



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 July 11, 1979. This record also includes policy actions taken during the period between the meeting on July 11, 1979, and the next regularly scheduled meeting held on August 14, 1979.

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 11, 1979

Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services had declined somewhat in the second quarter when a slackening in demands was intensified by reduced supplies of motor fuels and higher energy prices; in the first quarter the expansion in economic activity had slowed sharply, to an annual rate of 0.8 percent. The rise in average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to have accelerated somewhat further in the second quarter, from an annual rate of about 10 percent in the first quarter and around 8-3/4 percent during 1978.

Staff projections suggested a further contraction in economic activity over the next few quarters and an upturn beginning in 1980. Over the year ahead the increase in average prices was projected to be moderately below its pace in the first half of 1979. The rate of unemployment was expected to rise substantially.

In June the dollar value of retail sales fell for the third consecutive month, and in real terms such sales were estimated to be about 6-1/2 percent below their December 1978 peak. Unit sales of new automobiles declined further in June despite continued strength in sales of small domestic and foreign models.

In April and May total private housing starts were at an average annual rate of about 1-3/4 million units, up somewhat from the first quarter, when starts were depressed by unusually adverse weather conditions, but well below total starts in both 1977 and 1978. Combined sales of new and existing

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single-family homes in April and May were also above their first-quarter pace, but substantially below the peak rate in the fourth quarter of 1978.

The expansion in total nonfarm payroll employment slowed considerably during the second quarter to a pace well below that in the previous six months. Payroll employment in manufacturing declined in each month of the quarter, and the length of the average workweek fell appreciably from its relatively high first-quarter level. Nevertheless, the unemployment rate edged down in June to 5.6 percent, its lowest level since August 1974.

The index of industrial production rose 1.3 percent in May. The increase about offset a drop in April that was induced largely by a work stoppage in the trucking industry. The expansion in industrial production over the first five months of the year was less than 1 percent, compared with an increase of about 4 percent in the second half of 1978.

The latest survey of business plans taken by the Department of Commerce in late April and May suggested that spending for plant and equipment would expand 12.7 percent in 1979 as a whole; the survey taken three months earlier had suggested an increase of 11.3 percent. The new survey, like the earlier one, implied considerably more growth in the second half of the year than in the first half.

Manufacturers' new orders for nondefense capital goods picked up somewhat in May after having declined substantially in April. The machinery component of such orders--generally a good indicator of underlying trends in demand for business equipment--was up only slightly in May following a very large drop in April. Contract awards for commercial and industrial buildings--

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measured in terms of floor space--declined in May for the third consecutive month to a level well below the February peak.

Producer prices of finished goods and of materials rose much more rapidly in the first half of 1979 than during 1978. The increase in these indexes moderated in the second quarter, however, when prices of food products declined after having advanced at exceptional rates earlier in the year. Increases in prices of energy items were very rapid, especially in the second quarter.

The rise in the consumer price index accelerated to an annual rate of 13-1/2 percent over the first five months of 1979 compared with a rise of 9 percent in 1978. Price increases were widespread but were especially pronounced among energy-related items. Homeownership costs and food prices also increased sharply, although the rise in foods moderated in May.

The index of average hourly earnings of private nonfarm production workers rose at an annual rate of about 5-1/2 percent during the second quarter, down from increases averaging about 8-1/2 percent during the prior two quarters. The moderation was concentrated in the trade and service sectors. Recent collective bargaining agreements in two major industries provided for large increases in worker compensation.

In foreign exchange markets the dollar came under downward pressure in mid-June following several months of relative strength; since then its value against major foreign currencies had fallen about 3 percent and central banks had made large purchases of dollars. The dollar's weakness appeared to have been related to expectations of easier monetary conditions in the United

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States at a time when money market conditions were being tightened in key foreign countries and to concerns about the effects of sharply rising oil prices. The U.S. trade deficit for April and May had widened somewhat from the first-quarter rate, reflecting a sizable increase in the value of oil and other imports and little change in the value of exports.

Total credit outstanding at U.S. commercial banks continued to expand rapidly in May and June, but the rate of growth for the two months combined was down somewhat from the average pace in earlier months of the year. Increases in bank loans during May and June were concentrated in the business and real estate categories. Commercial paper issued by nonfinancial firms rose considerably further over the two months.

