



FEDERAL RESERVE

press release

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The Board of Governors of the Federal Reserve System 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 July 19-20, 1976

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 July 19-20, 1976^{1/}

1. Domestic policy directive

Preliminary estimates of the Commerce Department indicated that growth in real output of goods and services had moderated to a rate of 4.4 per cent in the second quarter, from an upward revised rate of 9.2 per cent in the first quarter. The preliminary estimates also indicated that average prices, as measured by the GNP fixed-weighted price index, had risen at an annual rate of 4.7 per cent in the second quarter, up from the relatively low rate of 4.2 per cent recorded in the first quarter. Staff projections continued to suggest that during the second half of the year real GNP would expand at a moderately rapid pace and that prices would rise somewhat faster than they had during the first half. Moreover, prospects appeared favorable for continuation of a good rate of expansion in real output into 1977.

A major element in the moderation of growth in real output in the second quarter was an apparent leveling off in the rate of inventory investment, following a sharp increase

^{1/} This meeting was held over a 2-day period, beginning on the afternoon of July 19.

in the first quarter. Final purchases in real terms grew at a somewhat higher rate in the second quarter than in the first. The expansion in personal consumption expenditures for both durable and nondurable goods slowed, but net exports of goods and services changed little in the second quarter, after having fallen sharply in the first.

Retail sales, which had declined appreciably in May, rebounded in June, reflecting widespread increases among the major categories of nondurable and durable goods. Nevertheless, the expansion in sales in the second quarter as a whole was only about half of that in the first.

Growth in industrial production decelerated in June to a relatively slow pace. While output of business equipment continued to expand and output of durable goods materials again rose strongly, production of both consumer nondurable goods and nondurable goods materials was about unchanged. The strike in the rubber industry, which had limited the gains in output in April and May, had little or no additional effect on output in June.

In the second quarter as a whole the gain in industrial output was considerably less than that in the first quarter.

A major element in the second-quarter slackening was a leveling off in production of nondurable goods, following a rapid accumulation of inventories in the preceding quarter. Overall output of durable goods rose almost as rapidly in the second quarter as in the first.

Capacity utilization, on the average, was virtually unchanged in June in the materials-producing industries. Utilization in the second quarter as a whole was about 80 per cent, compared with about 71 per cent at the cyclical low in the second quarter of 1975 and 93 per cent at the previous cyclical high in the fourth quarter of 1973. In the second quarter, utilization was about 86 per cent for nondurable goods materials and 76 per cent for durable goods materials.

The moderating pace of industrial expansion during recent months was reflected in labor market developments. Nonfarm payroll employment (adjusted for strikes), which had increased little in May, was unchanged in June. The recent weakness in employment was most evident in nondurable goods manufacturing, but gains in durable goods industries also tapered off. The unemployment rate edged up to 7.5 per cent in June from 7.3 per cent in May; however, the increase

may to some extent have reflected problems associated with seasonal adjustment.

Private housing starts rose somewhat further in June, reflecting a gain in single-family units, but total starts were little higher in the second quarter than in the first. Residential building permits declined in June, and the total for the second quarter was slightly below that for the first. Outstanding mortgage loan commitments at savings and loan associations had advanced further in May, the latest month for which data were available.

New orders for nondefense capital goods rose in May for the fifth consecutive month; for the first time in a year and a half such orders exceeded shipments and there was an increase in unfilled orders. Nonresidential construction activity remained depressed.

The wholesale price index for all commodities continued to rise at a moderate rate in June. Average prices of industrial commodities--which had changed little in May--rose appreciably in June, reflecting in large part increases in prices of steel mill products, gasoline, and machinery and equipment. At the same time, however, the rise in

wholesale prices of farm and food products slowed further; prices of manufactured animal feeds, soybeans, cotton, coffee, and cocoa increased, but prices of cattle, meats, sugar, and fresh fruits and vegetables declined.

The advance in the index of average hourly earnings for private nonfarm production workers slowed considerably in June from the rapid rate in May, which had been attributable in part to the impact of a major settlement in the transportation industry and to sizable wage increases in service industries. The rate of increase over the second quarter differed little from that over the first.

A staff analysis of the economic outlook suggested that the advance in business activity would soon improve from the relatively slow pace of recent months. The vigorous rebound in retail sales in June was regarded as evidence that the slowdown in consumer buying over the second quarter as a whole was temporary. The weakness, which had occurred at a time when inventories of nondurable goods were backing up, had been transmitted quickly to production and employment. Inventories, however, had not moved significantly out of line with sales. Consequently, it appeared that renewed

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strength in consumer spending--together with the gradual improvement of business capital outlays that was foreshadowed by rising new orders and other advance indicators--would in turn be transmitted rather promptly to significant gains in industrial activity and employment.

