FEDERAL RESERVE
press release

For Use at 4:10 p.m. February 9, 1979

The Federal Reserve Board 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 December 19, 1978. This record also includes policy actions taken during the period between the meeting on December 19, 1978, and the next regularly scheduled meeting held on February 6, 1979.

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 December 19, 1978

1. Domestic policy directive

The information reviewed at this meeting suggested greater strength in economic activity than had been evident at the time of the Committee's meeting a month earlier; growth in output of goods and services in the current quarter now appeared to be somewhat faster than the annual rate of 3.4 per cent indicated for the third quarter by preliminary estimates of the Commerce Department. The rise in average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be close to the annual rate of 8.2 per cent estimated for the third quarter.

Staff projections for the year ahead differed little from those prepared a month earlier. They continued to suggest a gradual slowing in the growth of economic activity as the year progressed. The rise in average prices was projected to remain rapid during 1979 and the rate of unemployment to rise marginally.

In November, the index of industrial production advanced an estimated 0.7 per cent, somewhat more than the gains in the preceding 2 months but close to the average monthly increase since the beginning of the year. Nonfarm payroll employment grew substantially in November for the second consecutive month. In manufacturing also, a large increase in employment was registered for the second month in a row and the average workweek rose somewhat further. The unemployment rate was unchanged at 5.8 per cent, close to its low for the year.

The dollar value of total retail sales expanded substantially in November and revised data indicated a sizable advance for October as well. Unit sales of new automobiles declined somewhat in November.

Total housing starts were at an annual rate of 2.1 million units in both October and November. Sales of new and existing single-family houses rose to new highs in October.

The latest Department of Commerce survey of business plans, taken in late October and November, suggested that spending for plant and equipment would expand at an annual rate of nearly 16 per cent in the current quarter but at the markedly lower rate of about 8 per cent in the first half of 1979. The survey also indicated that in 1978 as a whole fixed investment outlays would be 12.7 per cent greater than in 1977.

Manufacturers' new orders for nondefense capital goods advanced sharply in October, following sizable increases in other recent months.

The index of average hourly earnings of private nonfarm production workers increased at an annual rate of 8.3 per cent over the first 11 months of 1978, nearly 1 percentage point above the rise during 1977. Average producer prices of finished goods rose substantially in November for the third consecutive month despite more moderate increases in producer prices of food products than in the two earlier months. In October, the consumer price index advanced at an annual rate of 9 per cent, and the rate of increase for the year to date--about 9-1/2 per cent--was nearly 3 percentage points above that during 1977.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies fell sharply following the OPEC announcement on December 17 of a larger-than-anticipated increase in oil prices for 1979. Over the previous few weeks the dollar had declined slightly on balance. Nevertheless, at the time of this meeting it was still about 7 per cent above its low reached just prior to the November 1 announcement of the new program to strengthen the dollar. The U.S. trade deficit in October remained close to the annual rate recorded in the second and third quarters but well below that in the previous two quarters.

The growth of total credit at U.S. commercial banks was appreciably slower in November than in September and October. However, bank loans other than security loans continued to expand rapidly. To finance this expansion banks liquidated a sizable amount of security holdings and issued a substantial volume of large-denomination time deposits. Outstanding commercial paper of nonfinancial businesses rose considerably in November for the second consecutive month.

The narrowly defined money supply (M-1) declined at an annual rate of about 4-1/2 per cent in November. The contraction reflected, among other things, the shifts of funds from demand deposits to savings deposits associated with the introduction of the automatic transfer service (ATS) and effects of the substantial rise in short-term market interest rates since April. Meanwhile, growth of M-2 and M-3 slackened further. Sales of 6-month money market certificates at commercial banks and nonbank thrift institutions continued strong in November, but savings deposits and time deposits subject to interest rate ceilings contracted at commercial banks. Total inflows of funds to nonbank thrift institutions slowed in November after growing rapidly in the preceding

3 months; the rate of expansion was still considerably above that in the first half of the year. Over the first 11 months of the year, M-1, M-2, and M-3 grew at annual rates of about 7-1/4, 8-1/4, and 9-1/4 per cent, respectively.

