



# 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 August 14, 1979. This record also includes policy actions taken during the period between the meeting on August 14, 1979, and the next regularly scheduled meeting held on September 18, 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 August 14, 1979

1. Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services was continuing to decline in the current quarter; according to preliminary estimates of the Commerce Department, real output had fallen at an annual rate of 3.3 percent in the second quarter. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be rising at an annual rate close to the 10-1/2 percent that had been estimated for the second quarter.

Staff projections suggested some further contraction in economic activity and then an upturn beginning in 1980. Over the year ahead the rise in average prices was projected to moderate a little. The rate of unemployment was expected to increase substantially.

The dollar value of retail sales edged up in July, but in real terms such sales were estimated to be about 5-1/2 percent below their December 1978 peak. A sizable decline in sales of new automobiles contributed substantially to the recent weakness in retail sales. At the end of July, dealers' stocks of unsold cars, particularly of the less fuel-efficient models, were exceptionally large.

Growth in nonfarm payroll employment slowed considerably further in July after having expanded at a much reduced pace during the second quarter. In manufacturing, employment declined for the fourth month in a row and the average workweek remained at the reduced level of

May and June. However, the unemployment rate, at 5.7 percent, stayed within the narrow range that has prevailed since the beginning of the year.

The index of industrial production declined 0.3 percent in June, and available data suggested a further small decline in July to a level close to that of December 1978. The weakness in June and July was dominated by reduced output of consumer durable goods, especially motor vehicles.

Manufacturers' new orders for nondefense capital goods rose moderately in June but remained below their March peak. Contract awards for commercial and industrial buildings--measured in terms of floor space--declined for the fourth consecutive month.

Housing starts rose further in June but, at an annual rate of about 1.9 million, were still moderately lower than in 1977 and 1978. Sales of both new and existing single-family homes fell substantially in June.

Producer prices of finished goods and of materials rose sharply further in July, after a much more rapid rate of increase over the first half of 1979 than during 1978. In July the increases continued to be especially pronounced in energy-related items. Prices of consumer finished foods were unchanged, after having declined in the previous three months. However, producer prices of crude foods and animal feeds, which had also declined during the second quarter, rose substantially.

In June consumer prices continued to increase rapidly. The rise in energy prices accelerated further and increases in homeownership costs remained large. The rise in food prices moderated further, however, following especially sharp increases during the early months of the year. Over the first half of 1979, consumer prices rose at an annual rate of about 13-1/4 percent, compared with 9 percent in 1978.

In July the rise in the index of average hourly earnings of private nonfarm production workers picked up to an annual rate of about 8-1/2 percent, following a marked slowing in the advance during May and June. Over the first seven months of the year the rise was at an annual rate of 7-1/2 percent compared with 8-1/2 percent during 1978. In the nonfarm business sector, the advance in total compensation per manhour moderated in the second quarter from the very rapid pace in the first quarter, which had been affected by increases in social security taxes at the beginning of the year. The rise in unit labor costs was as rapid as in the first quarter, however, as output per manhour declined significantly further.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies declined somewhat further in the second half of July, and central banks made additional net purchases of dollars. The dollar recovered subsequently, but it was still about 3-1/2 percent below its level in early June. The U.S. trade deficit widened between the first and second quarters. A sizable increase in the value of oil and other imports exceeded the rise in nonagricultural exports.

Expansion of total credit outstanding at U.S. commercial banks, which had picked up in June, moderated in July to about the April-May pace. Growth in loans also moderated in July after an acceleration in June. Banks continued to add sizable amounts to their holdings of securities, especially U.S. government obligations. Growth in commercial paper issued by nonfinancial firms exceeded the strong second-quarter pace, owing in part to large sales by foreign issuers.

The monetary aggregates--M-1, M-2, and M-3--continued to expand rapidly in July. Growth in M-1, at an annual rate of about 10 percent, was moderately lower than in June but close to the average pace during the second quarter. Inflows to commercial banks of interest-bearing deposits included in M-2 increased slightly in July. Net inflows of funds to nonbank thrift institutions moderated somewhat, despite a pickup in net issuance of money market certificates by these institutions.

At its meeting on July 11, the Committee had decided on ranges of tolerance for the annual rates of growth in M-1 and M-2 during the July-August period of 2-1/2 to 6-1/2 percent and 6-1/2 to 10-1/2 percent respectively. The Committee had agreed that early in the 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.

