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 May 22, 1979. This record also includes policy actions taken during the period between the meeting on May 22, 1979, and the next regularly scheduled meeting held on July 11.

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 May 22, 1979

Domestic policy directive

The information reviewed at this meeting suggested a moderate pickup in growth of real output of goods and services in the current quarter from the sharply reduced pace in the first quarter; then, the annual rate of expansion had slowed to only 0.4 percent, from 6.9 percent in the preceding quarter, in part because unusually severe weather adversely affected private and public construction activity. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be rising as rapidly as they did in the first quarter, when the annual rate was about 10 percent, and well above the rate in the third and fourth quarters of 1978.

Staff projections continued to suggest sluggish growth in real output during the year ahead. The rise in average prices during the year was projected to remain rapid, but not so rapid as it was estimated to be over the first half of 1979. The rate of unemployment was expected to move up gradually.

In April the index of industrial production fell 1 percent and growth in nonfarm payroll employment slowed substantially from the rapid pace in the previous six months, in large part owing to effects of a work stoppage in the trucking industry early in the month. The unemployment rate in April was 5.8 percent, about the level prevailing since mid-summer 1978.

The dollar value of total retail sales increased somewhat further in April, but apparently average prices rose at a faster pace and in real terms retail sales extended their first-quarter decline. Unit sales of new automobiles declined appreciably in April, to about the average rate in the first quarter, although sales of small domestic and foreign models remained strong.

Total private housing starts edged down in April to an annual rate of 1-3/4 million units, following the partial recovery in March from the sharp, weather-related decline earlier in the year. In both 1977 and 1978, housing starts had totaled about 2 million units. In mortgage markets, interest rates generally had risen further in recent weeks, and available information suggested that mortgage commitments outstanding at savings and loan associations continued to decline in April.

The value of manufacturers' new orders for durable goods fell sharply in April, and declines were widespread among industry and product groupings. The decrease in orders for nondefense capital goods was especially large, following three months of sizable advances.

The index of average hourly earnings of private nonfarm production workers increased at an annual rate of about 8-1/4 percent during the first four months of 1979, the same rate as during 1978. Hourly compensation in the nonfarm business sector, including the effects of increases in social security taxes at the beginning of 1979, rose at an annual rate of 10-1/4 percent in the first quarter, up marginally from the average rate in 1978. In the first quarter, however, the rise in unit labor costs accelerated to an annual rate of 15 percent from 9 percent during 1978, as productivity declined.

Indexes for producer prices of finished goods and of materials continued to rise sharply in April, despite declines in average prices of both consumer foods and crude foods. During the first four months of the year, producer prices of finished goods rose at an annual rate of about 13 percent, compared with about 9-1/4 percent during 1978. Increases in prices in the four-month period were widespread.

During the first quarter, the consumer price index also rose at an annual rate of 13 percent, compared with 9 percent in 1978. The acceleration was attributable largely to energy items and foods.

In foreign exchange markets demand for the dollar remained strong in the five-week period after the April meeting of the Committee, partly in response to announcement of a further reduction in the U.S. merchandise trade deficit in March and to indications of persistence of increased rates of inflation abroad. The strength was reflected in a further rise of about 1-1/4 percent in the trade-weighted value of the dollar against major foreign currencies and in substantial sales of dollars by central banks. The trade deficit in the first quarter as a whole was slightly lower than in the preceding quarter and considerably lower than in earlier quarters of 1978.

Total credit outstanding at U.S. commercial banks grew rapidly in April, as it had on balance during the first quarter of the year.

The April growth was led by a rebound in expansion of business loans, which had slackened in March from rapid rates in January and February. Commercial paper issued by nonfinancial firms increased sharply in April for the second consecutive month.

The narrowly defined money supply, M-1, expanded sharply in April, after having declined on the average in the first quarter. A substantial part of the April increase was attributable to delays in the Treasury's processing of checks in payment of federal income taxes and to a bunching of tax refunds. Reflecting in part the behavior of M-1, growth of M-2 and M-3 accelerated to rapid rates in April from relatively slow rates in the first quarter. Inflows to commercial banks of the interest-bearing deposits included in M-2 rose substantially in April, following several months of considerably reduced growth, as net flows into money market certificates increased while outflows of savings deposits slowed. At nonbank thrift institutions, on the other hand, net flows into money market certificates moderated in April, and overall inflows of funds to these institutions receded from an already reduced pace in the first quarter.

