-1/4 per cent.

Inflows to banks of time and savings deposits other than negotiable CD's and inflows of deposits to nonbank thrift institutions remained slow in March, and growth rates for M-2 and M-3 were near the reduced rates in February. From the first quarter of 1977 to the first quarter of 1978, M-2 and M-3 grew about 8-1/2 and 10-1/2 per cent, respectively.

At its March meeting the Committee had decided that during the March-April period growth in M-1 and M-2 within ranges of 4 to 8 and 5-1/2 to 9 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 6-3/4 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 6-1/2 to 7 per cent. The members also agreed, however, that a reduction in the rate below 6-3/4 per cent would not be sought until the Committee had had an opportunity for further consultation.

Projections made on the basis of data that had become available in the days immediately following the March meeting suggested that over the March-April period both M-1 and M-2 would grow at rates that were high within their specified ranges. The figures were regarded as especially tentative, however, since the strength was concentrated in the part of the period for which growth rates were projected. Consequently, the Manager of the System Open Market Account continued to seek a Federal funds rate of about 6-3/4 per cent. Data becoming available later in the inter-meeting period suggested more moderate rates of growth in the monetary aggregates, and the weekly-average funds rate remained close to 6-3/4 per cent throughout the period.

Market interest rates in general were subjected to upward pressure during much of the inter-meeting period, apparently because of investor concerns about the deterioration in the balance of U.S. foreign trade, the acceleration of the rise in prices, and the possibility of a surge in monetary growth in April. Most interest rates--especially longer-term rates--increased somewhat on balance over the period. Recently, however, Treasury bill rates had declined, and on the day before this meeting the 3-month bill rate was somewhat below its level just before the March meeting.

Treasury borrowing remained relatively strong during the inter-meeting period. In addition to issuing $6.0 billion of short-term, cash-management bills, the Treasury raised $300 million of new money in its regular weekly bill auctions and more than $3 billion through sales of 2- and 5-year notes. The Treasury also announced that on April 19, the day after this meeting, it would auction about $2.2 billion of 2-year notes to refund the same amount of publicly held notes maturing on April 30. The Treasury was expected to announce the terms of its mid-May refunding on April 26.

Mortgage lending in March apparently picked up somewhat from the reduced pace of January and February, but in the first quarter as a whole the volume was below the peak reached in the fourth quarter of 1977. In February, the latest month for which data were available, mortgage commitment activity at nonbank thrift institutions weakened further as these institutions continued to experience reduced inflows of deposits. Average interest rates on new commitments for conventional home loans at savings and loan associations edged up further during the inter-meeting period to a level about 35 basis points above that in late December. Yields in the secondary markets for mortgages also continued upward, rising to a level 40 to 50 basis points higher than in late December.

In the Committee's discussion of the economic situation, most members indicated little or no disagreement with the staff projection of moderate growth in real GNP over the year ahead, following the current rebound from the slow pace estimated for the first quarter. However, several members expressed the view that growth would be stronger in the current quarter than had been projected. Of these members, two believed that growth would then slow significantly in the second half of 1978.

Concerning the current rebound in growth, one member thought that it could be considerably greater than had been projected, owing to the dynamics of the process of income creation, and that such additional strength at the current stage of the business expansion could have adverse consequences. In any case, he saw grounds for concern in the way the economic situation might be developing.

One of the members who thought that the near-term strength in activity would give way to very slow growth in the second half of the year believed that residential construction, and perhaps also consumer spending, would be weaker in that period than had been projected. At the same time, he expected the country's foreign trade position to be stronger than had been projected. The second member who anticipated a marked slowing of growth later in the year felt that such a development would not be undesirable; he shared the opinion of another member that the unemployment rate was approaching the level where unused labor resources of many kinds might be limited. A third member expressed disagreement with that view of the unemployment situation. He suggested that it was not widely held and that any tendency for the unemployment rate to stabilize near its current level was likely to lead to some sort of stimulative governmental policy measures.

One member commented that output could continue to grow at a moderate pace without generating unusual pressures because some slack still existed in the utilization of industrial capacity and of the labor force. With respect to the latter, he pointed out that a large number of persons in public service jobs created under Federal programs were available for other types of employment, even though they were not counted among the unemployed. He also noted that business fixed investment in real terms had not yet recovered to its previous high and that the inventory situation was favorable. Nevertheless, in his view, growth in over-all output might be held down if inflationary expectations led to increases in interest rates--thereby adversely affecting residential construction and business fixed investment--and if the international economic situation proved to have an adverse influence on the domestic economy.