About a week after the meeting, on July 19, projections suggested that over the July-August period growth in M-1 would be above the upper limit of the range specified by the Committee and that growth in M-2 would about equal the upper limit of its range. 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 20 the Board of Governors announced an increase in Federal Reserve Bank discount rates from 9-1/2 to 10 percent.

On July 27, with projections suggesting that over the two-month period growth of both M-1 and M-2 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 raise the upper limit of the range for the 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. Over the remainder of the intermeeting period the funds rate averaged just under 10-3/4 percent.

Short-term market rates in general rose during the intermeeting period. In late July most banks raised their loan rate to prime business borrowers from 11-1/2 to 11-3/4 percent. In long-term debt markets, however, interest rates changed little during the period, reflecting a relatively light schedule of new corporate and municipal bond offerings and also reactions to further evidence of a weakening economy. In home mortgage markets, yields on new mortgage commitments declined slightly.

In the Committee's discussion of the economic situation and outlook, none of the members expressed disagreement with the staff appraisal that real gross national product was continuing to decline in

the current quarter. However, members expressed considerable uncertainty about the duration and extent of the decline in activity.

On the one hand, it was suggested that a substantial decline in consumer spending--generated by high consumer debt and low consumer confidence as well as by energy problems and inflation--could have a major effect on business spending for plant and equipment. Concurrent weakness in those two sectors could quickly produce an unwanted accumulation of business inventories, a cumulative curtailment in output, and a sharp rise in unemployment.

On the other hand, it was observed, certain elements in the current situation suggested that the curtailment in output could be limited to modest proportions. For example, prices of common stocks on the average had been rising, in contrast with the more usual decline associated with the onset of recession, and various measures of risk premiums in markets for debt instruments had remained low by historical standards. Moreover, growth of the monetary aggregates had strengthened in recent months after a period of weakness, whereas generally in recession growth had weakened and then remained weak.

Members continued to express great concern about inflation. It was observed that for a long period elements in the economic situation had seemed to justify expectations of a reduction in the rise in prices. Such expectations had been disappointed. Moreover, little reduction could be expected in the short run because recent increases in energy prices had not yet fully worked through the price structure. It was

noted that the decline in the rate of inflation projected for the quarters immediately ahead was small, and much smaller than that associated with the previous recession. Thus, inflation might still be at a high rate when economic activity turned up again. Inflationary expectations appeared to have worsened in the sense that, more than ever before, consumers and businessmen seemed to take the inflationary environment into account in making spending and investing decisions.

In considering policy for the period immediately ahead, Committee members focused on the problems posed by emerging recession and its potential for substantial increases in unemployment, concurrent with strong monetary growth, high actual and expected rates of inflation, and an exposed position of the dollar in foreign exchange markets pending anticipated improvement in the U.S. foreign trade and current accounts. Any policy course in these circumstances necessarily involved unusual risks: prompt pursuit of a policy aimed at moderating the effects of the curtailment in output could be perceived as exacerbating inflation and thus could have perverse effects on economic activity and employment; a policy directed toward moderating inflation and lending support to the dollar in the foreign exchange markets could risk intensifying the recession.

There was little disagreement with the proposition that for the near term modest measures should be taken to direct policy toward slowing growth of the monetary aggregates. Control of monetary growth was regarded as essential to restore expectations of a decline in the rate of inflation over a period of time. It was suggested that public confidence in the



determination to direct monetary policy toward reducing inflation would have a constructive influence on the course of long-term interest rates and on sentiment in foreign exchange markets, and it might also be an element in wage and price determinations. Should developments over the months ahead suggest the desirability of policy measures aimed at reversing the decline in output, moreover, such measures would be more effective in an environment of confidence in the government's adherence to the fundamental objective of reducing inflation.

In support of modest measures directed toward restraint, it was suggested that monetary policy recently had not been so restrictive as it might have appeared. Monetary growth since the beginning of the year had been considerably greater than that indicated by M-1, owing to rapid expansion in close substitutes for demand deposits and currency. In addition, the increase in interest rates had been less than that in expected rates of inflation.

On the other hand, it was noted that interest rates were close to historic highs. Some doubt was expressed, moreover, that further restraint could have a significant effect on inflation, particularly in view of the role of energy in the rapid rate of increase in prices recently. In the face of clear evidence of weakening in economic activity, it was observed, the need to balance the objective of containing the recession with the goal of moderating inflation called for a steady policy for the time being.

