FEDERAL RESERVE

press release

For Use at 4:10 p.m. April 20, 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 March 20, 1979. This record also includes policy actions taken during the period between the meeting on March 20, 1979, and the next regularly scheduled meeting held on April 17, 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 March 20, 1979

1. Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services had moderated in the current quarter after having accelerated to an annual rate of 6.9 percent in the fourth quarter of 1978. The rise in average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to have been faster than the annual rate of 8.0 percent recorded in the third and fourth quarters of 1978.

Staff projections of growth in output over the four quarters of 1979 had been reduced somewhat from those prepared for the February meeting, in large part because of a reduction in the expected rate of expansion in the current quarter. The projections continued to suggest sluggish growth during the second half of the year. The rise in average prices was projected to remain rapid, and the rate of unemployment was expected to increase somewhat from its current level.

The dollar value of total retail sales rose slightly further in January and February, following several months of sizable gains, but sales in real terms apparently declined. Unit sales of new automobiles for the two months were just above the pace in the second half of 1978.

The index of industrial production was unchanged in January and increased 0.3 percent in February, following advances in the preceding three months that averaged about 0.7 percent. The slowdown appeared to be caused in part by adverse weather. Total nonfarm payroll employment, and also its manufacturing component, expanded appreciably further in the two months, although the increases were somewhat below the average monthly gains during the fourth quarter. The rate of unemployment was 5.7 percent in February, little changed from other recent months.

Total private housing starts fell sharply in January and declined further in February to an annual rate of 1.4 million units. In January total sales of new and existing single-family houses declined substantially.

The latest survey by the Department of Commerce of business plans, taken in late January and February, suggested that spending for plant and equipment would expand 11.3 percent in 1979, virtually the same as the gain that had been indicated by the December survey. The increase in 1978 was estimated to have been 13.3 percent. Manufacturers' new orders for nondefense capital goods advanced sharply in January after having risen considerably on balance during the fourth quarter.

The index of average hourly earnings of private nonfarm production workers rose at an annual rate of 4.3 percent in February, following increases averaging about 8.5 percent in the preceding four months. In some industries with relatively low wage rates, hourly earnings had increased sharply in January, when increased minimum wages became effective, and then changed little in February.

The trade-weighted value of the dollar against major foreign currencies had not changed on balance since the February 6 meeting of the Committee. The U.S. merchandise trade deficit rose sharply in January, but revised data suggested a smaller deficit for the fourth quarter of 1978 than had been published earlier. Imports, especially of oil, increased sharply in January, while exports declined slightly.

In January and February growth of total credit at U.S. commercial banks accelerated considerably from its reduced pace during late 1978. Expansion in business loans was unusually strong, and banks also added substantially to their holdings of securities.

M-1 declined in both January and February, M-2 changed little, and M-3 grew at a relatively slow rate. With interest rates remaining high, the behavior of all three monetary aggregates was affected by unusually large shifts of funds from deposits to money market mutual funds and other liquid assets. The weakness in M-1 also reflected the effects of continuing movements of funds from demand deposits to savings deposits associated with the recently authorized automatic transfer service (ATS) and negotiable orders of withdrawal (NOW) accounts in New York State.

Banks and thrift institutions financed credit expansion mainly through net additions to outstanding six-month money market certificates and large-denomination certificates of deposit, which are not subject to fixed ceilings on interest rates. Inflows of time and savings deposits subject to fixed rate ceilings continued to be inhibited by the availability of higher-yielding investment alternatives. Overall, inflows of interest-bearing deposits included in M-2 and M-3 remained at reduced levels. During the two-month period, banks obtained a sizable volume of funds from nondeposit sources and from repayments by foreign branches of advances from domestic head offices.

At its February meeting, the Committee had decided that open market operations should be directed at maintaining the weekly average federal funds rate at its current level of about 10 percent or slightly higher, 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. If the two-month growth rates appeared to be outside the indicated limits, the Manager of the System Open Market Account was to notify the Chairman promptly, who would then consult with the Committee to determine whether the situation called for supplementary instructions.

