FEDERAL RESERVE
press release

For Use at 4:10 p.m. December 22, 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 November 21, 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 November 21, 1978

1. Domestic policy directive

The information reviewed at this meeting suggested that output of goods and services was continuing to grow at a moderate pace in the current quarter, following expansion at an annual rate of 3.4 per cent in the third quarter and a somewhat faster rate on the average over the first two quarters of the year. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be continuing their rapid rise, about in line with the annual rate of 7-1/2 per cent estimated for the third quarter.

Staff projections of growth in output over the year ending in the third quarter of 1979 had been reduced from those of a month earlier. They now suggested a further slowing of expansion, in large part because of a reduction next year in the rise of business fixed investment and a decline in residential construction activity. The projections continued to suggest a rapid rise in average prices. The unemployment rate was expected to increase slightly from its October level.

In October the index of industrial production rose an estimated 0.5 per cent, the same as in September but somewhat below the average advance since last winter. Nonfarm payroll employment rose considerably in October following relatively small advances during the third quarter. In manufacturing, employment gains were the largest of the year and the average workweek edged up. The unemployment rate declined from 6.0 to 5.8 per cent.

Total private housing starts remained above an annual rate of 2 million units in September. However, sales of new units declined for the fourth consecutive month, and merchant-builder inventories of unsold single-family homes rose further. Sales of existing dwellings remained at an advanced level.

The dollar value of total retail sales declined somewhat in October following a sizable gain in August and a further advance in September. On balance, retail sales were modestly above their April level and slightly above their average in the third quarter. Unit sales of new automobiles increased in October but were still lower than in most other months since early spring.

The index of average hourly earnings of private nonfarm production workers increased at an annual rate of about 9 per cent in October; for the first 10 months of 1978 the advance was at a rate of 8.4 per cent, about 1 percentage point above the rise over 1977 as a whole. Total hourly compensation of nonfarm workers was estimated to have increased at an annual rate of nearly 10 per cent over the first three quarters of the year, about 1-3/4 percentage points faster than in 1977.

Average producer prices of finished goods rose substantially in October for the second consecutive month, reflecting in part a further large increase in producer prices of food products. In September the consumer price index rose at an annual rate of nearly 10 per cent following 2 months of somewhat smaller increases.

On October 24 the Government announced a new program aimed at moderating increases in prices and wages. The program included explicit numerical standards for price and wage increases, with voluntary compliance encouraged by a number of Government measures; procedures to minimize the inflationary impact of Government regulations; and a restrictive budget policy.

On November 1 a broad Government program was put in place to strengthen the dollar in foreign exchange markets and thereby to counter continuing domestic inflationary pressures. As part of this program the Federal Reserve announced the following actions: an increase in the discount rate from 8-1/2 to 9-1/2 per cent; establishment of a supplementary reserve requirement of 2 per cent against member bank time deposits in denominations of $100,000 or more; and increases in its reciprocal currency arrangements with the central banks of Germany, Japan, and Switzerland, and activation of the swap arrangement with the Bank of Japan. The U.S. Treasury announced related measures to mobilize key foreign currencies, including drawings on the U.S. reserve tranche in the International Monetary Fund; sales of special drawing rights; and issuance of foreign-currency-denominated securities. The Treasury also announced an increase in its monthly gold sales. The expanded availability of foreign currencies was to be used in a program of forceful intervention in exchange markets, coordinated with foreign central banks, to correct recent excessive exchange rate movements.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies declined substantially further during the last week of October, following large cumulative losses over recent months. After the announcement and initial implementation of the new support program on November 1, however, the dollar rose sharply--to a level somewhat above that in early October. The U.S. trade deficit in the third quarter was about unchanged from the second quarter.

In October the expansion of total credit at U.S. commercial banks slowed slightly from the pace in the third quarter. Bank loans other than security loans continued to grow rapidly, but bank investments were reduced somewhat. Outstanding commercial paper of nonfinancial businesses rose considerably in October after having changed little on balance during the previous 2 months.

The narrowly defined money supply (M-1) grew at an annual rate of about 3-1/4 per cent in October, after having expanded at rates of around 8-1/2 and 14 per cent in August and September, respectively; growth in M-2 and M-3 also moderated. Inflows of the interest-bearing deposits included in the broader aggregates slowed somewhat, although sales of 6-month money market certificates at both commercial banks and nonbank thrift institutions expanded sharply.

At its meeting on October 17, the Committee had agreed that early in the coming inter-meeting period operations should be directed toward a Federal funds rate of around 9 per cent, slightly above the rate of 8-3/4 per cent then prevailing. Subsequently, the objective for the Federal funds rate was to be raised or lowered in an orderly fashion within a range of

8-3/4 to 9-1/4 per cent. In setting a specific objective for the funds rate within that range, the Manager of the System Open Market Account was to be guided mainly by a range of tolerance of 5-1/2 to 9-1/2 per cent for the annual rate of growth in M-2 over the October-November period, provided that the rate of growth in M-1 over that period did not exceed 6-1/2 per cent.