Staff projections for the second half of 1976 differed little from those of a month earlier. They suggested that expansion in business fixed investment would accelerate gradually and that business investment in inventories would increase somewhat further, as manufacturers and distributors endeavored to maintain stocks in line with rising sales. It was also anticipated that growth in personal consumption expenditures would be more vigorous than in the second quarter and that residential construction activity would continue to recover. Growth in State and local government expenditures for goods and services was expected to remain relatively moderate, although the projected rates now were a little stronger than those of a month earlier.

The U.S. foreign trade balance shifted from a substantial deficit in April to a small surplus in May, as imports of fuels fell back from a temporarily increased level. For the

2 months combined, the deficit in the trade balance was at a rate sharply below that in the first quarter of the year, mainly because of sizable gains in exports of both agricultural and nonagricultural commodities. Imports of commodities other than fuels, which had expanded sharply in the first quarter, were at a somewhat reduced rate in the April-May period.

The average value of the dollar against leading foreign currencies, on a trade-weighted basis, remained relatively steady over the 4 weeks between the June and July meetings at about the level it had reached in April, after a rise of about 15 per cent over the preceding 12 months. Although rates of inflation had diminished in most foreign countries over the past year, with few exceptions they remained higher than in the United States.

During the inter-meeting period, downward pressure on the British pound and the Dutch guilder eased and that on the Italian lira was reversed. In the same period, upward pressure on the Japanese yen emerged and downward pressure on the French franc developed.

Total loans and investments at U.S. commercial banks increased slightly further in June as banks continued to add

to their holdings of Treasury securities. Outstanding business loans, after having risen in May for the first time since January, declined somewhat in June. Businesses expanded their total short-term indebtedness, as they had in May, but their demands for short-term funds were concentrated in the commercial paper market where interest rates had declined relative to lending rates at commercial banks.

The narrowly defined money stock (M_1), which had grown at an exceptionally rapid pace in April and then at a moderate rate in May, declined slightly in June. The decline probably reflected a variety of factors, including lagged adjustment of private money balances to desired levels following the April surge associated with a large drop in U.S. Government deposits at Federal Reserve and commercial banks, an unusually heavy use of demand deposit balances by corporations to make tax payments in June, and a slowing in currency growth that was likely to be temporary. Moreover, just as the April bulge in growth was influenced by the drop in Government deposits, the June decline was influenced by an unusually large increase in such deposits. The surge in Federal outlays that typically occurs at the end of the Government's fiscal

year was not so large in June as it had been in recent years, owing partly to aspects of the transition this year to a fiscal year running from October 1, 1976, to September 30, 1977.

Growth in M_2 and M_3 moderated in June, mainly because of the decline in M_1 . Also, inflows of the time and savings deposits included in the broader monetary aggregates slowed somewhat.

On the basis of quarterly average data, M_1 grew at an annual rate of 3-1/2 per cent in the second quarter of the year, compared with a rate of 2-1/2 per cent in the first quarter. M_2 and M_3 grew at rates of 11 and 12 per cent, respectively, in the second quarter, compared with rates of 10 and 11 per cent in the preceding quarter.

System open market operations since the June 22 meeting had been guided by the Committee's decision to seek bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead. Data that had become available in the days immediately following the June meeting suggested that in the June-July period growth in both M_1 and M_2 would be near the midpoints of the

ranges that had been specified by the Committee. Accordingly, System operations had been directed toward maintaining conditions of reserve availability consistent with a Federal funds rate of about 5-1/2 per cent--the rate prevailing at the time of the June meeting and the midpoint of the operating range that the Committee had specified for the inter-meeting period.

Subsequently, in early July, data becoming available suggested that in the June-July period growth in M_1 would be below the lower end of the specified range while growth in M_2 would be close to the lower limit of its range. In those circumstances, the System became a little more accommodative in the provision of reserves, and by midmonth the Federal funds rate had declined to around 5-1/4 per cent, the lower limit of the specified range. The rate remained close to that level over the rest of the inter-meeting period.