At the beginning of March, projections suggested that over the February-March period M-1 would grow at a rate moderately below the lower limit of the range established by the Committee and M-2 would grow at a rate just below the lower limit of its range. In a special telephone meeting on March 2, the Committee instructed the Manager to continue aiming for a weekly average federal funds rate of 10 percent or slightly higher.

Most market interest rates rose moderately on balance during the intermeeting period, after having declined in January. Yields on corporate bonds and on three-month Treasury bills moved up to their highest levels of the current economic expansion. Yields on most short-term instruments remained below levels reached around the turn of the year, however, and primary market rates on home mortgage loans were little changed from their year-end levels.

Effective March 15, 1979, regulations governing ceiling rates on six-month money market certificates issued by financial institutions were changed. The new rules prohibit the use of compounding in calculating allowable returns and eliminate the 1/4 point interest differential between commercial banks and thrift institutions when the ceiling rate is 9 percent or higher. The full differential will be in effect when the ceiling rate is 8-3/4 percent or less. When the six-month bill rate is between 8-3/4 and 9 percent, thrift institutions may pay a maximum 9 percent while commercial banks may pay up to the actual discount rate for six-month bills. These changes were designed to reduce somewhat the cost of money market certificates and to moderate the flow of funds into thrift institutions while permitting them to remain competitive over the longer run in attracting funds for housing.

In the Committee's discussion of the current economic situation, attention was drawn to the more rapid expansion in output of goods and services in the fourth quarter of 1978 than had been anticipated. The Commerce Department had just released a second upward revision in its estimate of growth in real gross national product in that quarter, and it was observed that the rate of resource utilization therefore was higher than had been thought earlier, accounting in part for the recent intensification of upward pressures on prices.

At the same time, it was noted, developments since the turn of the year were apparently mixed, contributing to increased uncertainty. Specifically, such indicators of business expenditures as new orders for capital goods, inventory investment, and short-term borrowing had been strong, and the demand for labor had remained bouyant. On the other hand, growth in personal income had weakened, retail sales had declined in real terms despite renewed strength in unit sales of new automobiles, and both the drop in housing starts and the sluggish performance of industrial output seemed to be attributable only in part to adverse weather.

Many members of the Committee thought that the staff was overly optimistic in projecting continued, if sluggish, growth in real GNP throughout the second half of 1979; they believed that the chances of a recession beginning before the end of the year or in early 1980 were fairly high. The recent increase in the price of oil, the acceleration of the overall rise in prices, and the sluggish growth of the monetary aggregates over the latest five months were cited among the factors that increased the probability of recession. The observation also was made that if a recession developed, it was likely to be moderate and short-lived.

Some concern was expressed that, in part because of the uncertain outlook for supplies and prices of some commodities, businesses might now be trying to raise their investment in both inventories and plant and equipment, thereby intensifying inflationary pressures currently and increasing both the chances and the probable severity of recession later. It was observed, however, that the current accumulation of inventories, to the extent that it reflected rebuilding of stocks drawn down in the fourth quarter and hedging against possible strikes, represented prudent business behavior and not a major shift away from the cautious attitudes that had prevailed for some time. With respect to plant and equipment, expenditures would be spread over a period when overall activity was not expected to be expanding rapidly, and subsequently the expenditures would yield additions to capacity and gains in productivity.

The members expressed some differences of opinion concerning prospects for prices. A significant easing from the rapid rise of recent months was suggested, to the extent that recent increases in prices represented temporary factors or were made in anticipation of possible price and wage controls. Moreover, slackening of economic activity later in the year could be expected to slow the rise in prices generally. The view was also expressed, however, that inflation would remain rapid even during a recession. In any case, it was observed, a long lag could be expected in the response of prices to the additional measures of restraint imposed toward the end of 1978.

