FEDERAL RESERVE

press release

For Use at 4:10 p.m. March 23, 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 February 6, 1979. This record also includes policy actions taken during the period between the meeting on February 6, 1979, and the next regularly scheduled meeting held on March 20, 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 February 6, 1979

1. Domestic policy directive

Growth in real output of goods and services had accelerated to an annual rate of 6.1 percent in the fourth quarter of 1978, according to preliminary estimates of the Commerce Department, from a rate of 2.6 percent in the third quarter. Average prices, as measured by the fixed-weight price index for gross domestic business product, rose at an annual rate of 8.3 percent in the fourth quarter, slightly faster than the rate in the third quarter.

Staff projections for 1979 suggested a marked slowing in the expansion of economic activity by the second quarter of the year and a sustained slow rate of growth during the remaining quarters. Average prices were projected to continue rising at a rapid pace, and the rate of unemployment was expected to increase somewhat from its level in the fourth quarter.

The index of industrial production increased an estimated 0.6 percent in December, close to its average gain in earlier months of the year. Expansion in nonfarm payroll employment, including employment in manufacturing, continued strong in December and January. The January rate of unemployment, at 5.8 percent, was essentially unchanged from the previous five months.

The dollar value of total retail sales expanded considerably further in December, following two months of substantial gains. After declining somewhat in November, unit sales of new automobiles picked up in December and the first 20 days of January to a pace in line with that in the July-October period.

Private housing starts were at an annual rate of 2.1 million units in December and in the fourth quarter as a whole. In November, however, total sales of new and existing single-family houses declined somewhat.

The latest Department of Commerce survey of business spending plans, taken in late November and December, suggested that spending for plant and equipment would expand 11.2 percent from 1978 to 1979. The estimated increase in 1978 was about 12-3/4 percent. Manufacturers' new orders for nondefense capital goods declined 11 percent over November and December, but orders for the fourth quarter as a whole were considerably above those in the third quarter.

The index of average hourly earnings of private nonfarm production workers rose at an annual rate of 10-1/2 percent in January; this rate of increase represented an acceleration from 8 percent in the fourth quarter and reflected in part a rise of about 9-1/2 percent in the minimum wage to $2.90 on January 1. The consumer price index rose at an annual rate of almost 8 percent, and average prices of producer finished goods at a rate of about 10-1/4 percent in the fourth quarter; both measures were up about 9 percent from December 1977 to December 1978. In early 1979 there were substantial increases in prices of many farm products and an upward adjustment in oil prices by the Organization of Petroleum Exporting Countries.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies moved generally upward after the turn of the year; by the date of this meeting the advance had about offset the sharp decline that followed the OPEC announcement on December 17 of a larger-than-anticipated increase in oil prices for 1979. The U.S. merchandise trade deficit was at an estimated annual rate of $30 billion in the fourth quarter of 1978, close to the rates recorded in the second and third quarters.

In December growth of total credit at U.S. commercial banks moderated considerably further from its reduced November pace, as the expansion of bank loans slowed sharply and banks continued to liquidate holdings of securities. However, data from large banks suggested a strengthening of business loan growth in January. Outstanding commercial paper of nonfinancial businesses continued to increase rapidly in December.

The narrowly defined money supply (M-1) declined at an annual rate of 1-1/2 percent over the December-January period.[1/] This further contraction appeared to reflect, among other influences, the shifts of funds from demand deposits to savings deposits associated with the recently introduced automatic transfer service (ATS) and negotiable order of withdrawal (NOW) accounts in New York State. There was virtually no growth in M-2 over the December-January period, while growth in M-3 slackened further as relatively high market interest rates continued to curb inflows of time and savings deposits subject to fixed interest rate ceilings.[2/]

1/ M-1 comprises private demand deposits and currency in circulation.
2/ M-2 comprises M-1 and commercial bank time and savings deposits other than large-denomination certificates of deposits. M-3 is M-2 plus deposits at nonbank thrift institutions (savings and loan associations, mutual savings banks, and credit unions).