At its meeting on November 21, the Committee had agreed that early in the inter-meeting period System open market operations should be directed toward attaining a weekly average Federal funds rate of about 9-7/8 per cent, slightly above the level prevailing at that time. Subsequently, the objective for the Federal funds rate was to be raised or lowered within the range of 9-3/4 to 10 per cent. In setting a specific objective for the funds rate, the Manager of the System Open Market Account was to be guided mainly by a range of tolerance of 6 to 9-1/2 per cent for the annual rate of growth in M-2 over the November-December period, provided that the rate of growth in M-1 over the same period did not appear to exceed 5 per cent.

Immediately following the November 21 meeting the Manager began to seek bank reserve conditions consistent with an increase in the weekly average Federal funds rate to around 9-7/8 per cent. Incoming data during the inter-meeting period suggested initially that growth in M-2 would be well within the range specified by the Committee and that growth in M-1 would be below 5 per cent. In subsequent weeks, newly available data led to progressively lower estimates of growth, and by the end of the first week in December the projections might, under normal circumstances, have called for a reduction in the objective for the Federal funds rate to 9-3/4 per cent. On December 8, however, the Committee approved a recommendation by the Chairman to instruct the Manager to continue aiming for a Federal funds rate of 9-7/8 per cent during the period before the next regular meeting of the Committee, unless growth of the aggregates should appear to weaken significantly further.

Most market interest rates rose further during the inter-meeting period, as financial markets seemed to react to indications of continued strength in business conditions, added evidence of intense inflationary pressures, and the OPEC announcement of a large increase in oil prices. Commercial banks raised the loan rate to prime business borrowers from 11 per cent to 11-1/2 per cent during the period. In mortgage markets interest rates continued to rise.

In the Committee's discussion of the economic situation and outlook, most members expressed little or no disagreement with the staff projection of a gradual slowing of the expansion during 1979 and of a slight rise in the unemployment rate. At the same time, however, the observation was made that the latest information provided contradictory indications of underlying trends in economic activity and some members commented on the prospects for alternative courses of activity. The members continued to anticipate that average prices of goods and services would rise rapidly, and it was observed that the outlook for inflation had been worsened by the recent OPEC announcement of a substantial rise in oil prices during 1979.

With respect to some of the economic information that had become available recently, it was suggested that the retail sales and employment statistics--and the apparent rate of growth in GNP in the current quarter--indicated underlying strength, while the behavior of the monetary aggregates so far in the fourth quarter could be symptomatic of current or near-term weakness in demands for goods and services. Similarly, the latest data on new orders for nondefense capital goods and on construction contract awards were strong, but according to the Commerce Department's survey of business plans, plant and equipment expenditures in the first half of 1979 would be weak.

Concerning the over-all situation, it was suggested on the one hand that the current and prospective pace of growth in activity was too rapid, that output was beginning to press against the limits of capacity, and that inflationary pressures--which for a long time had been greater than generally projected--were still increasing. An alternative appraisal of the latest data was that the strength in the current quarter, especially in consumer spending, most likely was an aberration--similar to others during the past few years--and that economic activity was remarkably well balanced for the present stage of the expansion. It was also suggested, however, that the strength in demands and activity, although possibly persisting for a quarter or two, might culminate in a recession in the second half of 1979.

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 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, most members of the Committee advocated some additional firming in money market conditions. A few members preferred to direct operations toward maintaining the money market conditions currently prevailing. No member recommended an easing in money market conditions per se, but one suggested that whether money market conditions were firmed or eased be determined altogether on the basis of the incoming evidence on the behavior of the monetary aggregates.

Several reasons were advanced for some additional firming in money market conditions. Available economic data suggested that growth of output had not yet been slowed and that inflationary pressures remained intense. The strength of demands for bank loans and other credit seemed to provide a more reliable indication of underlying economic conditions than did the recent weakness of growth in the monetary aggregates. In any case, it was observed, weakness in monetary expansion following a long period of strong growth could be accepted for a time. Some additional firming in money market conditions, moreover, would help to maintain public confidence in the program to moderate inflation and to support the foreign exchange value of the dollar.

In support of the preference for maintaining prevailing money market conditions, rather than firming, it was observed that over the preceding 2 months the Committee had increased monetary restraint substantially. Because the evidence on current and prospective economic developments was conflicting, the Committee ought to pause and evaluate the effects of its recent actions before contemplating additional firming; if the unexpected shortfall in monetary expansion persisted, it might contribute to a recession. The uncertainties in the current situation also provided the grounds for the proposal to base the Committee's objective for money market conditions altogether on the incoming evidence on the behavior of the monetary aggregates: It was suggested that whether fundamental economic conditions were strong or weak would inevitably become evident in renewal of rapid monetary expansion or in continuation of sluggish expansion, leading in either case to appropriate objectives for money market conditions.

