FEDERAL RESERVE
press release

For Use at 4:10 p.m. May 25, 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 April 17, 1979. This record also includes policy actions taken during the period between the meeting on April 17, 1979, and the next regularly scheduled meeting held on May 22, 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 April 17, 1979

1. Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services had slowed substantially in the first quarter of 1979 from the rapid annual rate of 6.9 percent in the fourth quarter of 1978. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to have increased considerably faster in the first quarter than in the prior two quarters, when they rose at an annual rate of 8.0 percent.

The staff projection of growth in output over the four quarters of 1979 had been reduced slightly from the one prepared a month earlier. The reduction reflected a revised estimate of much slower expansion for the first quarter, when economic activity was adversely affected by unusually severe weather; this slower growth was expected to be offset only in part by some rebound in the second quarter. The projection continued to suggest sluggish growth in the third and fourth quarters. The rise in average prices was projected to remain rapid, and the rate of unemployment was expected to move up moderately as the year progressed.

The dollar value of total retail sales expanded considerably in March after having changed little earlier in the year when the weather was an adverse influence. For the first quarter as a whole, retail sales declined in real terms, following a sharp advance in the fourth quarter of 1978. Unit sales of new automobiles rose substantially in March, reflecting large increases in sales of small domestic and foreign models; the first-quarter pace of sales was somewhat above that in the previous quarter.

The index of industrial production rose 0.8 percent in March following two months of virtually no change; the rate of advance for the first quarter was only about half that for the second half of 1978. In March total nonfarm payroll employment registered another large gain, which included a further sizable increase in manufacturing. The rate of unemployment remained at 5.7 percent, about the level prevailing since mid-summer 1978.

Total private housing starts were expected to rebound in March, after a sharp decline earlier in the year in part because of the weather; but scattered market reports suggested that the rebound would be limited. It appeared likely that the annual rate for the quarter as a whole would be well below the totals for 1977 and 1978. In February total sales of new and existing single-family houses fell for the fourth consecutive month.

The index of average hourly earnings of private nonfarm production workers, which had increased 8-1/2 percent during 1978, rose at an annual rate of about 8-3/4 percent during the first quarter. The recent rise was affected by the January advance in the minimum wage.

Producer prices of finished goods and of materials increased sharply further in March. Over the first quarter, prices of finished goods rose at an annual rate of almost 14 percent, compared with a rate of about 9 percent over the preceding six months. Consumer prices advanced at an annual rate of about 12 percent over the first two months of the year, compared with a rate of 8-1/2 percent during the second half of 1978. Particularly large increases in retail prices of food and energy and in homeownership costs contributed to the acceleration.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had risen about 1-1/4 percent since the March 20 meeting of the Committee. The strength of the dollar was especially pronounced against the yen and, to a lesser extent, against the Swiss franc and the mark. The U.S. merchandise trade deficit declined in February to about half the large deficit in January; the average for the two months was somewhat above the monthly average in the fourth quarter of 1978.

Total credit at U.S. commercial banks expanded at a much slower pace in March than in January and February, as growth in real estate and business loans moderated considerably and banks reduced their holdings of securities. However, commercial paper issued by nonfinancial firms increased sharply, and the overall rate of short-term business borrowing was maintained. For the first quarter as a whole, nonfinancial businesses substantially increased their borrowing in short- and intermediate-term markets. At the same time, they reduced their public offerings of bonds to the smallest quarterly total since 1973.

The narrowly defined money supply, M-1, grew somewhat in March after having declined in both January and February. The broader monetary aggregates, M-2 and M-3, expanded at relatively slow rates during the month, although growth in both measures picked up somewhat from the pace earlier in the year. The performance of M-1 reflected in part the continuing impact of movements of funds from demand deposits to savings deposits associated with the growth of the automatic transfer service (ATS) and of negotiable order of withdrawal (NOW) accounts in New York State. With market interest rates remaining at high levels, expansion in M-2 and M-3 was restrained by relatively limited inflows of interest-bearing deposits, despite further large flows into money market certificates at both commercial banks and nonbank thrift institutions. The behavior of all three monetary aggregates was still being influenced by shifts of funds from deposits to money market mutual funds and other high-yielding market instruments. From the fourth quarter of 1978 to the first quarter of 1979, M-1 declined at an annual rate of 2-1/2 percent, while M-2 and M-3 expanded at annual rates of about 1-1/2 percent and 4-1/2 percent respectively.

In March, banks increased sharply further their reliance on nondeposit sources to supplement their loanable funds, including Eurodollars and repurchase agreements. However, a substantial decline in large-denomination time deposits outstanding during the month partially offset the increase in nondeposit sources of funds.