However, growth in other time deposits, including 6-month money market certificates and large-denomination certificates of deposit, remained sizable. From the fourth quarter of 1977 to the fourth quarter of 1978, M-1, M-2, and M-3 expanded about 7-1/4, 8-1/2, and 9-1/2 percent, respectively; for all three monetary aggregates, growth was substantially less than it had been over the preceding year.

At its meeting on December 19, the Committee had agreed that early in the intermeeting period open market operations should be directed toward attaining a weekly average federal funds rate of 10 percent or slightly higher. This objective represented a slight increase from the prevailing level. Subsequently, the objective for the federal funds rate was to be maintained within the range of 9-3/4 to 10-1/2 percent. In setting a specific objective for the funds rate, the Manager of the System Open Market Account was to be guided mainly by the relationship between the estimated annual rates of growth in M-1 and M-2 over the December-January period and ranges of tolerance for those two monetary aggregates of 2 to 6 percent and 5 to 9 percent, respectively. If, with approximately equal weight given to M-1 and M-2, their rates of growth appeared to be significantly above the midpoints of the indicated ranges, the objective for the federal funds rate was to be raised in an orderly fashion within its range. On the other hand, the objective was to be lowered in an orderly fashion if the two-month growth rates appeared to be approaching the lower limits of the indicated ranges.

Immediately following the December 19 meeting the Manager of the System Open Market Account began to seek bank reserve conditions consistent with an increase in the weekly average federal funds rate to 10 percent or slightly higher, from a level around 9-7/8 percent. However, federal funds traded at somewhat higher levels around the year-end, reflecting uncertainties that affected demands for bank reserves. By late December, staff projections suggested that growth in M-2 over the December-January period would be at an annual rate well below the lower limit of the range of tolerance specified for that aggregate and growth in M-1 would be in the lower portion of its range of tolerance.

These developments pointed to a reduction in the objective for the federal funds rate toward the 9-3/4 percent lower limit of the specified range. However, on December 29 the Committee voted to modify its directive by calling for open market operations directed at maintaining the weekly average federal funds rate at about 10 percent or slightly above. This action was taken in view of uncertainties surrounding the interpretation of the behavior of the monetary aggregates and in light of domestic economic conditions and developments in domestic and international financial markets. On January 12 the Committee held a telephone conference to review the situation and to consider whether supplementary instructions were needed, but no change was made in the instruction to the Manager.

Most market interest rates declined on balance during the intermeeting period. Factors apparently contributing to this development included a market sentiment that further tightening in monetary policy had become less likely in light of the behavior of the monetary aggregates and the better performance of the dollar in foreign exchange markets. Another influence appeared to be the recent modest growth of total business credit demands. Commercial banks raised the loan rate to prime business borrowers from 11-1/2 to 11-3/4 percent during the period, but a few banks later reduced the rate back to 11-1/2 percent.

At this meeting, in conjunction with its discussion of the economic situation and outlook, the Committee reviewed its 12-month ranges for growth in the monetary aggregates. At its meeting in October 1978 the Committee had specified ranges of 6-1/2 to 9 percent for M-2 and 7-1/2 to 10 percent for M-3 for the period from the third quarter of 1978 to the third quarter of 1979. The Committee also had indicated that it expected growth of M-1 to be within a range of 2 to 6 percent--a range that reflected uncertainty concerning both the size and the speed of the expected shift of deposits from demand to savings accounts resulting from the introduction of ATS, and of NOW accounts in New York State. The associated range for commercial bank credit was 8-1/2 to 11-1/2 percent. The Committee also had decided that growth of M-1+ within a range of 5 to 7-1/2 percent appeared to be generally consistent with the ranges of growth for the other monetary aggregates. The ranges being considered at this meeting were for the period from the fourth quarter of 1978 to the fourth quarter of 1979.