At its meeting on April 17 the Committee had decided on ranges of tolerance for the annual rates of growth in M-1 and M-2 during the April-May period of 4 to 8 percent and 4 to 8-1/2 percent respectively. The Committee had agreed that early in the coming intermeeting period operations should continue to be directed toward maintaining the weekly average federal funds rate at around 10 percent or slightly higher.

Subsequently, if the two-month growth rates of M-1 and M-2, given approximately equal weight, appeared to be close to or beyond the upper or lower limits of the indicated ranges, the objective for the funds rate was to be raised or lowered in an orderly fashion within a range of 9-3/4 to 10-1/2 percent.

In late April projections suggested that over the April-May period M-1 and M-2 would grow at rates that were close to or above the upper limits of their respective ranges. In accordance with the directive issued at the meeting on April 17, operations were directed toward an increase in the federal funds rate to a level of about 10-1/4 percent. Subsequently, in early May, the two-month rates of growth projected for M-1 and M-2 were somewhat stronger. However, financial markets appeared to be in a sensitive state, and recent developments affecting supplies and distribution of energy were adding to uncertainties about economic prospects. Moveover, it appeared that the rapid pace of monetary growth was attributable in part to transitory forces. In the circumstances, and in view of the directive's instruction to give due regard to developing conditions in domestic financial markets, the objective for the federal funds rate was maintained at 10-1/4 percent.

Short-term interest rates in general changed little on balance during the intermeeting period. Declines following the April meeting were subsequently reversed in reaction to the rise in the federal funds rate and to large sales of Treasury bills by foreign monetary authorities in association with their sales of dollars in foreign exchange markets.

Yields on longer-term obligations rose somewhat during the period, apparently because of worsening expectations with regard to inflation. Mortgage yields were also influenced by the further slowdown of inflows of funds to thrift institutions.

In the Committee's discussion of the economic situation and outlook, the members in general agreed that the pace of expansion in economic activity had slowed significantly, apart from the effects of severe weather in the first quarter and of the work stoppage in the trucking industry early in the current quarter. Much of the latest information on developments in April--particularly manufacturers' new orders for durable goods, housing starts, industrial production, personal income, and retail sales--pointed to a weakening in demands and activity. Moreover, uncertainties concerning supplies of gasoline, as well as the overall price effects of the sharp increases in costs of energy, could be expected to dampen demands. A number of members now thought that a cyclical peak in activity might well be registered in the current quarter.

Despite the current risks of recession in activity, the slowing of the expansion from the excessively rapid pace in late 1978 was regarded as a desirable development, in view of the inflationary pressures that had been accumulating. It was noted that some reduction in growth of nominal GNP had been an objective of the restrictive policy actions taken last autumn, although the reduction had so far been reflected in growth of real GNP rather than in the rate of inflation.

Members continued to express great concern about inflation. Comments were made to the effect that inflationary expectations may have increased in recent months and that a risk of some acceleration of the rise in prices existed, along with the risk of recession, as the recent increases in the cost of oil worked their way through the price structure over a number of months. There was evidence that over time the rate of inflation had been less variable in the United States than in other industrial countries, suggesting that it would be more difficult to reduce the rate here. According to a number of economic projections, moreover, deceleration of inflation would be a slow and lengthy process. The observation was made that if the rate of inflation was not sharply reduced in the months immediately ahead, renewed expansion in business activity would begin with prices rising at a relatively fast pace.

At its meeting on February 6, 1979, the Committee had agreed that from the fourth quarter of 1978 to the fourth quarter of 1979 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: M-1, 1-1/2 to 4-1/2 percent; M-2, 5 to 8 percent; and M-3, 6 to 9 percent. The associated range for the rate of growth in commercial bank credit was 7-1/2 to 10-1/2 percent. It had also been agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be reconsidered in July or at any time that conditions might warrant.