The narrowly defined money supply, M-1, increased sharply in June and the broader measures of money, M-2 and M-3, also grew rapidly; expansion in all three measures, especially M-1, had slowed markedly in May following a surge in April. In June, inflows to commercial banks of interest-bearing deposits included in M-2 were large, as money market certificates expanded rapidly for the third consecutive month and savings deposits increased for the first time since September 1978. At nonbank thrift institutions, net inflows of funds were estimated to have picked up somewhat in June from a sharply reduced pace in May, even though net issuance of money market certificates by these institutions weakened further.

On a quarterly average basis, M-1 grew at an annual rate of about 7-1/2 percent in the second quarter after a decline at a rate of about 2 percent in the first quarter; M-2 and M-3 grew at rates of about 8-1/2 percent

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and 7-3/4 percent respectively in the second quarter, compared with rates of about 1-3/4 percent and 4-3/4 percent in the previous quarter. In the second quarter, banks increased considerably further their reliance on non-deposit sources such as repurchase agreements and Eurodollars to supplement their loanable funds. At the same time, they reduced the outstanding volume of large-denomination time deposits by more than the increase in funds from nondeposit sources.

At its meeting on May 22 the Committee had decided on ranges of tolerance for the annual rates of growth in M-1 and M-2 during the May-June period of 0 to 5 percent and 4 to 8-1/2 percent respectively. The Committee had agreed that early in the coming intermeeting period, the Manager of the System Open Market Account should continue to direct operations toward maintaining the weekly average federal funds rate at around 10-1/4 percent. Subsequently, if the two-month growth rates of M-1 and M-2, given approximately equal weight, appeared to be close to or beyond the upper or lower limits of the indicated ranges, the objective for the funds rate was to be raised or lowered in an orderly fashion within a range of 9-3/4 to 10-1/2 percent.

Subsequent to the meeting, incoming data on the monetary aggregates led to progressively higher projections of growth in M-1 and M-2 over the May-June period. By mid-June the projections suggested growth rates that were above the ranges specified by the Committee. The behavior of the aggregates would have called for an increase in the objective for the federal funds rate toward the 10-1/2 percent upper limit of its specified range. However, on June 15 the Committee modified the domestic policy directive adopted on

May 22 and called for open market operations directed at maintaining the weekly average federal funds rate at about 10-1/4 percent. Federal funds traded somewhat above the Committee's objective in late June and early July, in response to pressures associated with unusual churning in the money market around the midyear bank statement date and the July 4 holiday.

Most interest rates other than the federal funds rate fell substantially on balance during the intermeeting period. The declines appeared to be in response to the growing evidence that economic activity had been weakening. Declines in Treasury bill rates were accentuated by large cash redemptions of maturing bills and by the resumption of sizable net purchases by foreign central banks as the dollar came under pressure in foreign exchange markets. During June most banks reduced their loan rate to prime business borrowers from 11-3/4 to 11-1/2 percent. Despite relatively sizable declines in most interest rates, including bond yields, rates on conventional home mortgages in the primary market rose further during the intermeeting period. Thrift and other institutions continued to tighten their lending terms on residential mortgages in apparent response to relatively strong demands for credit and to uncertainty about prospective inflows of savings.

At this meeting, in conjunction with its discussion of the economic situation and outlook, the Committee reviewed its longer-run ranges for growth of the monetary aggregates. The Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act) requires the Board of Governors to transmit to the Congress by February 20 and July 20 of each year written reports concerning the objectives and plans of the Board and the Committee

with respect to the ranges of growth or diminution of the monetary and credit aggregates for the calendar year during which the report is transmitted and, in the case of the July report, the objectives and plans with respect to ranges for the following calendar year as well. Accordingly, the Committee reviewed the ranges for the period from the fourth quarter of 1978 to the fourth quarter of 1979 that it had established at its meeting on February 6, 1979, and for the first time considered preliminary ranges for the period from the fourth quarter of 1979 to the fourth quarter of 1980.^{1/}

At its meeting on February 6 the Committee had specified ranges of 1-1/2 to 4-1/2 percent for M-1, 5 to 8 percent for M-2, and 6 to 9 percent for M-3. The associated range for commercial bank credit was 7-1/2 to 10-1/2 percent. The range for M-1 had been established on the assumption that shifts in funds from demand deposits to savings accounts with automatic transfer facilities and to NOW accounts would dampen growth of measured M-1 by about 3 percentage points.