The Committee's review of its longer-run ranges at this time was undertaken for the first time within the framework of the Full Employment and Balanced Growth ("Humphrey-Hawkins") Act of 1978. That act, which amended section 2A of the Federal Reserve Act, requires the Board of Governors to transmit to the Congress by February 20 and July 20 of each year written reports concerning the objectives and plans of the Board and the Committee with respect to the ranges of growth or diminution of the monetary and credit aggregates for the calendar year during which the report is transmitted and, in the case of the July report, the objectives and plans with respect to ranges for the following calendar year as well. The act also requires that the written reports set forth a review and analysis of recent developments affecting economic trends in the Nation and the relationship of the plans and objectives for the aggregates to the short-term goals set forth in the most recent Economic Report of the President and to any short-term goals approved by the Congress.[1/]

With respect to the economic situation and outlook, most members of the Committee expressed little or no disagreement with the staff projection of a marked slowing in the expansion by the second quarter of 1979 and of a sustained slow rate of growth over the rest of the year accompanied by some increase in the rate of unemployment. However, a few members questioned whether a very slow pace of growth was sustainable and suggested that the onset of a recession before the end of the year, with a larger increase in the unemployment rate, was the more likely development. Other members thought that over the past few months the probabilities of the development of a recession before the end of this year had declined somewhat. It was also observed that expansion might prove to be stronger than projected by the staff, especially if businessmen believed that effective steps were being taken to moderate the rate of inflation.

The members continued to anticipate a relatively rapid rise in average prices. Inflation was viewed as a distortion that could contribute to the

1/ The Board's first report under the act was transmitted to the Congress on February 20, 1979.

development of a recession, and it was noted that forecasters typically had underestimated the strength of inflationary forces. In this connection, it was observed that the economy was operating at a higher rate in relation to its potential than had been thought earlier.

In contemplating ranges for the monetary aggregates for the year ahead, the Committee continued to face unusual uncertainties concerning the forces affecting monetary growth. A staff analysis had suggested that shifts in funds from demand deposits to savings accounts with automatic transfer services and to the NOW accounts in New York would depress growth of M-1 over the year by about 3 percentage points, but that projection was based on only a brief experience. Moreover, it appeared that the publicity associated with ATS and the sustained high level of interest rates had induced the public to reassess more generally the desirability of holding demand deposits. It was expected that such a reassessment would continue over the year ahead, reducing somewhat further the demand for M-1 in relation to income as the public moved funds from demand deposits to interest-bearing assets.

Significant uncertainties existed with respect to growth of M-2 and M-3 as well. It appeared that the level of market interest rates had been inducing the public to divert large amounts of funds from deposits subject to fixed ceiling rates into market instruments. The staff analysis suggested that diversions of funds would continue in the period ahead, although not in the proportions of recent months. Thus, growth of the interest-bearing deposits included in the broader monetary aggregates was projected to pick up but to remain slower during 1979 than during 1978.

In the Committee's discussion, stress was placed on the importance of adopting ranges for monetary growth over the year ahead that would be consistent with a reduction in the rate of inflation, thereby reinforcing the governmental actions over recent months in pursuit of that objective. It was observed that the adoption of ranges for 1979 that, after allowance for ATS, were indicative of slower monetary growth might well influence attitudes and expectations in such a way that the rate of inflation would decline significantly without an adverse effect on the rate of unemployment. In this connection, it was suggested that any indication of a move toward an easing of monetary policy might change expectations so as to aggravate inflationary forces and thus increase rather than reduce the risks of a recession. It was also suggested that lowering the ranges to a degree that contributed to the onset of a recession could lead to developments that in the longer run would be inflationary.

At the conclusion of the discussion, the Committee decided both to lower the ranges for growth of the monetary aggregates over the year ahead and to widen them slightly, reflecting in part the special factors expected to influence monetary growth and the uncertainties with respect to the magnitude of their impact. For the period from the fourth quarter of 1978 to the fourth quarter of 1979, the Committee adopted a range of 1-1/2 to 4-1/2 percent for M-1. After allowance for a dampening effect of about 3 percentage points projected to result from the further shifts in funds from demand deposits to savings accounts with automatic transfer facilities, that range allowed for the possibility of a significant deceleration of growth from the pace of recent years.