In considering policy specifications for the period immediately ahead, the Committee took note of a staff analysis suggesting that the

current growth rate of nominal GNP and other influences, including possibly a temporary accumulation of precautionary balances by the public in response to unusual uncertainties, were tending to support the demand for money. On the assumption of continuance of prevailing money market conditions, therefore, growth of both M-1 and M-2 over the August-September period most likely would be high relative to the Committee's longer-run ranges, although growth could be expected to slow substantially from the rapid rates of recent months.

At the conclusion of its discussion of policy, the Committee decided to instruct the Manager for Domestic Operations to direct open market operations initially toward an increase in the weekly average federal funds rate to about 11 percent. Subsequently, the objective for the funds rate was to be raised or lowered in an orderly fashion within a range of 10-3/4 to 11-1/4 percent, if M-1 and M-2 appeared to be growing over the August-September period at rates close to or beyond the upper or lower limits of the ranges specified for those monetary aggregates. The members decided that the two-month ranges of tolerance for the annual rates of growth in M-1 and M-2 should be 4 to 8 percent and 7 to 11 percent respectively. They 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.

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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 is continuing to decline in the current quarter, while prices on the average are continuing to rise rapidly. In July the dollar value of retail sales edged up; in real terms, sales were still substantially below those of last December. Growth in nonfarm payroll employment slowed considerably further, but the unemployment rate, at 5.7 percent, remained within the narrow range prevailing since the beginning of the year. Industrial production declined in June, and it apparently slackened further in July to about the level of last December. So far this year, broad measures of prices have increased at a much faster pace than during 1978, although producer prices of foods have declined since March. The rise in the index of average hourly earnings, which had slowed in May and June, picked up in July.

The trade-weighted value of the dollar against major foreign currencies declined somewhat further in the second half of July, and although it subsequently recovered, it remained below its level of early June. The U.S. trade deficit in the second quarter was larger than in the previous quarter, reflecting largely the significant rise in the price and value of oil imports.

Growth of M-1, M-2, and M-3 remained rapid in July. Inflows of interest-bearing deposits included in M-2 were slightly stronger than in June. At nonbank thrift institutions, inflows of deposits declined somewhat. Short-term market interest rates have risen over recent weeks, while long-term rates have changed little on balance. An increase in Federal Reserve discount rates from 9-1/2 to 10 percent was announced on July 20.

Taking account of past and prospective developments in employment, unemployment, production, investment, real income, productivity, international trade and payments, and prices, the Federal Open Market Committee seeks to foster monetary and financial conditions that will resist inflationary pressures while encouraging moderate economic expansion and contributing to a sustainable pattern of international transactions. At

its meeting on July 11, 1979, the Committee agreed that these objectives would be furthered by growth of M-1, M-2, and M-3 from the fourth quarter of 1978 to the fourth quarter of 1979 within ranges of 1-1/2 to 4-1/2 percent, 5 to 8 percent, and 6 to 9 percent respectively, the same ranges that had been established in February. 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 developing conditions in foreign exchange and domestic financial markets. Early in the period before the next regular meeting, System open market operations are to be directed at attaining a weekly average federal funds rate slightly above the current level. Subsequently, operations shall be directed at maintaining the weekly average federal funds rate within the range of 10-3/4 to 11-1/4 percent. In deciding on the specific objective for the federal funds rate the Manager for Domestic Operations shall be guided mainly by the relationship between the latest estimates of annual rates of growth in the August-September period of M-1 and M-2 and the following ranges of tolerance: 4 to 8 percent for M-1 and 7 to 11 percent for M-2. If rates of growth of M-1 and M-2, given approximately equal weight, 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 beyond the upper or lower limits 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 shall promptly notify the Chairman, who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Volcker, Balles, Coldwell, Kimbrel, Mayo, Partee, Schultz, Mrs. Teeters, Messrs. Wallich and Timlen. Votes against this action: Messrs. Black and Rice. (Mr. Timlen voted as an alternate member.)

Mr. Black dissented from this action because, in view of the rapid monetary growth in recent months, he preferred to specify lower ranges for growth of M-1 and M-2 over the August-September period in order to increase the probability of holding growth within the Committee's longer-run ranges. While he agreed that open market operations should be directed toward attaining a slight increase in the federal funds rate initially in the coming intermeeting period, he believed that the directive adopted by the Committee allowed for too rapid monetary growth before a further increase in the funds rate would be triggered.

Mr. Rice dissented from this action because he believed that an additional firming in money market conditions at this time, to restrict growth of money and credit, in the face of the evidence of weakening in economic activity would risk deepening the recession. In his view, the effort to balance the goal of reducing the rate of inflation with the objective of minimizing the impact of the recession called for a policy directed toward the maintenance of prevailing money market conditions unless growth of the monetary aggregates over the August-September period

appeared to be substantially faster or slower than the rates currently expected.