The System's slightly more accommodative posture, along with indications of a slowing in the pace of economic expansion, led to declines in most market interest rates in the first half of July. However, some rates turned up in the final days of the inter-meeting period following publication of preliminary data indicating large increases in the monetary aggregates

during the statement week ending July 7. On the day before this meeting the market rate on 3-month Treasury bills was 5.23 per cent, compared with 5.36 per cent on the day before the June meeting.

Markets for longer-term bonds were influenced also by a prospective reduction in the demand for funds. Capital market financing of corporations and of State and local governments--which had been large in June and, indeed, throughout the first half of the year--appeared likely to decline more than seasonally in July.

Conditions in the home mortgage market were relatively stable during the inter-meeting period. Interest rates in the primary market, which typically lag bond market developments, moved up a little further, but yields in the secondary market edged down. Demands for mortgage financing apparently continued strong in many parts of the country, and there were indications that savings and loan associations remained willing lenders. At the end of May, the latest month for which data were available, liquid asset holdings of the savings and loan associations were high relative to their outstanding loan commitments.

At this meeting the Committee reviewed its 12-month ranges for growth in the monetary aggregates. At its meeting in April, the Committee had specified the following ranges for growth over the period from the first quarter of 1976 to the first quarter of 1977: M_1 , 4-1/2 to 7 per cent; M_2 , 7-1/2 to 10 per cent; and M_3 , 9 to 12 per cent. The associated range for growth in the bank credit proxy was 6 to 9 per cent. The ranges being considered at this meeting were for the period from the second quarter of 1976 to the second quarter of 1977.

During the Committee discussion at this meeting, some members stressed the signs of hesitation in the economic expansion in the second quarter--in particular, the slowing in growth of consumer spending and industrial production and the less-than-expected strength in residential construction activity. It was also noted, however, that economic expansions at times have proceeded unevenly, with relatively rapid growth in one quarter often followed by relatively slow growth in the next quarter. In that light, growth in real GNP in the first half of the year--at an annual rate of nearly 7 per cent--was described as satisfactory, even though it resulted in part from a rise in inventory investment that was unlikely to be repeated in the second half of the year.

Several members expressed a belief that the pace of economic expansion would pick up again from the reduced rate in the second quarter, and a number anticipated that in the quarters immediately ahead growth in real GNP would be faster than that suggested by the staff projections. Business fixed investment and residential construction, in particular, were cited as likely to be stronger than projected. Some members also anticipated that Federal Government expenditures would prove to be more expansive than assumed at present.

In connection with the outlook for housing, attention was called to the ready availability of mortgage finance. It was also suggested that reduced vacancy rates and somewhat increased rents might have improved the outlook for starts of multifamily units.

The members who anticipated a relatively strong expansion in economic activity believed such expansion to be desirable because of the high rate of unemployment, and they believed also that it could be accommodated without undue strain, in light not only of the amount of unemployment but also of the margin of unused capacity to produce industrial materials. In this context, it was observed that the current recovery

had not been marked by speculation in inventories or by other types of speculation. Moreover, economic recovery in other industrial countries appeared to be proceeding at a moderate pace and without indications of speculation, in contrast with the worldwide economic expansion of 1972-74. It was suggested that the expansion in this country was not likely to accelerate to an unsustainable pace in the quarters immediately ahead. Nevertheless, some concern was expressed about the outlook for prices of goods and services.

In commenting on the growth range for H_1 for the period from the second quarter of this year to the second quarter of 1977, most members favored retaining the range of 4-1/2 to 7 per cent that the Committee had adopted in April for the year ending with the first quarter of 1977. No member favored an increase in the range. However, there was some sentiment for reducing the lower limit of the range by 1/2 of a percentage point, and some for reducing both the lower and upper limits by that amount.

Among the reasons advanced for lowering the range for H_1 were the belief on the part of some members that the rate of inflation would increase and expectations that Federal

Government expenditures would exceed current projections. It was noted also that from the first to the second quarter of 1976 M_1 had grown at a rate above the upper limit of the 4-1/2 to 7 per cent range adopted at the April meeting, and so a reduction in the range would be consistent with applying the 4-1/2 to 7 per cent range to the whole 15-month period from the first quarter of 1976 to the second quarter of 1977. In that light, retention of the existing range for the year ahead would imply somewhat faster growth over the next three quarters than would be consistent with the longer-run target for M_1 that had been adopted 3 months earlier.