With respect to the economic situation and outlook, no member of the Committee expressed disagreement with the staff appraisal that real gross national product had declined somewhat in the second quarter and that further declines were likely for the remaining two quarters of the year. The suggestion was made that the recession was most likely to be mild and

^{1/} The act also requires that the written reports set forth a review and analysis of recent developments affecting economic trends in the nation and the relationship of the plans and objectives for the aggregates to the short-term goals set forth in the most recent Economic Report of the President and to any short-term goals approved by the Congress. The Board's second report under the act was transmitted to the Congress on July 17, 1979.

short-lived. However, it could prove to be more severe than currently expected because the recent increases in prices of energy items and inflation generally were reducing disposable income and eroding the financial position of the household sector. Another reason advanced for thinking that the recession could be more severe was the possibility that the downturn in economic activity would become widespread among industrial countries.

Members continued to express great concern about inflation. It was suggested that the unexpectedly large increases in OPEC oil prices in late June had seriously harmed the government's anti-inflation efforts. Thus, winding down the rate of increase in prices might well take considerably longer than had been thought earlier and would be more costly in terms of its impact on output, employment, and real income. In that connection it was noted that time would be required to implement the new policies with respect to energy that the President was expected to announce within a few days. On the other hand, the public's perception of the urgency of the problem had increased, leading to a growing awareness that in the short run some loss of real income would have to be accepted for the sake of reestablishing growth in real income over the longer term.

In reviewing ranges for the monetary aggregates for the current year and contemplating ranges for 1980, the Committee continued to face unusual uncertainties concerning the forces affecting monetary growth. A staff analysis had suggested that shifts in funds from demand deposits to savings accounts with automatic transfer services and to NOW accounts had retarded the annual rate of growth of M-1 by the assumed amount of about

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3 percentage points in the first quarter of 1979 but by only about 1-1/2 percentage points in the second quarter; thus, from the fourth quarter of 1978 to the second quarter of 1979, the dampening effects of ATS and NOW accounts on growth of M-1 averaged about 2-1/4 percentage points. The outlook for the effects of these accounts on growth of M-1 was clouded, moreover, by a federal court decision handed down in April barring ATS and certain other payments services as of January 1, 1980, and by the possibility of further judicial review and of legislation concerning such services.

The demand for M-1 was unusually weak in the first quarter of 1979, even after allowance for the effects of the growth of ATS and NOW accounts, but money demand appeared to strengthen in the second quarter. Still, at an annual rate of about 2-3/4 percent from the fourth quarter of 1978 to the second quarter of 1979, growth of M-1 was just below the midpoint of the longer-run range established by the Committee in February, as the high level of interest rates reached in late 1978 and the continued tautness of markets in 1979 prompted the public to economize on non-interest-earning holdings of cash. The high level of market interest rates also induced the public to divert funds from deposits subject to fixed ceiling rates into market instruments, thereby further retarding growth of M-2 and M-3 over the first two quarters of 1979; their annual rates of growth, at 5-1/4 percent and 6-1/4 percent respectively, were just above the lower limits of their ranges. As a result of these developments, growth of all three monetary aggregates, which had moderated over the four quarters of 1978 from the pace of the preceding four quarters, slowed appreciably further in the first half of 1979.

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However, growth of commercial bank credit in the first half of 1979, at a rate of 11-1/2 percent, was slightly above its range and little different from the year before.

In the Committee's discussion, most members favored ranges for both 1979 and 1980 that would represent essentially a continuation of the policy posture adopted in early February. One member advocated a more restrictive policy for the balance of the current year. Some sentiment was expressed for narrowing the ranges for the period from the fourth quarter of 1978 to the fourth quarter of 1979, because passage of half of the year had reduced uncertainty about rates of growth over the whole period.

It was suggested that the ranges for 1980 might well be slightly lower than those for 1979, in recognition of the Committee's long-standing objective to move gradually toward rates of monetary expansion consistent with general price stability. The suggestion also was made to adopt slightly higher ranges for 1980 than for 1979, in view of the decline in activity that had just begun. It was observed, however, that any increase in the ranges for 1980 would not now be timely and that the Committee would reconsider the 1980 ranges next February in the light of the information then available about economic conditions. In any event, it was recognized that the current reexamination of the definitions of the monetary aggregates, which was being undertaken in light of the major institutional changes in the payments system, might in the near future lead to a new and improved set of money stock measures.