At its meeting on March 20 the Committee had decided on ranges of tolerance for the annual rates of growth in M-1 and M-2 during the March-April period of 4 to 8 percent and 3-1/2 to 7-1/2 percent respectively. The Committee had agreed that early in the coming intermeeting period operations should continue to be directed toward maintaining the weekly average federal funds rate at around 10 percent or slightly higher. Subsequently, if the two-month growth rates of M-1 and M-2, given approximately equal weight, 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.

In late March and early April staff projections suggested that over the March-April period M-1 would grow at a rate close to the lower limit of the range established by the Committee and M-2 at a rate just below the midpoint of its range. These projections were not viewed as sufficiently weak in relation to the Committee's ranges to call for a change in the federal funds rate objective of 10 percent or slightly higher.

Short-term interest rates fluctuated over a fairly wide range during the intermeeting period and generally rose a little on balance. Rates on short-term Treasury bills were under particular pressure in late March and early April from sales of bills by foreign official institutions. Long-term interest rates and mortgage yields also edged up on balance during the period.

In the Committee's discussion of the current economic situation and outlook, attention was drawn to the indications of considerably slower growth in real output of goods and services in the first quarter of 1979 than had appeared likely earlier. It was noted that residential construction and consumer spending for goods had weakened more than had been anticipated, and that such expansion as had occurred in the first quarter apparently reflected a substantial acceleration in the growth of business inventories. With respect to inventories, the observation was made that the overall rate of accumulation in the first two months of the year was not as high as had been feared earlier and that it seemed to be attributable largely to transitory influences.

The members in general anticipated relatively slow growth in economic activity for the near term, and some believed that growth could remain at a sluggish pace for an extended period. In view of business-cycle history, however, a number of members expressed doubt that growth could be sustained at a slow pace for many quarters. Many continued to believe that the probabilities of a downturn in activity before the end of 1979 were fairly high, especially in view of the unusually long duration of the current business expansion. It was also suggested by some that a pickup in activity, based in part on a surge in business demands for equipment and for inventories, might occur and persist for a time before an eventual downturn.

Various reasons were cited for thinking that economic activity might be near a cyclical turning point. Foremost among them was the dampening effect on expenditures for consumption and housing arising from the recent slowing of growth in personal income, from the impact of inflation on the purchasing power of personal income and on consumer wealth, and from the high level of consumer debt. Continued weakness in consumer spending might result in an unwanted increase in inventories. It was suggested that the relatively high rates of resource utilization and the recent strong preference in the business community to incur short-term rather than long-term debt were characteristic features of the late stages of a business expansion. And it was observed that over recent quarters the total of funds raised by nonfinancial sectors of the economy was estimated to have fallen considerably in relation to nominal gross national product, indicating a weakening in the overall demand for credit.

As at other recent meetings, great concern was expressed about inflation. It was observed that the rate of increase in prices had tended to accelerate from year to year recently and that there were few if any indications of a near-term reversal in that momentum. Forecasters in general had failed to anticipate the degree of the rise in prices, and some differences of opinion were expressed about the prospects for abatement in the rate of inflation in the latter part of 1979.

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 uncertainties concerning the forces affecting monetary growth. A staff analysis had suggested that M-1, after having registered a decline in the first quarter, would expand over the April-May period, reflecting in part rapid growth in nominal GNP. It was anticipated that shifts of funds from demand deposits to savings accounts with automatic transfer services and to NOW accounts in New York State, which were estimated to have depressed growth of M-1 by about 3 percentage points from the fourth quarter of 1978 to the first quarter of 1979, would have a somewhat less dampening effect on growth of M-1 in the period immediately ahead than in the first quarter. Moreover, it was assumed that the public's demand for money in relation to income would continue to shift downward, but at a sharply slower pace than in recent months. Thus, the rise in the income velocity of M-1 was expected to be relatively rapid, but less than the unusually rapid rate of the two most recent calendar quarters.

In the Committee's discussion at this meeting, as at the meeting on March 20, 1979, several members stressed their concern about the degree of the shortfall in monetary growth relative to the longer-run ranges that the Committee had adopted at its meeting on February 6. It was observed that restrictive policy actions taken in late 1978 had contributed to the recent slowing of monetary growth (after allowance for the impact of special factors) and apparently also to a moderation of the expansion in economic activity. Now, some easing in money market conditions might be appropriate, with the objective of raising growth of the monetary aggregates over a number of months into the longer-run ranges and of helping to support economic activity later in the year.