Committee members in general were deeply concerned about price prospects. Views were expressed to the effect that people in both the public and private sectors appeared as yet not to be making the sorts of difficult decisions required to reduce the pace of the rise in prices; that expectations of a high rate of inflation seemed to be growing and, as a result, actions of businessmen and consumers might tend to make their expectations self-fulfilling; that the rate of increase in wage rates might well accelerate if prices rose at the projected rate or if the labor contract recently negotiated in the coal industry were viewed as a pattern-setter; and that individual efforts to profit from inflation could lead to some speculative activity. The comment was also made that in the past several weeks the public's attention increasingly had been focused on the problem of inflation.

It was noted that the current rise in prices was more rapid than the rate that had been projected early in 1977. Questions were raised as to whether the recent acceleration of the rise was attributable primarily to special factors affecting foods and to the depreciation of the dollar in foreign exchange markets or whether it reflected more general influences, such as the pressures that frequently emerge in the latter phase of a business upswing or the effect of the rate of monetary growth during 1977. As at other recent meetings, the observation was made that monetary policy could be no more than one element in an effective program to fight inflation.

At this meeting the Committee reviewed its 12-month ranges for growth in the monetary aggregates. At its meeting in February 1978 the Committee had specified the following ranges for growth over the period from the fourth quarter of 1977 to the fourth quarter of 1978: 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 growth in commercial bank credit was 7 to 10 per cent. The ranges being considered at this meeting were for the period from the first quarter of 1978 to the first quarter of 1979.

In the Committee's discussion of the appropriate ranges, the members were unanimous in favoring retention of the existing range for M-1. It was suggested that it might be desirable, for technical reasons, to reduce the ranges for M-2 and M-3--or the range for M-3 alone. However, that suggestion had little support; most of the members advocated retaining the existing ranges for all of these aggregates.

In recognition of the Committee's continuing objective to move gradually toward longer-run rates of monetary expansion consistent with general price stability, several members expressed the view that it was more important at this time to pursue measures that would hold monetary growth within the existing ranges than it was to make further reductions in the ranges themselves. In this connection, it was pointed out that since the fourth quarter of 1976 the rate of growth of M-1 had exceeded the 6-1/2 per cent upper limit of the longer-run range in every quarter except the one just ended. In view of that record, it was suggested, the Committee could most effectively demonstrate its adherence to its longer-run objective and lend support to the administration's anti-inflation program by succeeding in holding monetary growth within the existing range.

The point was stressed that retention of the existing ranges for the year ahead should be interpreted as constituting a tighter monetary posture than had been contemplated when the ranges were adopted in February 1978. It was observed that since then the prospective rate of inflation had increased--which implied, other things being equal, that nominal GNP and the associated transactions demand for money would expand more rapidly than had been anticipated at that time. It was recognized that such an implication could form the basis of an argument for raising the 12-month range for M-1, or at least its upper limit. It was suggested, however, that the ultimate conclusion of such an argument was a monetary policy that always accommodated the existing rate of inflation and that could be expected to lead to still higher rates of inflation and still more rapid monetary growth.

In the discussion of the longer-run ranges for M-2 and M-3, it was observed that inflows of time and savings deposits to commercial banks and to nonbank thrift institutions might continue to be impeded by the margin by which market interest rates exceeded the Regulation Q ceiling rates on deposits other than large-denomination CD's. It was suggested, therefore, that a reduction in the range for M-3, and perhaps in the ranges for both M-2 and M-3, might be viewed as consistent with a retention of the existing range for M-1. In opposition to this view, it was noted that commercial banks would probably continue to expand substantially the outstanding volume of large-denomination CD's not subject to rate ceilings and that the nonbank thrift institutions also were becoming more aggressive in selling such instruments. It was recognized, moreover, that the probability of attaining growth rates for M-2 and M-3 within the existing ranges over the coming year could be influenced by an increase in the Regulation Q ceilings on deposit rates.