At the conclusion of the discussion, the Committee decided to retain the ranges for 1979 that it had established in February. Thus, for the period

from the fourth quarter of 1978 to the fourth quarter of 1979, the Committee reaffirmed ranges of 1-1/2 to 4-1/2 percent for M-1, 5 to 8 percent for M-2, and 6 to 9 percent for M-3. The associated range for commercial bank credit remained 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 in M-1 might vary in relation to its range to the extent of any deviation from that estimate. The Committee anticipated that for the period from the fourth quarter of 1979 to the fourth quarter of 1980, growth might be within the same ranges, depending upon emerging economic conditions and appropriate adjustments that might be required by legislation or judicial developments affecting interest-bearing transactions accounts.

It was understood that the longer-run ranges, as well as the particular aggregates for which ranges were specified, would be reconsidered at any time that conditions might warrant. It was also understood that short-run factors might cause growth rates from one month to the next to fall outside the ranges anticipated for the year.

The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the fourth quarter of 1978 to the fourth quarter of 1979: M-1, 1-1/2 to 4-1/2 percent; M-2, 5 to 8 percent; and M-3, 6 to 9 percent. Actual growth in M-1 might vary in relation to its range to the extent that the dampening effect of expansion in ATS and NOW accounts deviates from an estimate of about 3 percentage points. The associated range for bank credit is 7-1/2 to 10-1/2 percent.

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

Mr. Wallich dissented from this action because, with the Committee's objective of slowing the rate of inflation in mind, he believed that the range adopted for M-1, after allowance for the effects of ATS and NOW accounts, was too high. In his opinion, growth of the money stock, after allowance for the expansion in repurchase agreements and Eurodollars as well as for the effects of ATS and NOW accounts, had been considerably more rapid than indicated by the behavior of M-1.

The Committee agreed that for the period from the fourth quarter of 1979 to the fourth quarter of 1980, growth of M-1, M-2, and M-3, and of commercial bank credit, might be within the ranges adopted for 1979, depending upon emerging economic conditions and appropriate adjustments that may be required by legislation or judicial developments affecting interest-bearing transactions accounts.

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

In the discussion of policy for the period immediately ahead, members of the Committee in general favored directing open market operations initially toward maintaining the money market conditions currently prevailing, as indicated by a federal funds rate of about 10-1/4 percent, on the expectation that over the July-August period growth of M-1 and M-2 would be both moderate and consistent with their longer-run ranges. Some sentiment was expressed for a near-term reduction in the federal funds rate because of

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the downturn in economic activity, but it was agreed that current conditions in foreign exchange markets militated against a prompt reduction.

With respect to operations later in the period before the next regular meeting, most members thought that the objective for the federal funds rate should be moved up or down within its specified range only if growth of M-1 and M-2 appeared to be close to or beyond the upper or lower limits of their ranges. Most members favored specification of an intermeeting range of 9-3/4 to 10-1/2 percent for the federal funds rate, the same range that had been specified at the three preceding meetings. A range of 10 to 10-3/4 percent was also suggested, coupled with an instruction to the Manager to move the objective for the funds rate up within that range should the dollar come under severe downward pressure in foreign exchange markets. It was recognized, however, that the Committee could consult during the intermeeting period to consider giving additional instructions to the Desk in response to any new developments, including reactions to the President's forthcoming address on energy policy as well as to the behavior of the foreign exchange markets.

The suggestion was made that, in assessing the implications of the behavior of the aggregates for the Desk's objective for the federal funds rate, the Manager be instructed to give more weight to M-2, rather than approximately equal weight to M-1 and M-2, because of uncertainties about the interpretation of M-1. It was noted, however, that the course of M-2 was subject to considerable uncertainty because the six-month Treasury bill rate was hovering around the 9 percent trigger point that affects the

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relationship between the maximum rates that commercial banks and savings and loan associations may pay on money market certificates.

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 July-August period should be 2-1/2 to 6-1/2 percent and 6-1/2 to 10-1/2 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. 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 that real output of goods and services declined somewhat in the second quarter, as slackening in demands was intensified by reduced supplies and sharply higher prices of motor fuels. During the quarter, the dollar value of retail sales declined, and in real terms, sales in June were substantially below those of last December. Growth in nonfarm payroll employment slowed during the quarter to a pace considerably below that in the preceding six months, but the unemployment rate in June, at 5.6 percent, was somewhat lower than earlier in the year.

