FEDERAL RESERVE
press release

For Use at 4:00 p.m. October 22, 1976

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 September 21, 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 September 21, 1976

1. Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the third quarter had remained close to the pace in the second quarter, now indicated by revised estimates of the Commerce Department to have been at an annual rate of 4.5 per cent. The rise in the fixed-weighted price index for gross domestic business product in the third quarter also appeared to have changed little from that in the second quarter, now estimated by the Commerce Department to have been at an annual rate of 5.2 per cent.

Final purchases of goods and services appeared to have increased more rapidly in the third quarter than in the second. According to staff estimates, however, growth in real output had been restrained by adjustments in business inventory investment in response to the slackening in the expansion of consumer spending during the second quarter and to an accumulation of inventories of nondurable goods to levels in excess of those desired. Staff projections suggested that growth in real GNP would pick up somewhat in the fourth quarter and

would remain at a good rate well into 1977. The projections also suggested that average prices would continue to rise at about the recent pace.

The index of industrial production, which after revision showed a somewhat larger increase in July than had been indicated a month earlier, continued to expand in August. In the 2 months--and also over the 5-month period April through August--the over-all production index rose at an annual rate of about 6 per cent, compared with a rate of about 12 per cent over the first 3 months of the year.

In August, as in the preceding 4 months, output of nondurable goods was about unchanged, reflecting the earlier build-up in inventories and the sluggishness of consumer spending for such goods in the second quarter. Among durable goods, output of materials, construction supplies, and business equipment continued to rise; output of automotive products and other consumer goods was about unchanged.

Retail sales rose vigorously in August after having changed little on balance from April through July. Gains were widespread and were largest among stores selling automobiles, furniture and appliances, and other goods

for which consumers may exercise considerable discretion in their spending decisions. Sales of new automobiles in August, at an annual rate of 10-1/2 million units, equaled the levels reached in April and June, even though some of the popular 1976 models were in short supply. Sales of domestic models apparently rose further in early September.

Payroll employment in nonfarm establishments, which had risen substantially in July after 2 months of little change, rose appreciably further in August. The number of jobs in manufacturing increased somewhat, but most of the growth continued to be in retail trade, services, and State and local government. As indicated by the survey of households, both total employment and the civilian labor force changed little in August, and the unemployment rate edged up further from 7.8 to 7.9 per cent.

Growth in personal income--after accelerating in July, in part because of a bulge in transfer payments attributable to a cost-of-living increase in social security payments--slowed in August, as growth in transfer payments subsided, income of farm proprietors declined, and expansion in wage and salary payments moderated. Nevertheless, total

personal income in August was nearly 10 per cent higher than a year earlier.

The latest Department of Commerce survey of business plans for plant and equipment expenditures in 1976, conducted in late July and early August, indicated a 7.4 per cent increase over outlays in 1975--almost the same year-to-year increase as had been indicated by the survey taken in May. Actual expenditures in the second quarter3appeared to have fallen short of the expectations recorded in the earlier survey, but plans for the rest of 1976 called for larger increases than had been the case in May.

A strengthening in the outlook for plant and equipment outlays was suggested by monthly indicators. New orders for nondefense capital goods rose by an unusually large amount in July, marking the seventh consecutive month of advance. While orders in real terms were still below the pre-recession peak in the summer of 1974, they were substantially above the level of last December. In July unfilled orders for such goods showed the first significant increase of the current business expansion. Contract awards for commercial and industrial buildings--measured in terms of floor space--edged down in July, but the trend of awards had been upward since the beginning of the year.

Private housing starts declined in July but then rose by a somewhat larger amount in August; the average for the 2 months was slightly above the rate in the second quarter. Residential building permits increased in both months, and the average rate for the 2 months--the highest since the first quarter of 1974--was up substantially from the second-quarter rate. Throughout the summer months mortgage terms changed little, and sales of both new and existing houses were relatively strong. In July outstanding mortgage commitments at savings and loan associations advanced to a near-record level. Furthermore, some support for residential construction in the period ahead was provided by release of the remaining $2 billion in GNMA funding to purchase mortgages on multifamily structures at yields below market interest rates and by enactment of legislation that revised and extended authorization for several FHA subsidy programs.

The rise in the index of average hourly earnings for private nonfarm production workers, which had accelerated slightly in July, slowed again in August. Over the first 8 months of this year the rise in the index was somewhat below the rapid rate of increase during 1975.

The wholesale price index for all commodities was about unchanged in August, after having risen at a moderate rate in the preceding 3 months. Average prices of farm and food products declined appreciably--reflecting decreases in prices of grains, soybeans, manufactured animal feeds, hogs, pork, and raw cotton that were offset only in part by increases in prices of cattle, beef, and some other commodities. Prices of industrial commodities, as in July, rose at a faster pace than they had earlier in the year. Increases were widespread and were largest for fuels, lumber and wood products, rubber products, and transportation equipment.