Immediately following the October 17 meeting the Manager began to seek reserve conditions consistent with a weekly average Federal funds rate of around 9 per cent. However, because a sizable short-term need for reserves coincided with temporary market scarcities of Treasury obligations for collateral behind System repurchase agreements, Federal funds traded at around 9-1/4 per cent. As October progressed, the Manager did not take aggressive action to exert downward pressure on the funds rate, in light of conditions in foreign exchange markets and of the Committee's related instruction to give due regard to such developments. Accordingly, Federal funds continued to trade at around 9-1/4 per cent in the days prior to November 1.

As part of the Government program announced on November 1, the Committee had voted on October 31 to delegate authority to Chairman Miller to modify the domestic policy directive by raising the range for the Federal funds rate to 9-1/2 to 9-3/4 per cent and by instructing the Manager, in deciding on the specific objective for the rate within that range, to be guided by developing conditions in domestic and international financial markets; the Chairman approved the modification on November 1. During the first half of November, the Federal funds rate averaged in the upper half of that range. For several days immediately following the November 1 announcement, however, the rate was somewhat above the desired range as the Manager avoided aggressive action to reduce it during the initial stages of implementation of the new program.

The rise in the Federal funds rate during the inter-meeting period was accompanied by substantial increases in yields on most short-term market instruments. Advances in rates on Treasury bills were moderated, however, by large investments by foreign central banks of dollars obtained in currency support operations. Commercial banks increased the rate on loans to prime business borrowers from 10 per cent to 11 per cent during the period. Yields in bond markets advanced considerably during the second half of October, but a large portion of the increase was offset by sizable declines in early November. In mortgage markets, interest rates moved steadily higher over the inter-meeting period as demands for real estate credit remained strong. Residential mortgage lending apparently increased in October.

In the Committee's discussion of the economic situation and outlook, most members indicated that over the past month they had scaled down their expected rates of growth in real output of goods and services for the year ending in the third quarter of 1979. One or two members still anticipated moderate expansion over the period, but many projected slow growth, and some thought that a downturn in activity was likely or that the risks of an actual recession or a growth recession had increased. It was emphasized, however, that the uncertainties associated with any forecast of real output had increased significantly.

Most members expected that, over the year ending in the third quarter of 1979, the unemployment rate either would change little or would increase from the average level in the third quarter of 1978. All members continued to anticipate a rapid rise in average prices of goods and services.

The recent rise in short-term interest rates--specifically, its impact on the cost and possibly on the availability of mortgage credit--in addition to recent indications of a slowing next year in the rise of business fixed investment, was cited as one reason for reducing anticipated rates of growth in real output over the period ahead. On the other hand, the view was also expressed that the new program to strengthen the dollar and to counter inflationary pressures could have favorable effects on expectations, especially on those for inflation, and thereby could encourage spending. In this connection, it was noted that long-term bond yields had declined immediately after the announcement on November 1.

A difference in emphasis also existed with respect to Federal tax policy. Thus, it was suggested that prospects for sustaining the expansion in output had been improved by the recent enactment of reductions in income taxes. But it was also observed that the reductions would be largely offset by substantial increases in social security taxes in 1979.

Some skepticism was expressed, as it had been at the October meeting, that growth in output could be tapered down to a relatively slow rate without bringing on a recession, especially in view of the rapid inflation. It was stressed, on the other hand, that economic conditions in this period differed from those in other business expansions in ways that made it reasonable to expect a reduction in the rate of growth and a concomitant decrease in the rate of inflation without a slide into recession.

At its meeting in October the Committee had agreed that from the third quarter of 1978 to the third quarter of 1979 growth of M-2 and M-3 within ranges of 6-1/2 to 9 per cent and 7-1/2 to 10 per cent, respectively, appeared to be consistent with broad economic aims. M-1 was expected to grow over that period within a range of 2 to 6 per cent, depending in part on the speed and extent of transfers from demand to savings deposits resulting from the introduction of the automatic transfer service (ATS). The associated range for the rate of growth in commercial bank credit was 8-1/2 to 11-1/2 per cent. The Committee had also decided that growth of M-1+ within a range of 5 to 7-1/2 per cent appeared to be generally consistent with the ranges of growth for the other monetary aggregates. It had been agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings.