In contemplating policy for the period immediately ahead, the Committee took note of a staff analysis suggesting that over the May-June period growth of M-1 would be quite slow, in part because of the unwinding of the transitory effects of federal income tax payments and refunds that had contributed to its exceptionally rapid growth in April. It was expected that growth of M-2 over the two-month period would be retarded by the slow growth of M-1 but that growth of the interest-bearing component would remain relatively strong. The analysis pointed out that if M-1 and M-2 grew at annual rates of about 3-1/2 percent and 8 percent respectively over the six months from April to October, growth of the two monetary aggregates over the whole period from the fourth quarter of 1978 to October would be at the center of the longer-run ranges adopted by the Committee at its meeting in early February.

Most members of the Committee believed that, despite increasing signs of weakening in economic activity and the risks of recession, a general easing in monetary restraint at this time would be premature in view of the continuance of strong inflationary pressures. Given the staff expectations of slow growth in M-1 and M-2 over the May-June period, they favored a policy of directing open market operations early in the period immediately ahead toward maintaining the money market conditions currently prevailing, as represented by a federal funds rate of about 10-1/4 percent, and of having the objective for operations later in the period before the next meeting determined on the basis of incoming evidence on the behavior of the monetary aggregates in relation to that currently anticipated. In view of uncertainties concerning interpretation of credit conditions and monetary growth in the current environment, they also favored specifying unusually wide ranges for growth of M-1 and M-2 over the May-June period and giving greater weight than usual to money market conditions in the conduct of operations until the next meeting.

Two members of the Committee, stressing the signs of growing weakness in economic activity, favored easing policy and placing greater weight on the behavior of the monetary aggregates. Specifically, they advocated an immediate reduction in the objective for the federal funds rate to 10 percent in an effort to guard against a cumulative shortfall in monetary growth. On the other hand, one member advocated a more restrictive policy, represented initially by an increase in the objective for the funds rate to 10-1/2 percent, believing that such a policy would have a beneficial impact on inflationary expectations and only a slight effect on the course of real economic activity.

At the conclusion of the discussion the Committee decided that ranges of tolerance for the annual rates of growth in M-1 and M-2 over the May-June period should be 0 to 5 percent and 4 to 8-1/2 percent respectively. The Manager was instructed to direct open market operations initially toward maintaining the weekly average federal funds rate at about the current level, represented by a rate of 10-1/4 percent. Subsequently, if the two-month growth rates of M-1 and M-2 appeared to be close to or beyond the upper or lower limits of the indicated ranges, the objective for the funds rate was to be raised or lowered in an orderly fashion within a range of 9-3/4 to 10-1/2 percent, although it was understood that a reduction in the rate below 10 percent would not be sought until the Committee had an opportunity for further consultation. It was also agreed that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to M-1 and M-2.

As is customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

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

> The information reviewed at this meeting suggests a moderate pickup in growth of real output of goods and services in the current quarter from the sharply reduced pace in the first quarter, when public and private construction activity was adversely affected by unusually severe weather. In April, however, industrial production declined and growth in nonfarm payroll employment slowed, in large part owing to effects of a work stoppage in the trucking industry early in the month. The unemployment rate, at 5.8 percent, remained at about the level prevailing earlier in the year. The dollar value of total retail sales rose somewhat in April, although apparently by less than the increase in average prices. Over recent months, broad measures of prices have increased at a faster pace than during 1978, and the index of average hourly earnings has continued to rise rapidly.
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> Demand for the dollar has continued strong in exchange markets over the past five weeks, and the trade-weighted value of the dollar against major foreign currencies has risen further. The U.S. trade deficit declined further in March and was slightly lower in the first quarter as a whole than in the fourth quarter of 1978.

M-1 expanded sharply in April, after having declined in the first quarter, and M-2 and M-3 grew rapidly. The interest-bearing component of M-2 also grew rapidly, following several months of slow growth, as net flows into money market certificates at commercial banks increased while outflows of savings deposits slowed. At nonbank thrift institutions, net flows into money market certificates moderated, and overall inflows of funds receded from the already reduced pace of the first quarter. Since mid-April, short-term market interest rates have changed little, on balance; most longer-term rates have increased.

