FEDERAL RESERVE
press release

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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 September 18, 1979.

Such records for each meeting of the Committee are made available generally about a month after the next 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 September 18, 1979

1. Domestic policy directive

The information reviewed at this meeting suggested that economic activity in the current quarter was near its level in the second quarter when, according to revised estimates of the Commerce Department, real output of goods and services had declined at an annual rate of 2.4 percent. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be rising at a pace close to the annual rate of 10 percent estimated for the second quarter.

Staff projections suggested some further contraction in economic activity and then an upturn beginning in 1980. Over the year ahead, the rise in average prices was projected to moderate a little from the rapid rate of recent quarters, and the rate of unemployment was expected to increase substantially.

The dollar value of retail sales expanded moderately in July and August, but in real terms such sales changed little and were estimated to be about 4 percent below their December 1978 peak. Sales of new automobiles rebounded in July and August from relatively depressed levels in the previous month, and by the end of August dealers' inventories of unsold cars had been reduced from an unusually high level.

The index of industrial production fell 1.1 percent in August after changing little on balance from the peak reached in March. Output of consumer durable goods, especially auto assemblies, declined sharply further in August, and production of business equipment and materials, including automotive parts, also fell.

In August nonfarm payroll employment was virtually unchanged following several months of slowing growth. In manufacturing, employment declined for the fifth consecutive month and the average workweek fell somewhat from an already reduced level. The unemployment rate rose from 5.7 to 6.0 percent after having fluctuated in a range of 5.6 to 5.8 percent since the beginning of the year.

Private housing starts declined somewhat in July to an annual rate of 1.8 million units, close to the rate for the second quarter but well below the average for 1978. Sales of new and existing single-family homes increased in July but were still about 3 percent below their record pace in 1978.

The latest survey of business plans taken by the Department of Commerce in late July and August suggested that spending for plant and equipment would expand 13.2 percent in 1979 as a whole; the survey taken three months earlier had suggested an increase of 12.7 percent. The new survey implied substantially less growth in the second half of the year than in the first half. Manufacturers' new orders for nondefense capital goods declined considerably in July to a level about 15 percent below their March peak.

Producer prices of finished goods continued to rise rapidly in August. The advance was led by a further sharp increase in prices of energy items and by a substantial rise in prices of consumer foods, which had declined considerably over the previous four months. Prices of intermediate goods also continued to move up rapidly in August, but prices of crude goods changed little after having advanced substantially in most earlier months of the year.

In July consumer prices increased considerably further. As in other recent months a large portion of the rise was accounted for by sharp advances in energy prices and homeownership costs. Food prices were little changed for the second straight month. Over the first seven months of the year consumer prices rose at an annual rate of about 13 percent.

In August the rise in the index of average hourly earnings of private nonfarm production workers moderated appreciably, to an annual rate of about 2-3/4 percent. Over the first eight months of the year the increase was at an annual rate of just over 7 percent, compared with a rise of 8-1/2 percent during 1978. However, the increase in total hourly compensation in the nonfarm business sector was about as rapid in the first half of 1979 as it had been during 1978 and, with productivity declining, the rise in unit labor costs accelerated substantially.

In foreign exchange markets the dollar came under downward pressure in the last few days of August and the first few days of September, but its trade-weighted value against major foreign currencies had changed little on balance since the Committee's meeting in mid-August. The U.S. trade deficit narrowed sharply in July from its average level earlier in the year. Exports, especially of agricultural products, continued to rise strongly in July, while non-oil imports fell substantially.

Total credit outstanding at U.S. commercial banks grew more slowly in August than in most earlier months of the year. Banks' holdings of Treasury obligations declined and growth in their total loans moderated. However, business loans continued to expand rapidly in August and commercial paper issued by nonfinancial firms again increased sharply.