In the discussion of policy for the period immediately ahead, the members of the Committee agreed that, in seeking to achieve bank reserve and money market conditions broadly consistent with the longer-run ranges for monetary growth cited above, due regard should be given to the program for supporting the foreign exchange value of the dollar as well as to developing conditions in domestic financial markets and to uncertainties associated with the November 1 introduction of ATS. Against that background, the members differed somewhat in their views as to whether, and to what degree, additional firming in money market conditions should be sought during the next few weeks; no sentiment was expressed for easing money market conditions. As they had at the October meeting, moreover, most members favored giving greater weight than usual to money market conditions in the conduct of operations in the period before the next meeting, although some sentiment was expressed for a return to basing decisions for open market operations primarily on the behavior of the monetary aggregates.

The members favored directing open market operations early in the period before the next regular meeting toward maintaining the weekly average Federal funds rate at 9-3/4 per cent, the upper end of the 9-1/2 to 9-3/4 per cent range specified as of November 1, or slightly higher. With respect to the range in which the funds rate might be varied if growth in the aggregates appeared to approach or move beyond their specified limits, most members favored an upper limit of 10 per cent for the range; 10-1/8 and 10-1/4 per cent were also proposed. Lower limits from 9-1/2 to 9-3/4 per cent were suggested.

With respect to the monetary aggregates, almost all members proposed that the Committee take account of the unusual uncertainties associated with the introduction of ATS in the same way that it had at the October meeting--namely, by giving primary emphasis to growth of M-2 and by specifying only an upper limit, rather than a range, for growth of M-1. For the annual rate of growth in M-2 over the November-December period, most members favored a range with a lower limit of 6 per cent and an upper limit of 9 to 10 per cent. Almost all members proposed 5 or 5-1/2 per cent for the ceiling on growth of M-1 over the 2-month period.

At the conclusion of the discussion the Committee agreed to instruct the Manager to seek a Federal funds rate of around 9-7/8 per cent early in the period before the next regular meeting and subsequently to maintain the rate within a narrow band of 9-3/4 to 10 per cent. With regard to the specific objective for the rate within that range, the Committee instructed the Manager to be guided mainly by a range of tolerance for the annual rate of growth in M-2 over the November-December period of 6 to 9-1/2 per cent, provided that the rate of growth in M-1 over that period did not exceed 5 per cent. 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 objectives.

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

> The information reviewed at this meeting suggests that in the current quarter real output of goods and services is continuing to grow moderately. In October industrial production expanded further, nonfarm payroll employment rose considerably, and the unemployment rate declined from 6.0 to 5.8 per cent. Following 2 months of gains, the dollar value of total retail sales declined somewhat to a level slightly above the average in the third quarter. Average producer prices of finished goods rose substantially in October, as in September, in part because of further large increases in prices of foods. The advance in the index of average hourly earnings has been somewhat faster so far in 1978 than it was on the average during 1977. In late October the Government announced a new program aimed at moderating increases in prices and wages.
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> On November 1 a broad program to strengthen the dollar in foreign exchange markets and thereby to counter continuing domestic inflationary pressures was announced. The program included an increase in Federal Reserve discount rates from 8-1/2 to 9-1/2 per cent, establishment of a supplementary reserve requirement of 2 per cent against member bank time deposits in denominations of $100,000 or more, increases in Federal Reserve reciprocal currency arrangements with certain central banks, and other measures to mobilize key foreign currencies.
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> The trade-weighted value of the dollar against major foreign currencies declined rapidly during the last week of October, but following

the actions taken to strengthen the dollar, it rose sharply to a level somewhat above that in early October. The U.S. trade deficit was about the same in the third quarter as in the second quarter.

Growth in M-1, which had been rapid in August and September, slowed markedly in October, and growth in M-2 and M-3 also moderated. Inflows of the interest-bearing deposits included in the broader aggregates slowed somewhat, although sales of 6-month money market certificates at both commercial banks and nonbank thrift institutions expanded to record levels. Short-term market interest rates have risen substantially further since mid-October. Bond rates also have increased on balance, although they have declined appreciably since November 1; mortgage interest rates have continued to rise.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster monetary and financial conditions that will resist inflationary pressures while encouraging continued moderate economic expansion and contributing to a sustainable pattern of international transactions. At its meeting on October 17, 1978, in setting ranges for the monetary aggregates, the Committee recognized the uncertainties concerning the effects that the November 1 introduction of the automatic transfer service (ATS) would have on measures of the money supply, especially M-1. Against that background, the Committee agreed that appropriate monetary and financial conditions would be furthered by growth of M-2 and M-3 from the third quarter of 1978 to the third quarter of 1979 within ranges of 6-1/2 to 9 per cent and 7-1/2 to 10 per cent, respectively. The narrowly defined money supply (M-1) was expected to grow within a range of 2 to 6 per cent over the period, depending in part on the speed and extent of transfers from demand to savings deposits resulting from the introduction of ATS. The associated range for bank credit is 8-1/2 to 11-1/2 per cent. Growth of M-1+ (M-1 plus savings deposits at commercial banks and NOW accounts) in a range of 5 to 7-1/2 per cent was thought to be generally consistent with the ranges of growth for the foregoing aggregates. These ranges are subject to reconsideration at any time as conditions warrant.