Subsequent to the meeting, in late August, incoming data indicated that M-1 and M-2 were growing at rapid rates in August. On August 30, projections for the August-September period suggested that growth of M-1 would be at an annual rate well above the upper limit of the range that had been specified by the Committee and that growth of M-2 would be at about the upper limit of its range. Over the preceding week, the Manager for Domestic Operations had been aiming for a weekly average federal funds rate approaching the 11-1/4 percent upper limit of its specified range, and in the statement week ending August 29, the rate averaged 11.16 percent. In these circumstances, Chairman Volcker recommended that the upper limit of the range for the funds rate be raised to 11-1/2 percent, but with the understanding that not all of the additional leeway would be used immediately; use of the leeway would depend on subsequent behavior of the monetary aggregates and on developments in foreign exchange markets. The Committee voted to amend the domestic policy directive in accordance with the Chairman's recommendation.

On August 30, 1979, the Committee modified the domestic policy directive adopted at its meeting on August 14 by raising the upper limit of the intermeeting range for the federal funds rate to 11-1/2 percent and by instructing the Manager for Domestic Operations not to raise the objective for the weekly average funds rate to the new upper limit immediately but to be guided by the subsequent behavior of the monetary aggregates and by developments in foreign exchange markets.

Votes for this action: Messrs. Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Schultz, Mrs. Teeters, Messrs. Wallich and Timlen. Vote against this action: Mr. Rice. (Mr. Timlen voted as an alternate member.)

## 2. Authorization for Foreign Currency Operations

The Committee approved an increase from \$360 million to \$700 million in the System's swap arrangement with the Bank of Mexico and the corresponding amendment to paragraph 2 of the authorization for foreign currency operations, effective August 17, 1979. With this change paragraph 2 read as follows:

The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

<u>Foreign bank</u>	<u>Amount of arrangement (millions of dollars equivalent)</u>
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico	700
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	4,000
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

Votes for this action: Messrs. Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Rice, Schultz, Mrs. Teeters, Messrs. Wallich and Timlen. Votes against this action: None. (Mr. Timlen voted as an alternate member.)

This action was taken in light of the increase in recent years in the scale of economic and financial transactions between the United States and Mexico.

### 3. Authorization for Domestic Open Market Operations

At this meeting the Committee amended paragraph 2 of the authorization for domestic open market operations, effective immediately, to take account of amendments to the Federal Reserve Act enacted in June 1979. The amendments extended for two years the authority for lending to the Treasury through direct purchases of securities, under more restrictive conditions than formerly, and for the first time provided for an alternative means of assisting the Treasury in meeting short-term cash needs in more routine circumstances.

Specifically, the legislation provided authority for the System to purchase securities directly from the Treasury in unusual and exigent circumstances, for renewable periods not to exceed thirty days, when authorized by the Board of Governors pursuant to an affirmative vote of not less than five members. The legislation also provided authority for the System, subject to the approval and rules and regulations of the Federal Open Market Committee, to lend securities to the Treasury for sale in the open market. The Treasury would be required to repurchase the securities and return them to the System not later than six months after the date of



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sale. The total amount of securities loaned to and purchased directly from the Treasury at any one time may not exceed \$5 billion.

As amended, paragraph 2 read as follows:

The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (or, under special circumstances, such as when the New York Reserve Bank is closed, any other Federal Reserve Bank) (a) to lend to the Treasury such amounts of securities held in the System Open Market Account as may be necessary from time to time for the temporary accommodation of the Treasury, under such conditions as the Committee may specify; and (b) to purchase directly from the Treasury for renewable periods not to exceed thirty days, when authorized by the Board of Governors of the Federal Reserve System pursuant to an affirmative vote of not less than five members, for its own account (with discretion, in cases where it seems desirable, to issue participations to one or more Federal Reserve Banks) such amounts of special short-term certificates of indebtedness as may be necessary from time to time for the temporary accommodation of the Treasury, provided that the rate charged on such certificates shall be a rate of 1/4 of 1 percent below the discount rate of the Federal Reserve Bank of New York at the time of such purchases and provided that the total amount of such certificates held at any one time by the Federal Reserve Banks shall not exceed \$2 billion.

Votes for this action: Messrs. Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Rice, Schultz, Mrs. Teeters, Messrs. Wallich and Timlen. Votes against this action: None. (Mr. Timlen voted as an alternate member.)