Taking account of past and prospective developments in employment, unemployment, production, investment, real income, productivity, international trade and payments, and prices, it is the policy of the Federal Open Market Committee to foster monetary and financial conditions that will resist inflationary pressures while encouraging moderate economic expansion and contributing to a sustainable pattern of international transactions. At its meeting on February 6, 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 associated range for bank credit is 7-1/2 to 10-1/2 percent. These ranges will be reconsidered in July or at any time as conditions warrant.

In the short run, the Committee seeks to achieve bank reserve and money market conditions that are broadly consistent with the longer-run ranges for monetary aggregates cited above, while giving due regard to the program for supporting the foreign exchange value of the dollar and to developing conditions in domestic financial markets. Early in the period before the next regular meeting, System open market operations are to be directed at maintaining the weekly average federal funds rate at about the current level. Subsequently, operations shall be directed at maintaining the weekly average federal funds rate within the range of 9-3/4 to 10-1/2 percent. In deciding on the specific objective for the federal funds rate the Manager shall be guided mainly by the relationship between the latest estimates of annual rates of growth in the May-June period of M-1 and M-2 and the following ranges of tolerance: 0 to 5 percent for M-1 and 4 to 8-1/2 percent for M-2. If, with approximately equal weight given to M-1 and M-2, their rates of growth appear to be close to or beyond the upper or lower limits of the indicated ranges, the objective for the funds rate is to be raised or lowered in an orderly fashion within its range.

If the rates of growth in the aggregates appear to be above the upper limit or below the lower limit of the indicated ranges at a time when the objective for the funds rate has already been moved to the corresponding limit of its range, the Manager will promptly notify the Chairman, who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Miller, Volcker, Black, Coldwell, Kimbrel, Mayo, and Mrs. Teeters. Votes against this action: Messrs. Balles, Partee, and Wallich.

Messrs. Balles and Partee dissented from this action in view of indications that a cyclical peak might be near at hand. Thus, they favored a less restrictive policy posture, especially in view of the delayed impact of policy changes on the economy. In the present uncertain environment, they believed that some prompt easing in money market conditions, along with a greater emphasis on the behavior of the monetary aggregates in guiding the conduct of operations, would reduce the risk of a continuing shortfall in monetary growth and would tend to provide needed support to the economy later in the year.

Mr. Wallich dissented from this action because, in view of the strong inflationary pressures in the economy, he continued to favor a more restrictive policy posture. Believing that inflationary expectations had increased in recent months while interest rates had changed little, he thought that additional firming in money market conditions would have a favorable effect on such expectations and would have little effect on the course of real output.

Subsequent to the meeting, on June 15, incoming data indicated that M-1 and M-2 were growing at exceptionally rapid rates in early June, and projections suggested that for the May-June period both monetary aggregates would grow at annual rates above the upper limits of the ranges that had been specified by the Committee. Since the meeting on May 22 the Manager had been aiming for a weekly average federal funds rate of 10-1/4 percent. The behavior of the aggregates would have called for an increase in the objective for the funds rate toward the 10-1/2 percent upper limit of its specified range. However, in view of many indications of weakening in economic activity, the difficulties of interpreting the behavior of the aggregates in the light of these circumstances, the condition of financial markets, and the general uncertainty about the economic outlook, Chairman Miller recommended that the Manager be instructed to continue to aim for a federal funds rate of about 10-1/4 percent.

> On June 15, the Committee modified the domestic policy directive adopted at its meeting on May 22, 1979, to call for open market operations directed at maintaining the weekly average federal funds rate at about 10-1/4 percent.
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> > Votes for this action: Messrs. Miller, Balles, Black, Kimbrel, Mayo, Partee, Mrs. Teeters, and Mr. Timlen. Vote against this action: Mr. Coldwell. Absent: Messrs. Volcker and Wallich. (Mr. Timlen voted as alternate for Mr. Volcker.)