At its meeting on February 6, 1979, the Committee had agreed that from the fourth quarter of 1978 to the fourth quarter of 1979 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: 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 the rate of growth in commercial bank credit was 7-1/2 to 10-1/2 percent. It had also been agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be reconsidered in July or at any time that conditions might warrant.

In contemplating policy for the period immediately ahead, the Committee continued to face unusual uncertainties concerning the forces affecting monetary growth. A staff analysis had suggested that M-1 was likely to expand in March, contributing to a pick-up in growth of M-2. Nevertheless, M-1 was expected to register a decline in the first quarter, on a quarterly average basis. It was estimated that shifts of funds from demand deposits to savings accounts with automatic transfer services and to the NOW accounts in New York had depressed growth of M-1 by about 3 percentage points in the quarter. Moreover, it appeared that growth of both M-1 and M-2 had been affected by a downward shift in the public's demand for money in relation to income, although the magnitude of that effect was uncertain.

In the Committee's discussion, several members stressed their concern about the shortfall in monetary growth relative to the longer-run ranges that the Committee had adopted at its meeting on February 6, 1979, especially in view of the risks that a recession might develop in the period ahead. Supporting the goal of bringing growth of the monetary aggregates up into those ranges over a number of months, particularly because of the uncertainty about the outlook for economic activity, they favored directing operations in the period just after the meeting toward maintaining the money market conditions currently prevailing--as indicated by a federal funds rate of 10 percent or slightly higher--or toward a little less firmness in those conditions. The objective of operations later in the period before the next regular meeting of the Committee would be determined on the basis of the incoming evidence on the behavior of the monetary aggregates, although it was suggested that the Committee consult again before any change was made in the operational objective for the funds rate.

Other members of the Committee emphasized the recent acceleration of the rise in prices, and they believed that action should be taken to demonstrate that inflation represented the greatest risk to economic stability over a period of time. Accordingly, they advocated directing initial operations in the period ahead toward a slight firming in money market conditions, represented by an increase in the objective for the federal funds rate to about 10-1/4 percent. Their prescription for operations later in the period called for holding the objective for the funds rate within a relatively narrow range.

At the conclusion of the discussion the Committee decided that ranges of tolerance for the annual rates of growth in M-1 and M-2 over the March-April period should be 4 to 8 percent and 3-1/2 to 7-1/2 percent, respectively. The Manager was instructed to direct open market operations initially toward maintaining the federal funds rate at about the current level, represented by a rate of about 10 percent or slightly higher. Subsequently, if the two-month growth rates of M-1 and M-2 appeared to be significantly above or below the midpoints of the indicated ranges, the objective for the funds rate was to be raised or lowered in an orderly fashion within a range of 9-3/4 to 10-1/2 percent. It was also agreed that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of M-1 and M-2.

As is customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

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

> The information reviewed at this meeting suggests that in the current quarter growth in real output of goods and services has moderated from the rapid rate in the last quarter of 1978, while the rise in prices has accelerated. In January and February the dollar value of total retail sales rose slightly further. Nonfarm payroll employment continued to expand over the two-month period, but in part because of severe weather, industrial production increased little. The unemployment rate in February, at 5.7 percent, was virtually unchanged from its level in January and in late 1978. Over recent months, on balance, the index of average hourly earnings has continued to rise rapidly.
>
> The trade-weighted value of the dollar against major foreign currencies has shown no net change since early February. The U.S. trade deficit in January was larger than the monthly average in the fourth quarter of 1978, to some extent because of a bulge in imports of oil.
>
> M-1 declined in both January and February, in part because of the continuing effects of the growth of the automatic transfer service. With market interest rates continuing high, inflows of the interest-bearing deposits included in M-2 and M-3 remained at reduced levels, despite substantial flows into money market certificates at both commercial banks and nonbank thrift institutions. Over the two months, consequently, M-2 changed little and M-3 grew at a relatively slow rate. The behavior of all three monetary aggregates was affected by shifts of funds from deposits to money market mutual funds and other liquid assets. Most market interest rates have risen in recent weeks, after having declined in January.
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> 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. Early 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. Subsequently, operations shall be directed at maintaining the weekly average federal funds rate within the range of 9-3/4 to 10-1/2 percent. 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 March-April period of M-1 and M-2 and the following ranges of tolerance: 4 to 8 percent for M-1 and 3-1/2 to 7-1/2 percent for M-2. If, with approximately equal weight given to M-1 and M-2, their rates of growth appear to be significantly above or below the midpoints of the indicated ranges, the objective for the funds rate is to be raised or lowered in an orderly fashion within its range.

