FEDERAL RESERVE press release

For Use at 4:10 p.m. November 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 October 6, 1979.

Such records for each meeting of the Committee are made available generally a few days 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 October 6, 1979

Domestic policy directive

This meeting of the Committee was called by the Chairman to consider actions that might be taken, in conjunction with actions being contemplated by the Board of Governors, to improve control over the expansion of money and bank credit in the light of developing speculative excesses in financial and commodity markets and additional evidence of strong inflationary forces in the economy. Special attention was given to the conduct of open market operations in order to contain growth in the monetary aggregates within the ranges previously adopted by the Committee for the year ending in the fourth quarter of 1979.

The information available at the time of the meeting suggested somewhat stronger economic activity in the third quarter than had been indicated at the time of the Committee's meeting on September 18, and real output of goods and services was estimated to have recovered a significant part of the second-quarter decline. According to staff projections, however, a decline in activity in the fourth quarter still appeared probable. Prices on the average were continuing to rise somewhat more rapidly than anticipated earlier, in part because of additional large increases in energy items and renewed upward pressures on foods. Moreover, developments in spot and futures markets for a number of commodities were indicative of an intensification of speculative activity and of the possibility of a further surge in prices.

In foreign exchange markets the weighted average value of the dollar against major foreign currencies had declined substantially since the Committee's meeting in mid-September, and monetary authorities had purchased, net, a large amount of dollars. Over the last few days dollar exchange rates had strengthened somewhat and gold prices had fallen considerably from record highs, apparently in anticipation of official actions to support the dollar. However, the atmosphere in the exchange markets remained sensitive and unsettled.

In accordance with the Committee's decision at its meeting on September 18, open market operations initially were directed toward a slight increase in the federal funds rate to about 11-1/2 percent. On September 18, moreover, the Board of Governors announced an increase in Federal Reserve Bank discount rates from 10-1/2 to 11 percent. Subsequently, open market operations were aimed at maintaining the funds rate at about 11-1/2 percent, although the rate generally was somewhat higher during the week preceding this meeting. Interest rates had remained under considerable upward pressure since mid-September, and most yields had risen to new highs for the year.

The monetary aggregates--M-1 and M-2--continued to expand at rapid rates in September, and growth in bank credit appeared to have accelerated appreciably from its pace in the prior two months. Banks were reported to have financed a substantial portion of their loan growth through sizable increases in the outstanding volume of large-denomination certificates of deposit and through continued large borrowings in the Eurodollar market.

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. After allowance for the deviation from the earlier estimate, the equivalent range for M-1 was 3 to 6 percent.

Over the first three quarters of the year, growth in M-1, M-2, and M-3 was within the ranges for 1979 set by the Committee. However, growth in all three monetary aggregates became increasingly rapid after the first quarter. Thus M-1 grew at annual rates of about 7-1/2 and 9-1/2 percent in the second and third quarters respectively, after a decline at a rate of about 2 percent in the first quarter. Growth in M-2 and M-3 accelerated to annual rates of about 12 percent and 10-1/4 percent respectively in the third quarter. For bank credit, growth exceeded its 1979 range in each of the first three quarters. In order that growth of the monetary aggregates fall within the Committee's ranges for the whole of 1979, expansion during the final quarter of the year would have to slow substantially from the rapid rates of recent months.

In the Committee's discussion of policy for the period immediately ahead, the members agreed that the current situation called for additional measures to restrain growth of the monetary aggregates over the months ahead. The members felt that growth of the aggregates at rates within the ranges previously established for 1979 remained a reasonable and feasible objective in the light of the available information and the business outlook. Given that objective, most members strongly supported a shift in the conduct of open market operations to an approach placing emphasis on supplying the volume of bank reserves estimated to be consistent with the desired rates of growth in monetary aggregates, while permitting much greater fluctuations in the federal funds rate than heretofore. A few members, while urging strong action to restrain monetary growth, expressed some preference for continuing to direct daily open market operations toward maintenance of levels of the federal funds rate and other short-term interest rates that appeared to be consistent with the Committee's objectives for growth in the monetary aggregates. The advantages and disadvantages of the different approaches were discussed.

The principal reason advanced for shifting to an operating procedure aimed at controlling the supply of bank reserves more directly was that it would provide greater assurance that the Committee's objectives for monetary growth could be achieved. In the present environment of rapid inflation, estimates of the relationship among interest rates, monetary growth, and economic activity had become less reliable than before, and monetary growth since the first quarter of 1979 had exceeded the rates expected despite substantial increases in short-term interest rates. Committee members recognized that for a number of reasons the relationship between growth of various reserve measures and growth of the monetary aggregates was not precise; thus the shift in emphasis to controlling reserves improved prospects for achievement of the Committee's objectives for monetary growth over the next few months but did not assure it.