At the conclusion of the discussion the Committee agreed to instruct the Manager to direct open market operations toward raising the Federal funds rate to 10 per cent or slightly higher early in the period before the next regular meeting and subsequently to maintain the rate within a range of 9-3/4 to 10-1/2 per cent. With regard to the objective for the rate within that range, the Committee instructed the Manager to be guided by ranges of tolerance for the annual rates of growth of M-1 and M-2 of 2 to 6 per cent and 5 to 9 per cent, respectively. Thus, after a 2-month interruption, the Committee agreed to return to its practice of specifying a range rather than only an upper limit for M-1 and of instructing the Manager to give approximately equal weight to the behavior of M-1 and M-2 in assessing the behavior of the aggregates; it did so because recent experience had suggested that the impact of ATS on the annual rate of growth of M-1 could be estimated within fairly narrow limits. However, the Committee decided that the Manager should respond more quickly to relatively high than to relatively low rates of growth in the aggregates. Specifically, the objective for the funds rate was to be raised in an orderly fashion within its range if the 2-month growth rates of M-1 and M-2 appeared to be significantly above the midpoints of the indicated ranges. On the other hand, the objective was to be lowered in an orderly fashion only if the 2-month growth rates appeared to be approaching the lower limits of the indicated ranges.

The next regular meeting of the Committee was scheduled for February 6, 1979, but it was understood that a telephone conference would be held in mid-January to consider whether supplementary instructions were needed. It was also understood that the Chairman would call upon the Committee to consider the need for supplementary instructions if significant inconsistencies appeared to be developing among the Committee's objectives or if, before mid-January, the behavior of the monetary aggregates appeared to call for a reduction in the objective for the Federal funds rate toward the lower limit of its range.

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 has picked up somewhat from the rate in the third quarter. In November, as in October, the dollar value of total retail sales expanded substantially. Industrial production and nonfarm payroll employment rose considerably further, and the unemployment rate remained at 5.8 per cent. Over recent months, broad measures of prices and the index of average hourly earnings have risen rapidly.

The trade-weighted value of the dollar against major foreign currencies declined sharply following OPEC's announcement on December 17 of increased oil prices for 1979, after having declined slightly over the previous few weeks, but it remains substantially above the low reached just prior to the actions taken on November 1 to strengthen the dollar. The U.S. trade deficit in October was at about the rate recorded in the second and third quarters.

M-1 declined in November, only in part because of shifts of funds from demand deposits to savings deposits after the introduction of the automatic transfer service (ATS) at the beginning of the month. Over the first 11 months of 1978, M-1 grew at an annual rate of about 7-1/4 per cent. Growth of M-2 and M-3 slackened further in November; they grew at rates of about 8-1/4 and 9-1/4 per cent, respectively, over the first 11 months of the year. Inflows of deposits to nonbank thrift institutions slowed in November, after having grown rapidly in the preceding 3 months. Market interest rates in general have risen further in recent weeks.

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 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 10-1/2 per cent. In deciding on the specific objective for the Federal funds rate the Manager shall be guided mainly by the relationship between the latest estimates of annual rates of growth in the December-January period of M-1 and M-2 and the following ranges of tolerance: 2 to 6 per cent

> for M-1 and 5 to 9 per cent for M-2. If, giving approximately equal weight to M-1 and M-2, their rates of growth appear to be significantly above the midpoints of the indicated ranges, the objective for the funds rate shall be raised in an orderly fashion within its range; if their rates of growth appear to be approaching the lower limits of the indicated ranges, the funds rate shall be lowered in an orderly fashion within its range.
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> 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, Willes, and Winn. Votes against this action: Mrs. Teeters and Mr. Wallich.

Mrs. Teeters dissented from this action because she believed that for the time being open market operations should be directed toward maintaining the money market conditions currently prevailing. In her view, the Committee should wait to evaluate the effects of the substantial firming in money market conditions of the past 2 months before contemplating any additional firming.

Mr. Wallich dissented from this action because he favored a somewhat more restrictive policy posture than that adopted by the Committee. In his opinion, the underlying economic situation was still strong and the strength of demands was adding to inflationary pressures and expectations while interest rates were not high in real terms and were not exerting strong restraint.