In the short run, the Committee seeks to achieve bank reserve and money market conditions that are broadly consistent with the longer-run ranges for monetary aggregates cited above, while giving due regard to the program for supporting the foreign exchange value of the dollar, to developing conditions in domestic financial markets, and to uncertainties associated with the introduction of ATS. Early in the period before the next regular meeting, System open market operations are to be directed at attaining a weekly average Federal funds rate slightly above the current level. Subsequently, operations shall be directed at maintaining the weekly average Federal funds rate within the range of 9-3/4 to 10 per cent. In deciding on the specific objective for the Federal funds rate, the Manager is to be guided mainly by a range of tolerance for the annual rate of growth over the November-December period of 6 to 9-1/2 per cent in M-2, provided that the rate of growth in M-1 does not appear to exceed 5 per cent.

The objective for the funds rate is to be raised or lowered within its range if the rate of growth of M-2 appears to be close to or beyond the upper or lower limit of its range. Weight is to be given to M-1 if it appears to be growing at a rate close to or above its limit.

If the rates of growth in the aggregates appear to be falling outside the limits of the indicated ranges at a time when the objective for the funds rate has already been moved to the corresponding limit of its range, the

Manager will promptly 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, Partee, Mrs. Teeters, Messrs. Wallich, Willes, and Winn. Votes against this action: None.

Subsequent to the meeting, on December 8, nearly final estimates indicated that in November M-1 had declined and M-2 had expanded at a slow pace. For the November-December period, staff projections suggested that the annual rates of growth in M-1 and M-2 would be about 1/4 per cent and 6-1/4 per cent, respectively; for M-2, the projected rate was close to the lower limit of the 6 to 9-1/2 per cent range specified by the Committee. During recent weeks the Federal funds rate had averaged about 9-7/8 per cent. In light of the behavior of the aggregates, the Manager might, under normal circumstances, have sought to reduce the funds rate to about the 9-3/4 per cent lower limit of its specified range. Given current circumstances, however, Chairman Miller recommended that the Manager be instructed to continue to aim for a Federal funds rate of about 9-7/8 per cent during the period before the next regular meeting of the Committee, unless growth of the aggregates appeared to weaken significantly further.

On December 8, 1978, the Committee modified the domestic policy directive adopted at its meeting of November 21, 1978, to call for open market operations directed at maintaining the Federal funds rate at about the prevailing level of 9-7/8 per cent during the period before the next meeting unless growth of the aggregates appeared to weaken significantly further.

Votes for this action: Messrs. Miller, Baughman, Coldwell, Eastburn, Partee, Mrs. Teeters, Messrs. Wallich, Willes, Winn, and Timlen. Votes against this action: None. Absent and not voting: Mr. Volcker. (Mr. Timlen voted as alternate for Mr. Volcker.)

2. Authorization for foreign currency operations

At its meeting of March 21, 1978, the Committee had reaffirmed an agreement with the Treasury under which the Federal Reserve would undertake to "warehouse" foreign currencies held by the Exchange Stabilization Fund (ESF)--that is, to make spot purchases of foreign currencies from the ESF and simultaneously to make forward sales of the same currencies at the same exchange rate to the ESF--if that should prove necessary to enable the ESF to deal with potential liquidity strains. Specifically, the Committee had agreed that the Federal Reserve would be prepared, if requested by the Treasury, to warehouse up to $1-1/2 billion of eligible foreign currencies, of which half would be for periods of up to 12 months and half for periods of up to 6 months.

On December 14, 1978, the Committee amended paragraph 1A of the authorization for foreign currency operations to provide for transactions in foreign currencies directly with the U.S. Treasury as well as with the ESF. Concurrently, the Committee agreed to raise the amount of eligible foreign currencies that the Federal Reserve would be prepared to warehouse to $1-3/4 billion at this time. These actions were taken in view of the first issuance of Treasury securities denominated in foreign currencies as one of the measures announced on November 1 in implementation of the broad program to strengthen the dollar and thereby to counter continuing domestic inflationary pressures. The Treasury was scheduled to receive payment of somewhat more than 1-1/2 billion dollars equivalent of German marks on December 15, 1978.

As amended, paragraph 1A read as follows:

> 1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Austrian schillings
Belgian francs
Canadian dollars
Danish kroner
Pounds sterling
French francs
German marks
Italian lire
Japanese yen
Mexican pesos
Netherlands guilders
Norwegian kroner
Swedish kronor
Swiss francs

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