The monetary aggregates--M-1, M-2, and M-3--continued to expand at relatively rapid rates in August and early September, although somewhat less rapidly than in June and July. Growth in demand deposits slowed considerably in August but the slowdown was partly offset by an acceleration in growth of currency. Expansion in time and savings deposits included in M-2 moderated slightly in August and net inflows of funds to nonbank thrift institutions also slowed somewhat. Growth in money market mutual funds and other short-term non-deposit investments had remained rapid in recent weeks.

At its meeting on August 14, the Committee had decided on ranges of tolerance for the annual rates of growth in M-1 and M-2 during the August-September period of 4 to 8 percent and 7 to 11 percent respectively. The Committee had agreed that in the coming intermeeting period the Manager for Domestic Operations of the System Open Market Account should direct open market operations initially toward an increase in the weekly average federal funds rate to a level of about 11 percent. Subsequently, if the two-month growth rates of M-1 and M-2, given approximately equal weight, 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 10-3/4 to 11-1/4 percent.

Soon after the meeting, incoming data indicated that M-1 and M-2 were growing at rapid rates in August. On August 30, projections for the August-September period suggested that growth of M-1 would be well above the upper limit of the range that had been specified by the Committee and that growth of M-2 would be at about the upper limit of its range. Over the preceding week, the Manager for Domestic Operations had been aiming for a weekly average federal funds rate approaching the 11-1/4 percent upper limit of the intermeeting range, and in the statement week ending August 29, the rate average 11.16 percent. In these circumstances, the Committee voted on August 30 to amend the domestic policy directive by raising the upper limit of the range for the funds rate to 11-1/2 percent, but with the understanding that not all of the additional leeway would be used immediately; use of the leeway would depend on subsequent behavior of the monetary aggregates and on developments in foreign exchange markets. In the week preceding today's meeting, the funds rate averaged about 11-3/8 percent.

Short-term interest rates rose substantially during the intermeeting period, in response to strong business demands for credit as well as to the System's actions firming money market conditions and to expectations of further monetary restraint. Bond yields also increased somewhat. During the period, banks raised their loan rate to prime business borrowers in steps from 11-3/4 percent to a new record of 13 percent. On August 16, the Board of Governors announced an increase in Federal Reserve Bank discount rates from 10 to 10-1/2 percent.

In home mortgage markets, yields on new mortgage commitments rose to new highs in early September and, according to field reports, nonrate lending terms were tightened further by numerous lenders. However, the volume of mortgage lending appeared to be well maintained.

In the Committee's discussion of the economic situation and outlook, none of the members expressed disagreement with the staff appraisal of some further contraction in real gross national product after the current quarter's interruption of the decline. However, members continued to express uncertainty about the duration and extent of the contraction in activity.

In one view, recent domestic developments were consistent with no more than a mild contraction. While several months had elapsed since the first signs of economic weakness and the automobile industry in particular was in recession, activity and demand for labor in certain industries and regions of the country remained strong. The unemployment rate had increased little from a level that, under prevailing market conditions, some observers associated with full employment; retail sales in real terms had leveled out in the summer, after a decline over the first half of the year; and business inventories appeared to be undergoing a moderate correction. Moreover, a new labor contract in the automobile industry had been negotiated without a work stoppage, eliminating one potential disturbance. Abroad, growth of industrial activity appeared sufficiently robust to contribute to improvement in this country's net exports and thereby to lend support to domestic activity.

In an alternative view, the contraction in activity could become more severe. Recent indicators of demands suggested mounting weakness, and business inventories--up sharply in July, according to the latest available data--were unlikely to be worked down easily. Industrial activity abroad--as in the United States, adversely affected by the petroleum situation, by inflation, and by instability in foreign exchange markets--might not contribute so much to improvement in U.S. net exports.

A major problem in the current situation, it was observed, was the tendency of inflation to raise effective income tax rates and thereby to reduce real disposable income and consumption expenditures. The sharp increase in oil prices, moreover, had similar effects.

Members continued to express great concern about the rapid rise in prices. It was observed that inflation was more persistent now than it had been in earlier periods of some weakening in demands and that there was still a tendency to underestimate its strength. Furthermore, the current and foreseeable rate of inflation could itself lead to additional shocks to the economy.