If the rates of growth in the aggregates appear to be above the upper limit or below the lower limit 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, Balles, Black, Mayo, Partee, and Mrs. Teeters. Votes against this action: Messrs. Volcker, Coldwell, Kimbrel, and Wallich.

Messrs. Volcker, Coldwell, Kimbrel, and Wallich dissented from this action because they favored a somewhat more restrictive policy posture, in view of strong inflationary forces reinforced by pressure on capacity in some industries and in view of the near-term potential for excessive inventory demands. They believed that, despite uncertainty about prospects for economic activity later this year, some additional firming in money market conditions at this time was appropriate to help in containing inflationary pressures and maintaining renewed confidence in the dollar in foreign exchange markets.

2. Review of continuing authorizations

This being the first regular meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1979, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. The Committee reaffirmed the authorization for domestic open market operations, the authorization for foreign currency operations, and the special authorization relating to System obligations in Swiss francs in the forms in which they were then outstanding.

> Votes for these actions: Messrs. Miller, Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Mrs. Teeters, and Mr. Wallich. Votes against these actions: None.

In reviewing the authorization for domestic open market operations, the Committee took special note of paragraph 3, which authorizes the Reserve Banks to engage in the lending of U.S. government securities held in the System Open Market Account under such instructions as the Committee might specify from time to time. That paragraph had been added to the authorization on October 7, 1969, on the basis of a judgment by the Committee that in the existing circumstances such lending of securities was reasonably necessary to the effective conduct of open market operations and to the implementation of open market policies, and on the understanding that the authorization would be reviewed periodically. At this meeting the Committee concurred in the judgment of the Manager that the lending activity in question remained reasonably necessary and that, accordingly, the authorization should remain in effect subject to review in six months.

3. Foreign currency directive

The Committee reaffirmed the foreign currency directive, with a technical modification. In paragraphs 1 and 4(c), the word "proposed" was deleted preceding the references to IMF Article IV in recognition that Article IV had been put in place since the Committee had last conducted its annual review of all its continuing authorizations and directives. As amended paragraphs 1 and 4(c) read as follows:

> 1. System operations in foreign currencies shall generally be directed at countering disorderly market conditions, provided that market exchange rates for the U.S. dollar reflect actions and behavior consistent with the IMF Article IV, Section 1.
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> 4. System foreign currency operations shall be conducted:
>
> C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under the IMF Article IV.

> Votes for this action: Messrs. Miller, Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Mrs. Teeters, and Mr. Wallich. Votes against this action: None.

4. Procedural instructions with respect to foreign currency operations

In December 1976 the Committee agreed upon procedural instructions intended to clarify the respective roles of the Committee, the Foreign Currency Subcommittee, and the Chairman in providing guidance to the Manager of the System Open Market Account with respect to proposed or ongoing foreign currency operations under the authorization for foreign currency operations and the foreign currency directive. Under paragraphs 1A and 1B of the procedural instructions, the Manager is required to obtain clearance from the Foreign Currency Subcommittee (or from the Chairman, if consultation with the Subcommittee is not feasible in the time available) for operations in excess of specified daily and intermeeting limits. Under paragraph 2A, the Manager is required to obtain clearance from the Committee (or from the Foreign Currency Subcommittee or from the Chairman, if consultation with the Committee is not feasible in the time available) for operations in excess of a specified intermeeting limit. In order to facilitate implementation of the broad Government program to strengthen the dollar in foreign markets announced on November 1, 1978, the daily and intermeeting limits were suspended.