In support of retaining the existing range, however, it was pointed out that growth in M_1 from the third to the fourth quarter of 1975 and then to the first quarter of 1976 had fallen short of the Committee's longer-run ranges. Consequently, growth in M_1 measured to the level in the second quarter of 1976 from the different bases in the second, the third, and the fourth quarter of 1975 was, in each case, within the 4-1/2 to 7 per cent range. It was observed also that the second-quarter bulge in M_1 reflected rapid growth only in April rather than continuously throughout the quarter:

M_1 grew at a moderate rate in May and actually declined slightly in June. Although the outlook for activity was seen as generally favorable, this did not appear to be an appropriate time to reduce the range in view of the recent hesitation in the course of the economic expansion. Moreover, the rise in the income velocity of M_1 , which had been unusually rapid over the first year of economic recovery, could not reasonably be expected to continue at such a fast pace. In fact, the rise had moderated recently.

With respect to the ranges for M_2 and M_3 , most Committee members favored some reduction in either the upper limit, the lower limit, or both. Those members who favored some reduction in the range for M_1 had the same general reasons for wishing to reduce the ranges for the broader monetary aggregates. Those who favored retaining the existing range for M_1 anticipated that growth in the broader aggregates would be somewhat lower in relation to growth in M_1 than it had been in recent quarters. Inflows to banks and to nonbank thrift institutions of the time and savings deposits included in the broader aggregates had slowed somewhat recently, in part because market interest rates on short-term securities had

increased a little since April and in part because nonbank thrift institutions were bidding less aggressively for savings. Moreover, some further slowing in savings inflows was likely as economic activity continued to expand. It was observed, however, that even with a small reduction in the ranges for the broader aggregates, the range for M_3 would still imply that the financing for a considerable rise in the volume of residential construction activity would be available.

In addition, note was taken of the fact that at recent meetings when the longer-run ranges for the monetary aggregates had been reviewed, the Committee had taken small steps toward its longer-term objective of returning growth in the monetary aggregates toward rates consistent with general price stability. Against that background, it was observed that some downward adjustment in the ranges for M_2 and M_3 at this time would be another small and prudent step in the desired direction.

At the conclusion of the discussion, the Committee agreed that the existing 4-1/2 to 7 per cent range for M_1 should be retained for the 1-year period ending with the second quarter of 1977. The members decided to reduce the upper end of the range for M_2 by 1/2 of a percentage point and that for M_3

by 1 percentage point; thus, the ranges projected were 7-1/2 to 9-1/2 per cent for M_2 and 9 to 11 per cent for M_3 . The associated range for growth in the bank credit proxy was 5 to 8 per cent.

As at earlier meetings, it was agreed that the longer-term ranges, as well as the particular list of aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It was also understood that, as a result of short-run factors, growth rates from month to month might well fall outside the ranges contemplated for annual periods.

In the discussion of current policy at this meeting, the Committee took note of a staff analysis suggesting that in the July-August period various factors that appeared to have depressed M_1 balances in June would no longer be operating and, therefore, that M_1 would expand appreciably. The analysis also suggested that if the Federal funds rate were to remain near 5-1/4 per cent over the 4-week period until the next meeting of the Committee, other short-term interest rates were unlikely to change significantly. In those circumstances, inflows to commercial banks of time and savings deposits other than

negotiable CD's were likely to expand from the June volume as a result of the declines in interest rates that had occurred since midyear.

The Treasury was expected to raise a substantial amount of new money during the forthcoming inter-meeting period, in connection with its anticipated refunding of securities maturing in mid-August. About \$4.6 billion of the maturing issues were held by the public.

As to policy for the period immediately ahead, members differed little in their preferences for ranges of growth in the monetary aggregates over the July-August period and for the midpoint of the inter-meeting range of tolerance for the Federal funds rate. For M_1 , the members were inclined to favor 2-month ranges of 4 to 8 or 4-1/2 to 8-1/2 per cent; for M_2 , the ranges mentioned were 7-1/2 to 11-1/2 and 8 to 12 per cent. With respect to the Federal funds rate, the ranges preferred by most members were centered on the prevailing rate of 5-1/4 per cent.