At its meeting on July 11, 1979, the Committee reaffirmed the ranges for monetary growth in 1979 that it had established in February. Thus, the Committee 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 commercial bank credit was 7-1/2 to

10-1/2 percent. Having established the range for M-1 in February on the assumption that expansion of ATS and NOW accounts would dampen growth by about 3 percentage points over the year, the Committee also agreed that actual growth of M-1 might vary in relation to its range to the extent of any deviation from that estimate. It now appeared that expansion of such accounts would reduce measured growth of M-1 over the year by about 1-1/2 percentage points.

In contemplating policy for the period immediately ahead, Committee members took note of a staff analysis suggesting that growth of M-1 was likely to taper off during the September-October period in response to the lagged effects of the substantial increase in interest rates during the summer and the prospective weakening of expansion in nominal GNP. However, growth over the two months would still be relatively high. Growth of M-2 was also expected to moderate, mainly as a result of the behavior of M-1 but also because of a reduction in growth of savings and small time deposits at commercial banks in response to the increased level of interest rates.

In the Committee's discussion, most members favored a policy of directing open market operations toward a slight additional firming in money market conditions early in the period before the next regular meeting and of having subsequent operations guided by incoming evidence on the behavior of the monetary aggregates. Because of the rapid monetary expansion of recent months, these members in general favored specification of ranges for growth of M-1 and M-2 over the September-October period that were indicative of less tolerance for relatively high than for relatively low growth. Sentiment was also expressed for directing open market operations toward maintaining the money market conditions currently prevailing, unless incoming evidence suggested that growth of the monetary aggregates over the September-October period would deviate significantly from the rates currently expected. No member advocated an easing in money market conditions in the period immediately ahead.

Members who favored policy measures directed toward some additional firming in money market conditions stressed the importance of achieving a significant reduction in the pace of monetary expansion over the months ahead. Such a reduction was necessary if growth over the year ending in the fourth quarter of 1979 was to be held well within the longer-run ranges that had been reaffirmed by the Committee in July. Additional measures to restrain monetary growth, moreover, would tend to lower expected rates of inflation and, consequently, would have a constructive influence on a range of decisions affecting prices and wages as well as the value of the dollar in foreign exchange markets.

It was suggested, in addition, that monetary policy had not been as restrictive as it might have appeared. Despite the level of interest rates, credit demands and credit expansion remained strong. Interest rates after allowance for expected rates of inflation were not high. Furthermore, monetary growth this year had been greater than indicated by M-1 alone, owing to rapid expansion in close substitutes for demand deposits and currency.

In support of a policy directed toward maintenance for the time being of prevailing money market conditions, members emphasized the substantial rise in interest rates over the past two months and the tendency of changes in rates to affect monetary growth and economic activity only after a considerable lag. In this connection, it was observed that growth of demand deposits had slowed markedly in July and August, while expansion of M-1 had been supported by an unexplained pickup in growth of currency in circulation. Growth of the monetary aggregates was likely to taper off in coming months, and additional firming in money market conditions might slow growth to an unwanted degree. In the current circumstances, the Committee should avoid policy actions that might intensify the developing weakness in economic activity.

At the conclusion of its discussion of policy, the Committee decided to instruct the Manager for Domestic Operations to direct open market operations initially toward a slight increase in the weekly average federal funds rate to about 11-1/2 percent. Subsequently, the objective for the funds rate was to be raised or lowered in an orderly fashion within a range of 11-1/4 to 11-3/4 percent if the monetary aggregates appeared to be growing over the September-October period at annual rates close to or beyond the upper or lower limits of the following ranges: M-1, 3 to 8 percent; and M-2, 6-1/2 to 10-1/2 percent. They 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 third quarter real output of goods and services remained near the reduced level of the preceding quarter and that prices on the average continued to rise rapidly. In August, as in July, the dollar value of retail sales expanded moderately, but sales in real terms changed little and were substantially below those of last December. Industrial production dropped from the May-July level, largely because of sharp curtailments in output of motor vehicles and parts. Nonfarm payroll employment was unchanged; the unemployment rate rose from 5.7 percent to 6.0 percent, thus moving above the narrow range in which it had fluctuated since the beginning of the year. Producer prices of finished goods continued to rise rapidly in August, led by further large increases in energy items and a substantial advance in consumer foods following a significant decline over the preceding four months. The rise in the index of average hourly earnings over the first eight months of this year was moderately below the pace during 1978, but the increase in total hourly compensation in the nonfarm business sector has been about as rapid this year as last.