Subsequent to the meeting, on December 29, 1978, projections of growth in the monetary aggregates suggested that for the December-January period M-2 would grow at an annual rate well below the lower limit of the 5 to 9 per cent range specified by the Committee and that M-1 would grow at a rate in the lower portion of its range of 2 to 6 per cent. Since the meeting of the Committee on December 19 the Manager had been aiming for a Federal funds rate of about 10 per cent or slightly above, although Federal funds had been trading at higher levels in response to exceptional demands for excess bank reserves near the end of the year. The behavior of the aggregates would have called for a reduction in the objective for the funds rate toward the 9-3/4 per cent lower limit of its specified range. However, in view of uncertainties about the interpretation of the behavior of the aggregates at this time, and against the background of domestic and international economic and market conditions, Chairman Miller recommended that the Manager be instructed to continue to aim for a Federal funds rate of

10 per cent or slightly above, pending a review of the situation in the telephone conference, tentatively planned for January 12.

> On December 29, 1978, the Committee modified the domestic policy directive adopted at its meeting of December 19, 1978, to call for open market operations directed at maintaining the weekly average Federal funds rate at about 10 per cent or slightly above.
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> > Votes for this action: Messrs. Miller, Volcker, Baughman, Coldwell, Eastburn, Partee, Mrs. Teeters, Messrs. Wallich, Willes, and Winn. Votes against this action: None.

On January 12 the Committee held a telephone conference to review the situation and to consider whether supplementary instructions were needed. However, no change was made in the instruction to the Manager to continue to direct open market operations toward maintaining the weekly average Federal funds rate at about 10 per cent or slightly above.

2. Authorization for foreign currency operations

Paragraph 1D of the Committee's authorization for foreign currency operations authorizes the Federal Reserve Bank of New York, for the System Open Market Account, to maintain an over-all open position in all foreign currencies not to exceed $1.0 billion, unless a larger position is expressly authorized by the Committee. On November 1, 1978, an open position of $5 billion had been authorized. At the meeting on December 19, 1978, the Committee authorized an increase in this limit to $8 billion to provide further flexibility for Federal Reserve operations in the foreign exchange markets undertaken pursuant to the Committee's foreign currency directive.

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

Pursuant to an agreement with the Treasury under which the Federal Reserve would undertaken to "warehouse" foreign currencies--that is, to make spot purchases of foreign currencies and simultaneously to make forward sales of the same currencies at the same exchange rate--the Committee had agreed on December 14, 1978, to raise the amount that the Federal Reserve would be prepared to warehouse from $1-1/2 billion to $1-3/4 billion equivalent of such foreign currencies. That action had been taken in view of the impending receipt by the Treasury of somewhat more than $1-1/2 billion dollars equivalent of German marks resulting from its first issuance of securities denominated in foreign currencies as one of the measures of the broad program announced on November 1 to strengthen the dollar.

At this meeting the Committee agreed to raise the amount of eligible foreign currencies that the Federal Reserve would be prepared to warehouse to $5 billion. The Committee also agreed to warehouse such currencies for periods of up to 12 months; previously the agreement had provided that half of the authorized amount would be for periods of up to 6 months and half for periods of 12 months. These actions were taken in view of additional Treasury offerings of securities denominated in foreign currencies in prospect for early 1979.

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

3. Authorization for domestic open market operations

On January 15, 1979, Committee members voted to increase from $3 billion to $5 billion the limit on changes between Committee meetings in System Account holdings of U. S. Government and Federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective immediately, for the period ending with the close of business on February 6, 1979.

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

This action was taken on recommendation of the System Account Manager. The Manager had advised that large-scale sales of securities since the December meeting--required primarily to counter the effect on member bank reserves of an unusually and unexpectedly high level of float--had reduced the leeway for further sales to about $100 million. It appeared likely that additional sales would be required because current projections indicated a need for further reserve-absorbing operations over the coming weeks.

Subsequently, Committee members voted to increase the limit specified in paragraph 1(a) by an additional $1 billion, to $6 billion, effective immediately, for the period ending with the close of business on February 6, 1979.

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

This action was taken on recommendation of the Manager. On January 26 he had advised that, despite the Committee's action on January 15 to raise the inter-meeting limit to $5 billion, the leeway available for further sales would be only about $350 million as of the close of business on January 26. Since January 15 required reserves had been weaker than had been expected, and a decline of currency in circulation had provided reserves while float had remained high.