Industrial production recovered in May, after having declined in April in large part because of a work stoppage. Over the first half of this year, broad measures of prices increased at a much faster pace than during 1978, although producer prices of foods declined in the second quarter. The rise in the index of average hourly earnings has slowed in recent months.

Downward pressure on the dollar in foreign exchange markets emerged in mid-June after several months of strength, and since then the trade-weighted value of the dollar against major foreign currencies has declined about 3 percent. The U.S. trade deficit for April and May combined widened somewhat from the first-quarter rate.

M-1 expanded sharply in June, after having increased little in May, and M-2 and M-3 also grew rapidly. Inflows of interest-bearing deposits included in M-2 grew rapidly in June, as net flows into money market certificates at commercial banks expanded further and savings deposits increased for the first time since last September. At non-bank thrift institutions, inflows of deposits picked up from the sharply reduced pace in May. On a quarterly average basis, M-1 grew at an annual rate of about 7-1/2 percent in the second quarter, compared with a decline at a rate of about 2 percent in the first quarter; M-2 and M-3 grew at rates of about 8-1/2 percent and 7-3/4 percent respectively in the second quarter, compared with rates of about 1-3/4 percent and 4-3/4 percent in the first quarter. Market interest rates in general have declined substantially over the past several weeks, but mortgage interest rates have risen further.

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. The Committee agreed that these objectives would be furthered by growth of M-1, M-2, and M-3 from the fourth quarter of 1978 to the fourth quarter of 1979 within ranges of 1-1/2 to 4-1/2 percent, 5 to 8 percent, and 6 to 9 percent respectively, the same ranges that had been established in February. Having established the range for M-1 in February on the assumption that expansion of ATS and NOW accounts would dampen growth by about 3 percentage points over the year, the Committee also agreed that actual growth in M-1 might vary in relation to its range to the extent of

any deviation from that estimate. The associated range for bank credit is 7-1/2 to 10-1/2 percent. The Committee anticipates that for the period from the fourth quarter of 1979 to the fourth quarter of 1980, growth may be within the same ranges, depending upon emerging economic conditions and appropriate adjustments that may be required by legislation or judicial developments affecting interest-bearing transactions accounts. These ranges will be reconsidered at any time as conditions warrant.

In the short run, the Committee seeks to achieve bank reserve and money market conditions that are broadly consistent with the longer-run ranges for monetary aggregates cited above, while giving due regard to 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 July-August period of M-1 and M-2 and the following ranges of tolerance: 2-1/2 to 6-1/2 percent for M-1 and 6-1/2 to 10-1/2 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, Balles, Black, Coldwell,
Kimbrel, Mayo, Partee, Rice, Mrs. Teeters,
and Mr. Wallich. Votes against this action:
None.

About a week after the meeting, on July 19, projections suggested that over the July-August period M-1 would grow at an annual rate moderately above the upper limit of the range of 2-1/2 to 6-1/2 percent that had been specified by the Committee and that M-2 would grow at a rate about equal to the upper limit of its range of 6-1/2 to 10-1/2 percent; in those circumstances, the Manager began to aim for a weekly average federal funds rate at about the 10-1/2 percent upper limit of its range. On July 27, with the projections suggesting that growth of both M-1 and M-2 over the July-August period would exceed the upper limits of their ranges and with the objective for the federal funds rate at the upper limit of its range, the Committee voted to modify the directive adopted at the meeting on July 11. Specifically, the Committee raised the upper limit of the intermeeting range for the federal funds rate to 10-3/4 percent and instructed the Manager to aim for a rate within a range of 10-1/2 to 10-3/4 percent, depending on subsequent behavior of the monetary aggregates, on conditions in foreign exchange markets, and on the current Treasury financing.

On July 27, the Committee modified the domestic policy directive adopted at its meeting on July 11, 1979, by raising the upper limit of the intermeeting range for the federal funds rate to 10-3/4 percent and by instructing the Manager to aim for a weekly average rate within a range of 10-1/2 to 10-3/4 percent, depending on subsequent projections of growth of M-1 and M-2 over the July-August period, on conditions in foreign exchange markets, and on the current Treasury financing.

Votes for this action: Messrs. Miller, Volcker, Black, Coldwell, Partee, Rice, Wallich, Guffey, Roos, and Winn. Vote against this action: Mrs. Teeters. Absent: Messrs. Balles, Kimbrel, and Mayo. (Messrs. Guffey, Roos, and Winn voted as alternates for Messrs. Balles, Kimbrel, and Mayo respectively.)