At the conclusion of its discussion the Committee decided to retain the existing ranges for the monetary aggregates. Thus, the ranges for the period from the first quarter of 1978 to the first quarter of 1979 were 4 to 6-1/2 per cent for M-1, 6-1/2 to 9 per cent for M-2, and 7-1/2 to 10 per cent for M-3. The associated range for growth in commercial bank credit was set at 7-1/2 to 10-1/2 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. It was also understood that short-run factors might cause growth rates from month to month to fall outside the ranges anticipated for the year ahead.

> The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the first quarter of 1978 to the first quarter of 1979: 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 bank credit is 7-1/2 to 10-1/2 per cent.

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

In considering the language of the domestic policy directive to be adopted at this meeting, Committee members agreed that in the statement of the Committee's general policy stance in the fourth paragraph more weight should be given to the objective of resisting inflationary pressures by citing that objective first. As revised, the statement said that "it is the policy of the Federal Open Market Committee to foster bank reserve and other financial conditions that will resist inflationary pressures while encouraging continued moderate economic expansion and contributing to a sustainable pattern of international transactions."

In the discussion of policy for the period immediately ahead, members of the Committee took account of the likelihood that the demand for money would expand significantly in association with the current rebound in economic activity and of the early indications that M-1 was growing rapidly in April. All of the members agreed that operations designed to achieve firmer money market conditions needed to be undertaken promptly if M-1 growth were to be held to a path reasonably consistent with the Committee's longer-run range. At the same time the members felt that, pending additional evidence on the pace of monetary expansion, the degree of firming sought should be modest.

Although members of the Committee were in general agreement on objectives for the period immediately ahead, they differed somewhat in their preferences for operating specifications. For the annual rate of growth in M-1 over the April-May period, most members favored ranges of 4 to 8 per cent or 5 to 9 per cent, but a few expressed a preference for 5-1/2 to 9-1/2 per cent. Two members advocated wider ranges because of the month-to-month volatility of the measure of monetary growth; one suggested a range of 4 to 9 per cent, and the other a range of 2 to 8 per cent. For M-2 most members advocated ranges of 5-1/2 to 9-1/2 per cent or 6 to 10 per cent, but there was some sentiment for slightly lower ranges.

All of the members favored directing open market operations during the coming inter-meeting period initially toward a Federal funds rate slightly above the current level of 6-3/4 per cent. Views differed somewhat with respect to the degree of leeway for operations during the inter-meeting period in the event that growth in the monetary aggregates appeared to be deviating significantly from the midpoints of the specified ranges. Most members favored a range for the weekly-average Federal funds rate extending from 6-3/4 to 7-1/4 or to 7-1/2 per cent, but there was some sentiment for a lower limit of 6-1/2 per cent. Those advocating a lower limit of 6-3/4 per cent suggested that any decline in the weekly-average funds rate from the current level would be inappropriate, particularly in view of recent developments in foreign exchange markets. At the same time several members suggested that if the Committee allowed for an increase in the funds rate of as much as 3/4 of a percentage point over the inter-meeting period by setting the upper limit of the range at 7-1/2 per cent, it should also reach an understanding that operations would not be directed toward achieving a rate above 7-1/4 per cent before the Committee had had an opportunity for further consultation.

At the conclusion of the discussion the Committee decided that growth in M-1 and M-2 over the April-May period at annual rates within ranges of 4 to 8-1/2 per cent and 5-1/2 to 9-1/2 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.

In the judgment of the Committee such growth rates were likely to be associated with a weekly-average Federal funds rate slightly above the current level of 6-3/4 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 6-3/4 to 7-1/2 per cent. It was also agreed, however, that an increase in the rate above 7-1/4 per cent would not be sought until the Committee had had an opportunity for further consultation.

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 members also agreed that in the conduct of day-to-day operations, account should be taken of emerging financial market conditions, including the conditions in foreign exchange markets.

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 was small in the first quarter, owing in part to the unusually severe weather and the lengthy strike in coal mining, but that economic activity was rebounding in the latter part of the period. In March industrial production and nonfarm payroll employment increased sharply further. The unemployment rate edged up from 6.1 to 6.2 per cent, as the civilian labor force expanded substantially. Retail sales recovered much more in February than had been reported earlier, and sales rose considerably further in March. The pace of the rise in wholesale prices remained rapid, reflecting further large increases in farm products and processed foods. The index of average hourly earnings accelerated in the first quarter, largely because of the increase in minimum wages at the beginning of the year.
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> The trade-weighted value of the dollar against major foreign currencies declined sharply after the March 31 announcement of a very large increase in the U.S. foreign trade deficit for February. But over the past week the dollar has recovered to about its level of 4 weeks ago.
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> M-1, which had declined in February, rose moderately in March. Inflows to banks of time and savings deposits other than negotiable CD's and inflows to nonbank thrift institutions remained slow. Most market interest rates, especially longer-term rates, have increased somewhat on balance in recent weeks.