The consumer price index advanced at an annual rate of 6 per cent in both July and August, the same as the average monthly rate in the second quarter. Average retail prices of foods increased little in the latest 2 months, while average retail prices of other commodities and of services rose at an annual rate of about 7 per cent. Increases were relatively large for gasoline and other fuels, for apparel, and for used cars.

The average value of the dollar against leading foreign currencies remained relatively steady over the 5 weeks between

the August and September meetings of the Committee. The dollar declined somewhat against most of those currencies, but it rose against the pound sterling.

On September 1 the Mexican peso--which had been pegged to the U.S. dollar at the same rate for 22 years--was allowed to float, and the peso immediately depreciated more than 40 per cent. On September 12 the Finance Minister announced that as long as possible the Bank of Mexico would hold the peso at a rate equivalent to a 37 per cent depreciation against the dollar but that maintenance of this rate did not represent a return to a fixed parity.

The U.S. foreign trade deficit rose sharply in July to a level considerably above the average monthly deficit in the first half of the year. The value of exports continued to expand in July, but the value of imports rose substantially more--reflecting sizable increases in the physical quantity of industrial supplies and consumer goods and in prices of coffee. Imports of fuels, which had surged upward in June, changed little in July.

Staff projections for the period through the second quarter of 1977 suggested that growth in real output of goods and services would be at a somewhat higher rate than

in the second and third quarters of 1976. It was expected that expansion in business fixed investment would accelerate and that business investment in inventories would increase as manufacturers and distributors endeavored to maintain stocks in line with rising sales. It was also anticipated that personal consumption expenditures would grow at a faster rate than they had in the second and third quarters of 1976; that residential construction activity would continue to increase; and that State and local government expenditures would expand at a moderate pace.

Total bank credit rose further during August. However, most of the increase was associated with the Treasury's huge August financing; banks acquired a substantial volume of the new Treasury issues and substantially increased their loans to securities dealers. Business loans at banks contracted again, following the modest increase in July. Moreover, the outstanding volume of commercial paper of nonfinancial businesses rose little, even though the spread between the bank prime rate and market interest rates continued to favor business borrowing in the commercial paper market. With business demands for short-term credit remaining slack, two large banks lowered their prime rate from 7 to 6-3/4 per cent in mid-September.

It was anticipated that business loan demands at banks would remain sluggish in the weeks immediately ahead and that banks would continue to use a substantial part of their time and savings deposit inflows to increase holdings of Treasury coupon issues. At the same time banks were likely to permit the outstanding volume of CD's to decline further.

The narrowly defined money stock (M_1) grew at a seasonally adjusted annual rate of just under 6 per cent during August, somewhat below the rate of 6-3/4 per cent in July. Demand deposits had increased sharply during the first half of August, before payment on the new issues offered in the Treasury's financing. But they declined after the payment date for these new issues.

Growth in M_2 also slowed in August from the strong pace in July. The slackening reflected in part the behavior of M_1, but in addition, expansion in the time deposit component of M_2 slowed sharply. On the other hand, savings deposit inflows at banks accelerated. Inflows of deposits to savings and loan associations and to mutual savings banks also accelerated, and growth in M_3 remained rapid.

Over the first 8 months of this year--from December 1975 to August 1976--M_1 grew at a rate near the midpoint of the

Committee's longer-run range for that aggregate. However, growth in M_2 and M_3 was high relative to the Committee's longer-term ranges. The relatively rapid growth in the broader aggregates resulted mainly from lower-than-expected short-term interest rates associated with slower-than-expected expansion in nominal GNP and in credit demands.

The rate of increase in M_1 thus far in 1976 was consistent with the view that the downward shift in the demand for currency and demand deposits that was so evident in 1975 may have slowed. As a result, the velocity of M_1 increased on the average over the second and third quarters of 1976 at a much slower rate than over the preceding three quarters, when it had risen at a rate of almost 9-1/4 per cent.

System open market operations since the August meeting had been guided by the Committee's decision to maintain prevailing bank reserve and money market conditions, provided that M_1 and M_2 appeared to be growing at about the rates then expected. Since incoming data indicated that in the August-September period the aggregates would grow at rates well within the projected ranges, open market operations continued to be directed toward maintaining reserve conditions consistent with a Federal funds rate of about 5-1/4 per cent--the rate prevailing at the time of the August meeting.