The ranges adopted for M-2 and M-3 were 5 to 8 percent and 6 to 9 percent respectively. The associated range for the growth of commercial bank credit was reduced to 7-1/2 to 10-1/2 percent. It was understood that the longer-run ranges, as well as the particular aggregates for which ranges were specified, would be reconsidered in July or at any time that conditions might warrant. It was also understood that short-run factors might cause growth rates from one month to the next to fall outside the ranges anticipated for the year.

> The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the fourth quarter of 1978 to the fourth quarter of 1979: M-1, 1-1/2 to 4-1/2 percent; M-2, 5 to 8 percent; and M-3, 6 to 9 percent. The associated range for bank credit is 7-1/2 to 10-1/2 percent.
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> > Votes for this action: Messrs. Miller, Volcker, Baughman, Coldwell, Eastburn, Partee, Mrs. Teeters, and Mr. Mayo. Votes against this action: Messrs. Wallich and Willes. Absent: Mr. Winn. (Mr. Mayo voted as alternate for Mr. Winn.)

Messrs. Wallich and Willes dissented from this action because, with the Committee's objective of slowing the rate of inflation in mind, they preferred to specify lower ranges for growth of the monetary aggregates. Mr. Willes believed that the range adopted for M-1, after allowance for the effects of ATS and a possible further downward shift in the public's demand for money, represented an increase from the ranges that had been adopted during 1978. Mr. Wallich thought that, after allowance for the expansion in repurchase agreements and Eurodollars in addition to the other forces affecting growth of M-1, the range adopted represented too much of an increase from the ranges set earlier.

In the discussion of policy for the period immediately ahead, most members of the Committee favored directing operations initially toward maintaining the money market conditions currently prevailing, as indicated by a federal funds rate of 10 percent or slightly higher, but some sentiment was expressed for a slight additional firming in money market conditions. The views of the members differed primarily with respect to the influence that the incoming evidence concerning growth of the monetary aggregates should have on the objective for the funds rate later in the period before the next meeting.

A few members, emphasizing the rate of inflation and the position of the dollar in foreign exchange markets, advocated an approach similar to that in the directive issued at the meeting in December; that directive instructed the Manager to vary the objective for the federal funds rate within its range more quickly in response to relatively high than to relatively low rates of monetary growth. A few others, emphasizing the uncertainties in the outlook for domestic economic activity and for employment and the weakness of monetary growth over recent months, preferred a symmetrical approach in which the objective for the funds rate would be changed no more promptly in response to relatively high than to relatively low rates of monetary growth. A number of members suggested that, in any event, the Committee consult again before any change was made in the objective for the federal funds rate.

The Committee decided to instruct the Manager to direct open market operations toward maintaining the weekly average federal funds rate at about the current level, provided that over the February-March period the annual rates of growth of M-1 and M-2, given approximately equal weight, appeared to be within ranges of 3 to 7 percent and 5 to 9 percent, respectively. The

Committee agreed that if growth of M-1 and M-2 for the two-month period appeared to be outside the indicated limits, the Manager was promptly to notify the Chairman, who would then consult with the Committee to determine whether the situation called for supplementary instructions.

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 fourth quarter of 1978 growth in real output of goods and services picked up sharply from the reduced rate in the third quarter. In December, as in the preceding two months, the dollar value of total retail sales expanded substantially, and industrial production and nonfarm payroll employment rose considerably further. Employment continued to grow in January, and the unemployment rate, at 5.8 percent, was virtually the same as in the final months of 1978. Over recent months, broad measures of prices and the index of average hourly earnings have continued to rise rapidly.
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> The trade-weighted value of the dollar against major foreign currencies has tended upward since the turn of the year, returning to about its level in mid-December prior to the OPEC announcement of increased oil prices. The U.S. trade deficit in the fourth quarter of 1978 was at about the same rate as in the second and third quarters.
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> M-1 increased little in December and appears to have declined in January, in part because of the continuing effects of the introduction of the automatic transfer service (ATS) on November 1, and M-2 and M-3 grew at relatively slow rates. With market interest rates relatively high, inflows to banks of the interest-bearing deposits included in M-2 slowed sharply, and inflows of deposits to nonbank thrift institutions slackened further. Over the year from the fourth quarter of 1977 to the fourth quarter of 1978, M-1, M-2, and M-3 grew about 7-1/4, 8-1/2, and 9-1/2 percent, respectively. Most market interest rates have declined on balance in recent weeks.