Differences of view were more marked with respect to the appropriate width of the range for the Federal funds rate. At its previous meeting, the Committee had agreed upon a relatively narrow range--5-1/4 to 5-3/4 per cent--on the

grounds that both a significant easing and a significant firming of money market conditions were undesirable--the former because of the possibility that such easing might have to be reversed shortly and the latter because of the element of uncertainty in the economic outlook. At this meeting some members favored specifying a relatively narrow funds rate range--5 to 5-1/2 per cent was suggested--in part for the same reasons. Another reason advanced was uncertainty about the forces leading to recent wide fluctuations in the growth rates of M_1 . It was pointed out that the Committee met regularly every month and that for the relatively brief span of 4 weeks before the next regularly scheduled meeting the System could seek to maintain money market conditions close to those now prevailing while the members assessed the various uncertainties in the present situation. Such a course, it was noted, would reduce the risk of whipsawing financial markets. Finally, it was suggested that if the Committee adopted a relatively narrow range for the Federal funds rate, the operating instructions contained in the last paragraph of the domestic policy directive issued to the Federal Reserve Bank of New York should give greater weight than usual to money market conditions.

Most members, however, favored specifying a somewhat wider range for the Federal funds rate--either 5 to 5-3/4 per cent or 4-3/4 to 5-3/4 per cent. Some of these members also stressed the existing uncertainty about the forces influencing the behavior of the monetary aggregates--in particular, about the causes of the pattern of rapid growth of M_1 in April, moderate growth in May, and a slight decline in June--but in their view this uncertainty was a reason for specifying a wider range for the Federal funds rate and for continuing to base operating decisions in the period immediately ahead primarily on the behavior of the aggregates. It was argued that specification of a narrow range for the Federal funds rate might well lead to growth in the aggregates at rates that were above or below the ranges specified for the July-August period.

At the conclusion of the discussion the Committee decided to seek bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead. Specifically, the Committee concluded that growth in M_1 and M_2 over the July-August period at annual rates within ranges of 4 to 8 per cent and 7-1/2 to 11-1/2 per cent,

respectively, would be appropriate. As at other recent meetings, the Committee decided that, in assessing the behavior of the aggregates, approximately equal weight should be given to i_1 and i_2 .

It was agreed that until the next meeting the weekly average Federal funds rate might be expected to vary in an orderly way within a range of 4-3/4 to 5-3/4 per cent. As 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 growth in real output of goods and services, which had been vigorous in the first quarter, moderated in the second quarter as a consequence of a smaller advance in consumer spending and little change in the rate of inventory accumulation. In June growth in industrial production slowed and nonfarm payroll employment changed little. The unemployment rate edged up to 7.5 per cent from 7.3 per cent in May, but this increase may have partly reflected seasonal adjustment problems. Retail sales rebounded strongly in June. The rise in the wholesale price index for all commodities remained moderate, as the advance in average prices of farm products and foods slowed

further. However, average prices of industrial commodities rose more than in other recent months. The advance in the index of average wage rates slowed considerably in June following a sharp rise in May; over the second quarter as a whole the index rose at about the same rate as in the first quarter.

The average value of the dollar against leading foreign currencies has remained relatively steady in recent weeks. In May there was a small surplus in the U.S. foreign trade balance.

M_1 , which had grown moderately in May, declined slightly in June. From the first to the second quarter, however, M_1 expanded at an 8.4 per cent annual rate because of the exceptional rise in April. Growth in M_2 and M_3 moderated in June, mainly because of the decline in M_1 , although inflows of the time and savings deposits included in the broader aggregates also slowed somewhat. Short-term market interest rates have declined somewhat in recent weeks, and most long-term rates have edged down.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to achieve bank reserve and money market conditions consistent with moderate growth in monetary aggregates over the period ahead.

Votes for this action: Messrs. Burns, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Winn.

Vote against this action: Mr. Volcker.

Mr. Volcker dissented from this action because in the present circumstances he would not wish to raise or lower the Federal funds rate by as much as 1/2 of a percentage point--a change that might be interpreted as a strong signal of a change in policy and that could have repercussions in financial markets--in response merely to short-term fluctuations in the monetary aggregates that might well prove transient.

2. Memorandum of discussion

At this meeting the Committee reviewed its decision of May 18, 1976, to discontinue the memorandum of discussion after the memorandum for the meeting of March 15-16, 1976, in response to requests for reconsideration received from the respective Chairmen of the Senate and House banking committees.

Following discussion, the Committee decided to reaffirm the decision in question.

Votes for this action: Messrs. Burns, Volcker, Balles, Black, Gardner, Jackson, Kimbrel, Lilly, Partee, Wallich, and Mayo.

Vote against this action: Mr. Coldwell.

Absent and not voting: Mr. Winn. (Mr. Mayo voted as alternate for Mr. Winn.)

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Mr. Coldwell, who had dissented from the action of May 18, dissented also from this action to reaffirm the earlier decision.