During the inter-meeting period the Federal funds rate deviated little from the 5-1/4 per cent midpoint of the operating range that had been specified by the Committee. However, most other interest rates declined further--by amounts ranging to nearly 20 basis points in short-term markets and to as much as 30 basis points in intermediate- and long-term markets. A relatively light calendar of new corporate bond issues for the months immediately ahead and a shading of market forecasts of the fourth-quarter volume of Treasury cash borrowing contributed to the declines in rates. In addition, market participants apparently interpreted incoming economic data as indicative of slower expansion in output and less rise in prices than they had anticipated earlier.

The Treasury raised another $3.2 billion of new money during the inter-meeting period--by adding $1.1 billion to the auction of 2-year notes in late August and by issuing $2.1 billion of a new 4-year note on which payment was made in mid-September. The Treasury also announced that it would raise $820 million of new money when it rolled over a 2-year note that would mature at the end of September. Because of these operations, and also because Federal spending had fallen short of earlier expectations, it

now seemed likely that the Treasury cash balance at the end of September would be quite high--possibly in excess of $15 billion.

The further general decline of bond yields carried indexes of yields on State and local government issues to the lowest levels since February 1975. Municipal borrowers took advantage of the reduced interest costs by maintaining their bond offerings in July and August at a relatively high rate for that time of year, but the offerings were readily absorbed. Fire and casualty insurance companies contributed importantly to the strengthened demands for municipal bonds.

Average interest rates for new commitments on primary home mortgages changed little over the inter-meeting period, but yields in the more sensitive secondary market edged down in response to the further decline in bond yields. The over-all volume of funds raised in residential mortgage markets remained large. Most of the new residential mortgages continued to be absorbed by savings and loan associations or into pools of mortgages used by GNMA as collateral for new issues of guaranteed securities. Savings and loan associations acquired nearly a fifth of these new issues.

During the Committee's discussion of the economic situation at this meeting no member expressed substantial disagreement with the staff projection of stronger growth in real GNP over the quarters immediately ahead. However, two members expressed uncertainty about the timing with which the anticipated strengthening in economic activity would actually develop, and it was suggested that the chances of a shortfall from the projected rates of growth appeared to have increased recently. One member questioned whether the strike under way in the automobile industry might not have a significantly adverse effect on expansion in aggregate output, at least over the near term--although others stated that in the past the bulk of output losses resulting from major strikes had generally tended to be made up within a short period. Also, uncertainties about the course of prices--in particular, concern that cost pressures might push prices up at a more rapid rate--were seen as a possible dampening influence on business spending plans.

Other members expressed the view that recent economic statistics justified optimism about the outlook. The index of industrial production had been revised upward to show a significant increase in July, and it had continued to rise

at the same pace in August. Figures on retail sales--which had appeared sluggish for a time--had been revised upward for June and July, sales were reported to have expanded sharply in August, and weekly estimates suggested that they had remained strong in early September. And while the advance in personal income was reported to have slowed appreciably in August, the slowing was attributable in part to estimates of a decline in farm proprietors' income, figures for which were highly conjectural. The situation with respect to business income also appeared to have been healthy recently.

It was also emphasized that the behavior of new orders for nondefense capital goods and of other advance indicators suggested that a more rapid increase in business fixed investment was in the making. With respect to business inventories, some significant adjustments had been made, no troublesome excesses were apparent, and attitudes remained appropriately cautious. Residential construction activity was not so strong as one might wish, but a slow uptrend was in progress; the August figures for housing starts and building permits were reassuring.

At its July meeting the Committee had agreed that from the second quarter of 1976 to the second quarter of 1977, average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: M_1, 4-1/2 to 7 per cent; M_2, 7-1/2 to 9-1/2 per cent; and M_3, 9 to 11 per cent. The associated range for growth in the bank credit proxy was 5 to 8 per cent. It was agreed that the longer-term ranges, as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings. It also was understood that short-run factors might cause growth rates from month to month to fall outside the ranges contemplated for annual periods.

As to policy for the period immediately ahead, Committee members in general advocated continuation of the current stance. Interest rates, especially on long-term debt, had been adjusting downward, it was observed, in good measure because of improving confidence that the rate of inflation was being reduced, and also because of stability in the Federal funds rate. One or two members, taking note of uncertainties in the outlook for economic activity, suggested that open market operations in pursuit of the

Committee's objectives for the period immediately ahead might be conducted so that any deviations would be on the side of ease. At the same time, other members felt that any marked easing in the near term might be misinterpreted in the market.

In considering the ranges for M_1 and M_2 to be specified for the September-October period, the Committee took account of, among other things, the relatively rapid growth in the time and savings deposit component of M_2 that appeared to be materializing for September, given the attractiveness of rates offered on time and savings deposits in relation to market interest rates. There was near unanimity in the preferences expressed for ranges of growth in the monetary aggregates over the September-October period. The members favored a 2-month range of 4 to 8 per cent for M_1 and either 8 to 12 or 9 to 13 per cent for M_2. It was suggested that the relatively rapid growth in M_2 ought to be accommodated. At the same time, two members cited the rapid growth in M_2 in recent months as an argument for specifying the lower of the two ranges. One member suggested giving greater weight to M_2 than to M_1 in assessing the implications of the behavior of the aggregates for System open market operations.