The dollar came under downward pressure in foreign exchange markets in the last days of August and the early days of September, but its trade-weighted value against major foreign currencies has changed little on balance since mid-August. The U.S. trade deficit in July was sharply reduced from the average in the first half of the year.

Growth of M-1, M-2, and M-3 was relatively rapid in August and early September, although not so rapid as in June and July. Market interest rates have risen appreciably over recent weeks. An increase in Federal Reserve discount rates from 10 to 10-1/2 percent was announced on August 16.

Taking account of past and prospective developments in employment, unemployment, production, investment, real income, productivity, international trade and payments, and prices, the Federal Open Market Committee seeks 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. At its meeting on July 11, 1979, 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 same ranges that had been established in February. Having established the range for M-1 in February on the assumption that expansion of ATS and NOW accounts would dampen growth by about 3 percentage points over the year, the Committee also agreed that actual growth in M-1 might vary in relation to its range to the extent of any deviation from that estimate. The associated range for bank credit is 7-1/2 to 10-1/2 percent. The Committee anticipates that for the period from the fourth quarter of 1979 to the fourth quarter of 1980, growth may be within the same ranges, depending upon emerging economic conditions and appropriate adjustments that may be required by legislation or judicial developments affecting interest-bearing transactions accounts. These ranges will be reconsidered 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 developing conditions in foreign exchange and domestic financial markets. 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 11-1/4 to 11-3/4 percent. In deciding on the specific objective for the federal funds rate the Manager for Domestic Operations shall be guided mainly by the relationship between the latest estimates of annual rates of growth in the September-October period of M-1 and M-2 and the following ranges of tolerance: 3 to 8 percent for M-1 and 6-1/2 to 10-1/2 percent for M-2. If rates of growth of M-1 and M-2, given approximately equal weight, 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 beyond the upper or lower 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 shall promptly notify the Chairman, who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Volcker, Kimbrel, Mayo, Partee, Schultz, Mrs. Teeters, Messrs. Wallich, and Timlen. Votes against this action: Messrs. Balles, Black, Coldwell, and Rice. (Mr. Timlen voted as an alternate member.)

Messrs. Balles, Black, and Coldwell agreed with the majority that open market operations should be directed toward attaining a slight increase in the federal funds rate initially in the coming intermeeting period, but they dissented because they believed that, given the excessive monetary growth in recent months relative to the Committee's longer-run ranges, the directive adopted by the Committee would allow for too rapid monetary growth before an additional increase in the objective for the funds rate would be triggered. To enhance the prospects for achieving the Committee's objective of restraining monetary growth they preferred, moreover, to provide leeway for a rise in the funds rate to an upper limit of 12 percent.

Mr. Rice dissented from this action because he believed that an additional firming in money market conditions would intensify the developing weakness in economic activity and was unlikely to affect the rate of inflation favorably within six to nine months. In his judgment, monetary growth most likely would slow in the months immediately ahead even if current money market conditions were maintained, and growth of the monetary aggregates over the year ending in the fourth quarter of 1979 probably would fall within the Committee's longer-run ranges.

2. Authorization for domestic open market operations

The Committee took note of paragraph 3 of the authorization for domestic open market operations, 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 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 for Domestic Operations that the lending activity in question remained reasonably necessary and that, accordingly, the authorization should remain in effect subject to review in six months.

Votes for this action: Messrs. Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Rice, Schultz, Mrs. Teeters, Messrs. Wallich, and Timlen. Votes against this action: None. (Mr. Timlen voted as an alternate member.)