However, an easing in money market conditions was generally regarded as premature in the current environment of rapidly rising prices, although it was felt that monetary policy could have little if any immediate effect on prices of food, energy, and housing items, which had been largely responsible for the recent acceleration of the overall rise. Given the staff expectation of a near-term strengthening of monetary growth, most members advocated or found acceptable a policy of directing operations early in the period immediately ahead toward maintaining the money market conditions currently prevailing, as represented by a federal funds rate of 10 percent or slightly higher, and of having the objective for operations later in the period before the next regular meeting determined on the basis of incoming evidence on rates of growth of the monetary aggregates over the April-May period in relation to the growth rates currently anticipated.

A few members advocated an immediate increase in the objective for the federal funds rate to 10-1/4 percent or 10-1/2 percent and a range for subsequent operations providing for a further increase in the funds rate if incoming evidence suggested relative strength in growth of the monetary aggregates. They stressed the recent acceleration in the rise in prices and high rates of resource use, and they continued to believe that action should be taken to demonstrate that inflation represented the greatest risk to economic stability over a period of time. In their view, inflationary expectations had increased over recent months while interest rates on balance had changed little. In the current circumstances, moreover, they attached little significance to the behavior of the monetary aggregates.

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 April-May period should be 4 to 8 percent and 4 to 8-1/2 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 close to or beyond the upper or lower limits 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 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 first quarter of 1979 growth in real output of goods and services slowed substantially from the rapid rate in the last quarter of 1978, while the rise in prices accelerated. In March the dollar value of total retail sales, industrial production, and nonfarm payroll employment expanded considerably, but part of the strength was attributable to recovery from the effects of severe weather in the preceding two months. For the first quarter as a whole, retail sales in real terms declined somewhat,

following a sharp increase in the fourth quarter of 1978, and the advance in industrial output slowed appreciably. Growth in employment remained strong in the quarter, however, and the unemployment rate in March, at 5.7 percent, was virtually unchanged from its level in late 1978 and the first two months of 1979. Over recent months, broad measures of prices have increased at a faster pace than during 1978, and the index of average hourly earnings has continued to rise rapidly.

The trade-weighted value of the dollar against major foreign currencies has risen over the past four weeks, with the dollar showing particular strength against the yen, the Swiss franc, and the mark. The U.S. trade deficit in February was about half the size of the large deficit in January, but the average for the two months was above the monthly average in the fourth quarter of 1978.

M-1 increased slightly in March after having declined in both January and February. 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, and the broader monetary aggregates continued to grow at relatively slow rates. From the fourth quarter of 1978 to the first quarter of 1979, M-1 declined at an annual rate of about 2-1/2 percent, in part because of the effects of the growth of the automatic transfer service, and M-2 and M-3 grew at rates of about 1-1/2 percent and 4-1/2 percent respectively. The behavior of all three monetary aggregates was affected by shifts of funds from deposits to money market mutual funds and other liquid assets. Since mid-March, market interest rates generally have risen somewhat, on balance.

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 April-May period of M-1 and M-2 and the following ranges of tolerance: 4 to 8 percent for M-1 and 4 to 8-1/2 percent for M-2. If, with approximately equal weight given to M-1 and M-2, their rates of growth appear to be close to or beyond the upper or lower limits 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, Kimbrel, Mayo, Partee, and Mrs. Teeters. Votes against this action: Messrs. Volcker, Coldwell, and Wallich.

Messrs. Volcker, Coldwell, and Wallich dissented from this action because they continued to favor a somewhat more restrictive policy posture, in view of strong inflationary forces reinforced by pressure on capacity in some industries. They believed that, despite uncertainty about prospects for economic activity later this year, some additional firming in money market conditions at this time would help in limiting inflationary pressures by curbing inflationary expectations quickly.

On April 27 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 domestic policy directive adopted at the meeting on April 17.

2. Authorization for foreign currency operations

On May 9 the Committee voted to amend paragraph 5 of the authorization for foreign currency operations, effective immediately, to authorize purchases of U.S. Government securities from foreign central banks under agreements for repurchase of such securities within 30 calendar days, when appropriate in connection with arrangements to provide investment facilities for foreign currency holdings. Paragraph 5 as amended read as follows:

5. Foreign currency holdings shall be invested insofar as practicable, considering needs for minimum working balances. When appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

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 Manager of the System Open Market Account to provide an additional investment mechanism for System balances of foreign currencies. The mechanism involved (1) a transaction with a foreign central bank in which the System would sell a foreign currency spot and buy it forward; and (2) a repurchase agreement in which the System would acquire U.S. Treasury securities from the foreign central bank for the same period of time involved in the foreign currency transaction.