Committee members suggested that the shift in operating techniques, along with the other actions being contemplated by the Board of Governors, would tend to increase confidence at home and abroad in the System's determination to achieve its objectives for monetary growth and to avoid further deterioration in the inflationary outlook. Partly because it would increase uncertainty about the near-term course of interest rates, the new operating technique should induce banks to exercise greater caution in extending credit and might dampen speculative behavior by increasing its risks and costs. Altogether, the System's action would tend to moderate inflationary expectations, thereby exerting a constructive influence over time on decisions affecting wages and prices in domestic markets and on the value of the dollar in foreign exchange markets.

The observation was made that the new emphasis in open market operations might be accompanied by larger increases in interest rates in the immediate future than would otherwise occur. On the other hand, the emphasis on reserves also could be expected to produce a shift toward easier conditions in money markets more promptly whenever the demand for money and credit abated significantly in response to a weakening in economic activity. The point was made that an easing in money market conditions under circumstances in which growth of monetary aggregates was restrained, economic activity was weakening, and the rise in prices was moderating should not adversely affect inflationary expectations and the value of the dollar in foreign exchange markets.

At the conclusion of the discussion and after full consideration of the advantages and disadvantages of alternative courses of action, the Committee agreed that in the conduct of open market operations over the remainder of 1979 the Manager for Domestic Operations should place primary emphasis on restraining expansion of bank reserves in pursuit of the Committee's objective of decelerating growth of M-1, M-2, and M-3 to rates that would hold growth of these monetary aggregates over the year from the fourth quarter of 1978 to the fourth quarter of 1979 within the Committee's ranges for that period. Specifically, the Committee instructed the Manager to restrain expansion of bank reserves to a pace consistent with growth from September to December at an annual rate on the order of 4-1/2 percent in M-1 and about 7-1/2 percent in M-2 and M-3, provided that in the period before the next regular meeting the federal funds rate remained generally within a range of 11-1/2 to 15-1/2 percent. Because such rates of expansion would result in growth of the monetary aggregates in the uppper part of their ranges for the year, the Committee also agreed that over the three-month period somewhat slower growth would be acceptable.

The Committee anticipated that the shift to an operating approach that placed primary emphasis on the volume of reserves would result in both a prompt increase and greater fluctuations in the federal funds rate. It was recognized that on particular days, or for several days, the federal funds rate might rise above or fall below the general limits established, and those limits were interpreted to apply to weekly averages. The Committee also agreed that it would consider whether supplementary instructions were needed if it appeared that operations to achieve the necessary restraint in expansion of reserves would tend to maintain the federal funds rate within 1 percentage point of the upper limit of its range of 11-1/2 to 15-1/2 percent. It was understood, moreover, that the Committee's decisions with respect to open market operations in the period immediately ahead had implications for Federal Reserve Bank discount rates.

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

> 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. The range for M-1 had been established on the basis of an assumption that expansion of ATS and NOW accounts would dampen growth by about 3 percentage points over the year. It now appears that expansion of such accounts will dampen growth by about 1-1/2 percentage points over the year; thus, the equivalent range for M-1 is now 3 to 6 percent. 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 restrain expansion of reserve aggregates to a pace consistent with deceleration in growth of M-1, M-2, and M-3 in the fourth quarter of 1979 to rates that would hold growth of these monetary aggregates over the whole period from the fourth quarter of 1978 to the fourth quarter of 1979 within the Committee's longer-run ranges, provided that in the period before the next regular meeting the weekly average federal funds rate remains within a range of 11-1/2 to 15-1/2 percent. The Committee will consider the need for supplementary instructions if it appears that operations to restrain expansion of reserve aggregates would maintain the federal funds rate near the upper limit of its range.

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.)

On October 6, after the meeting of the Committee, the Board of Governors unanimously approved complementary actions also directed toward assuring better control over the expansion of money and bank credit and toward curbing speculative excesses in financial and commodity markets. Specifically, the Board approved an increase in Federal Reserve Bank discount rates from 11 percent to 12 percent and established a marginal reserve requirement of 8 percent on increases in the total of managed liabilities of member banks, Edge corporations, and U.S. agencies and branches of foreign banks. (Managed liabilities include large-denomination time deposits with maturities of less than one year, Eurodollar borrowings, repurchase agreements against U.S. Government and federal agency securities, and borrowings of federal funds from institutions other than members of the Federal Reserve System.)

Subsequently, on October 22, 1979, the Committee held a telephone conference to review the situation and to consider whether supplementary instructions to the Manager were needed. Since October 6, expansion of total reserves had exceeded the pace consistent with the Committee's objective for growth of the monetary aggregates during the fourth quarter. At the same time, the federal funds rate had begun fluctuating close to the upper limit of the 11-1/2 to 15-1/2 percent range established by the Committee. It was recognized that the desired restraint in the expansion of total reserves might involve continued pressure on money market conditions, including higher levels of member bank borrowings from the Federal Reserve than had been anticipated, as banks made orderly adjustments that would in time slow monetary growth. It was not clear, however, that retention of the 15-1/2 percent upper limit of the range for the federal funds rate would be inconsistent with the desired restraint on monetary growth. Moreover, unsettled conditions in financial markets also suggested no change in the upper limit of the range for the federal funds rate. Consequently, no change was proposed in the domestic policy directive issued at the meeting on October 6.