Taking account of past and prospective developments in employment, unemployment, production, investment, real income, productivity, international trade and payments, and prices, it is the policy of the Federal Open Market Committee to foster monetary and financial conditions that will resist inflationary pressures while encouraging moderate economic expansion and contributing to a sustainable pattern of international transactions. The Committee agreed that these objectives would be furthered by growth of M-1, M-2, and M-3 from the fourth quarter of 1978 to the fourth quarter of 1979 within ranges of 1-1/2 to 4-1/2 percent, 5 to 8 percent, and 6 to 9 percent, respectively. The associated range for bank credit is 7-1/2 to 10-1/2 percent. These ranges will be reconsidered in July or 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 and to developing conditions in domestic financial markets. In the period before the next regular meeting, System open market operations are to be directed at maintaining the weekly average federal funds rate at about the current level, provided that over the February-March period the annual rates of growth of M-1 and M-2, given approximately equal weight, appear to be within ranges of 3 to 7 percent and 5 to 9 percent, respectively. If growth of M-1 and M-2 for the two-month period appears to be outside the indicated limits, the Manager will promptly notify the Chairman, who will then consult with the Committee to determine whether the situation calls for supplementary instructions.

Votes for this action: Messrs. Miller, Volcker, Baughman, Eastburn, Partee, Mrs. Teeters, Messrs. Wallich, Willes, and Mayo. Vote against this action: Mr. Coldwell. Absent: Mr. Winn. (Mr. Mayo voted as alternate for Mr. Winn.)

Mr. Coldwell dissented from this action because he preferred to direct open market operations early in the coming period toward a slight firming in money market conditions. He felt that the greatest danger currently was an intensification of inflationary pressures and that the longer-range prospects for inflation were unacceptable.

Subsequent to the meeting, at the beginning of March, projections suggested that over the February-March period M-1 would grow at an annual rate moderately below the lower limit of the range of 3 to 7 percent that had been specified by the Committee and M-2 would grow at a rate just below the lower limit of its range of 5 to 9 percent. On March 2 the Committee held a telephone meeting to determine whether the situation called for supplementary instructions. In light of contradictory evidence concerning underlying trends in economic activity following the strong performance in the fourth quarter of 1978, Chairman Miller recommended that the Manager be instructed to continue to aim for a weekly average federal funds rate of about 10 percent or slightly higher. The members concurred in the Chairman's recommendation.

By unanimous vote, the Committee modified the domestic policy directive adopted at its meeting on February 6, 1979, to call for continuance of open market operations directed toward maintaining the weekly average federal funds rate at about 10 percent or slightly above.

Votes for this action: Messrs. Miller, Volcker, Black, Coldwell, Kimbrel, Mayo, Partee, Mrs. Teeters, Messrs. Wallich, and Guffey. Absent: Mr. Balles (Mr. Guffey voted as alternate for Mr. Balles.)

2. Authorization for domestic open market operations

At this meeting the Committee voted to set a limit of $5 billion on changes between Committee meetings in holdings of U.S. Government and Federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective for the period ending with the close of business on March 20, 1979. During the period since its meeting on December 19, 1978, the Committee had temporarily increased the limit specified in paragraph 1(a) in two steps, from $3 billion to $5 billion and subsequently to $6 billion until the close of business on February 6, 1979. The action to set the limit at $5 billion for the coming period was taken to provide flexibility for operations in view of the magnitude of float and other factors that might affect reserves in the weeks ahead and in view of the length of the interval until the next Committee meeting scheduled for March 20, 1979.

Votes for this action: Messrs. Miller, Volcker, Baughman, Coldwell, Eastburn, Partee, Mrs. Teeters, Messrs. Wallich, Willes, and Mayo. Votes against this action: None. Absent: Mr. Winn. (Mr. Mayo voted as alternate for Mr. Winn.)