With respect to the Federal funds rate, the members agreed that it would be appropriate to maintain the prevailing level of 5-1/4 per cent so long as the monetary aggregates were growing at about the rates expected. They differed, however, in their preferences for the width of the range for the funds rate. Some members advocated retention of the 5 to 5-1/2 per cent range that had been specified at the August meeting. Others advocated a range of 4-3/4 to 5-3/4 per cent--and one favored a still wider range. Others proposed a range that was not symmetrical around the prevailing rate of 5-1/4 per cent--specifically, a range of 4-3/4 to 5-1/2 per cent. In support of that proposal, it was suggested that because of the recent sluggishness in the economic expansion, it would be appropriate to permit more easing in money market conditions in response to indications of unexpected weakness in growth of the aggregates than tightening in response to unexpected strength.

It was observed that, if the Committee specified a wider range for the Federal funds rate than it had at the August meeting, it would be appropriate to place greater emphasis than at that meeting on the behavior of the

aggregates in formulating the operating instructions contained in the last paragraph of the domestic policy directive issued to the Federal Reserve Bank of New York. One member suggested that, because of the uncertainties about the economic situation and outlook, it would be appropriate for the Committee to emphasize steady growth in the monetary aggregates--just as uncertainties about the changing demand function for money around the beginning of the year had made it appropriate, in his view, to place more emphasis on interest rate stability.

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 September-October period at annual rates within ranges of 4 to 8 per cent and 8 to 12 per cent, respectively, would be appropriate. The Committee also decided that, in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of M_1 and of M_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 5-1/2 per cent. It

was also agreed that the Manager should continue to aim for a Federal funds rate of 5-1/4 per cent, unless growth in the monetary aggregates appeared to be deviating significantly from the midpoints of the specified ranges. 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 has remained moderate in the current quarter. In August industrial production continued to expand at about the average rate in the preceding 4 months. Retail sales apparently rose vigorously, after having changed little on balance since April. Payroll employment in nonfarm establishments rose appreciably further, but according to household survey data, the unemployment rate edged up from 7.8 to 7.9 per cent. The wholesale price index for all commodities was about unchanged in August, as a substantial decline in average prices of farm products and foods offset another large increase in average prices of industrial commodities. So far this year the advance in the index of average wage rates has been somewhat below the rapid rate of increase during 1975.

The average value of the dollar against leading foreign currencies has remained relatively steady in recent weeks, declining somewhat against most of these currencies but rising against the pound sterling. The Mexican peso was allowed to depreciate on September 1 and in recent days has been about 37 per cent below its old value against the dollar. In July the U.S. foreign trade deficit increased sharply.

M_1 and M_2 grew at moderate rates in August. Inflows of the time and savings deposits included in M_2 were relatively strong, although they slackened from the high rate in July. Inflows of deposits to nonbank thrift institutions accelerated, however, and growth in M_3 remained rapid. Most market interest rates have declined somewhat further in recent weeks.

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, Volcker, Balles, Black, Coldwell, Gardner, Jackson, Kimbrel, Lilly, Wallich, and Winn. Votes against this action: None. Absent and not voting: Mr. Partee.

2. Financing arrangements with Mexico

On the day before this meeting it was announced that the U.S. Treasury Department and the Federal Reserve had made arrangements with the Government of Mexico under which up to $600 million would be available to the Bank of Mexico to counter disorderly exchange market conditions during a transition period pending the receipt of medium-term financing from the International Monetary Fund.

Following the devaluation of the peso on August 31, 1976, the Mexican Government had developed a detailed economic program designed to cope with Mexico's balance of payments problem. Subsequently, the Managing Director of the International Monetary Fund had advised the Mexican authorities that he found the program adequate to deal with Mexico's balance of payments problem and was prepared to recommend that the Fund's Executive Board authorize drawings by Mexico under the Extended Fund Facility and other facilities of the Fund.

At the time these arrangements were made, the Bank of Mexico had outstanding drawings of $360 million on its swap line with the Federal Reserve. These drawings were due to mature in early October. The arrangements provided that,

at the option of the Mexican Government, the Federal Reserve would make available amounts repaid in advance of maturity under the existing swap line, up to $180 million. The remaining amounts would be made available by the Treasury through the Exchange Stabilization Fund.

These arrangements were approved on behalf of the Federal Open Market Committee by the Foreign Currency Subcommittee, consisting of Messrs. Burns, Volcker, Gardner, and Wallich.