At this meeting, in light of experience gained in conducting operations under procedural instructions, the Committee decided to reinstate limits under the procedural instructions and at the same time to modify them in order to provide more leeway for operations without formal consultations with the Foreign Currency Subcommittee or the Committee. In practice, the management of the System Open Market Account consults with members of the Subcommittee on a continuing basis.

The limit on daily changes in the System's overall open position in foreign currencies specified in paragraph 1A was raised from $100 million to $300 million, and the intermeeting limit was raised from $300 million to $600 million; the limit on daily changes in the System's net position in a single foreign currency specified in paragraph 1B was raised from $100 million to $150 million, or to $300 million when the operation is associated with repayment of swap drawings, and the intermeeting limit was eliminated. The Committee also raised from $500 million to $1.5 billion the intermeeting limit on changes in the System's overall open position in foreign currencies specified in paragraph 2A. The procedural instructions as amended read as follows:

> In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager of the System Open Market Account, shall be guided by the following procedural understandings with respect to consultations and clearance with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.
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> 1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):
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> A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.
>
> B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.
>
> C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1B.
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> D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million, or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System, and about any operations that are not of a routine character.

Votes for this action: Messrs. Miller, Volcker, Balles, Black, Kimbrel, Mayo, Partee, Mrs. Teeters, and Mr. Wallich. Vote against this action: Mr. Coldwell.

Mr. Coldwell dissented from this action because he believed that the new limit of $1.5 billion specified in paragraph 2A was too high. He preferred a limit of $1 billion.

5. Authorization for domestic open market operations

Paragraph 2 of the authorization for domestic open market operations specified a limit of $2 billion on Federal Reserve Bank holdings of special short-term certificates of indebtedness purchased directly from the Treasury. On March 29, 1979, the Committee voted to raise the limit to the statutory ceiling of $5 billion, effective immediately, for the period ending with the close of business on April 17, 1979, the date of the next scheduled meeting.

Votes for this action: Messrs. Miller, Volcker, Balles, Black, Coldwell, Mayo, Partee, Mrs. Teeters, Messrs. Wallich, and Roos. Votes against this action: None. Absent: Mr. Kimbrel (Mr. Roos voted as alternate for Mr. Kimbrel).

The temporary debt ceiling of $798 billion was scheduled to expire at midnight on March 31, 1979, and the Congress was not expected to act on debt ceiling legislation before April 2, 1979. The Treasury had postponed several auctions of securities designed to raise funds to repay maturing debt and to meet cash outlays in early April. The Committee's action was taken on recommendation of Chairman Miller to provide maximum operating flexibility for the Treasury.

On April 2, 1979, the Committee voted to modify paragraph 1C of the authorization, effective immediately, for the period until the close of business on April 6, 1979, to permit arrangement of one-day RP's with dealers, in connection with special Treasury financings, at the rate at which the securities were auctioned. Under paragraph 1C, rates on RP's with dealers must be determined by competitive bidding, unless otherwise expressly authorized by the Committee.

> Votes for this action: Messrs. Miller, Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Mrs. Teeters, and Mr. Wallich. Votes against this action: None.

This action was taken on the recommendation of the management of the System Open Market Account. The management had advised that delay in enactment of a new temporary debt ceiling had created a severe cash problem for the Treasury, which might persist for some days. The Treasury planned to deal with the problem through the sale of sizable amounts of securities for payment on the day of the auction. However, dealers might experience difficulty in bidding in the auction, because awards of the securities might be made too late in the day to allow the dealers to make normal financing arrangements.

The Committee's action provided assistance in marketing such securities by assuring dealers that in the event financing proved to be difficult to obtain for the first day on which the securities were issued, financing could be made available for one day through repurchase agreements at the same rate at which the securities were sold.