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 resist inflationary pressures while encouraging continued moderate economic expansion and contributing to a sustainable pattern of international transactions.

Growth of M-1, M-2, and M-3 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, from the first quarter of 1978 to the first quarter of 1979 appears to be consistent with these objectives. The associated range for bank credit is 7-1/2 to 10-1/2 per cent. 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 April-May period to be within ranges of 4 to 8-1/2 per cent for M-1 and 5-1/2 to 9-1/2 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 slightly above the current level. 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 6-3/4 to 7-1/2 per cent. In the conduct of day-to-day operations, account shall be taken of emerging financial market conditions, including the conditions in foreign exchange markets.

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

Subsequent to the meeting, on May 5, a telephone conference meeting was held to consult about System open market operations, pursuant to the decision at the April meeting that an increase in the Federal funds rate above 7-1/4 per cent, within the specified range of 6-3/4 to 7-1/2 per cent, would not be sought until the Committee had had an opportunity for further consultation.

The latest estimates had indicated that M-1 had grown at a very rapid pace in April. For the April-May period staff projections had suggested that the annual rate of growth in M-1 would be well above the upper limit of the range of 4 to 8-1/2 per cent specified by the Committee in the next-to-last paragraph of the domestic policy directive issued at the meeting of April 18.

Growth in M-2 for the 2-month period had been projected to be at about the upper limit of the Committee's range of 5-1/2 to 9-1/2 per cent for that aggregate. During the preceding week the Federal funds rate had averaged about 7-1/4 per cent, 1/2 of a percentage point above the level prevailing at the time of the April meeting.

It was reported during the telephone conference that the Commerce Department's preliminary estimates indicated that real GNP had declined at an annual rate of 0.6 per cent in the first quarter, a somewhat weaker performance than had been anticipated at the time of the April meeting, but that real GNP appeared to be rising more rapidly in the second quarter than the staff had projected then. The behavior of GNP in both quarters was importantly affected by temporary influences.

The acceleration of growth of nominal GNP in the current quarter from the reduced pace in the first quarter appeared to be the main factor explaining the sharp acceleration of monetary growth in April. Other transitory forces--specifically, mobilization of cash by the public to make unusually large payments of Federal income taxes not withheld, somewhat slower processing of tax returns, and the upsurge in the volume of trading on the stock exchanges--might also have contributed to the April rate of monetary growth.

In its discussion the Committee agreed that, while the firming in money market conditions that had been accomplished since the meeting of April 18 had clearly been appropriate, there was some question as to whether further firming at this point would be desirable. Specifically, the Committee concluded that it would be appropriate to await some further evidence on the economic outlook and some indication of the extent to which the April surge in M-1 would subside.

At the conclusion of the discussion the Committee directed the Manager, until further instructed, to seek to maintain the weekly-average Federal funds rate at about 7-1/4 per cent, with any deviations tending to be in the direction of higher rather than lower funds rates.

> On May 5, 1978, the Committee modified the domestic policy directive adopted at its meeting of April 18, 1978, to direct the Desk, until further instructed, to seek to maintain the weekly-average Federal funds rate at about the prevailing level of 7-1/4 per cent, with any deviations tending to be in the direction of higher rather than lower funds rates.

Votes for this action: Messrs. Miller, Volcker, Baughman, Gardner, Jackson, Partee, Wallich, and Winn. Votes against this action: Messrs. Black and Willes. Absent and not voting: Messrs. Coldwell and Eastburn. (Mr. Black voted as alternate for Mr. Eastburn.)

Messrs. Black and Willes dissented from this action because they preferred to make use of the full range that had been specified for the Federal funds rate. They believed that, given the accelerated pace of expansion in nominal GNP, growth of both M-1 and M-2 would be subjected to persistent upward pressure throughout the rest of the second quarter and that a further upward adjustment in the funds rate at this time would be helpful in moderating such pressures and, like the firming that had already occurred, would be regarded as a positive step in resisting inflationary pressures.