

FEDERAL RESERVE press release



For Use at 4:10 p.m.

January 11, 1980

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 November 20, 1979.

Such records for each meeting of the Committee are made available generally a few days after the next 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 November 20, 1979

1. Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services was falling in the current quarter following a stronger rebound in the third quarter than had been anticipated at the time of the Committee's meeting on October 6. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be rising at a pace close to the annual rate of 10 percent in the first three quarters of the year.

Staff projections suggested a further contraction in economic activity during the first half of 1980 and an upturn later in the year. The rise in average prices was projected to moderate slightly as the year progressed, and the rate of unemployment was expected to increase substantially.

Retail sales fell considerably in October, after having expanded rapidly during the third quarter in both constant and current dollars. Sales of new automobiles fell sharply in October and weakened further in early November.

The index of industrial production changed little in October and remained near its midyear level. Nonfarm payroll employment rose substantially after three months of limited gains, but the rate of unemployment edged up to 6.0 percent.

Private housing starts declined in October to an annual rate of 1.76 million units, compared with an average rate of 1.83 million units in both the second and third quarters, and building permits for new housing units fell appreciably. Sales of new and existing single-family homes were at a relatively high level in September, but available information suggested lower combined sales in October.

Producer prices continued to rise at a rapid rate in October, reflecting further sharp advances in energy items and the spreading impact on costs of earlier increases in energy prices. In September consumer prices also continued to move up rapidly, with the most pronounced increases concentrated in the energy, food, homeownership, and apparel components.

In October the rise in the index of average hourly earnings of private nonfarm production workers moderated to an annual rate of about 3-1/2 percent, but over the first 10 months of the year the advance was close to the rapid pace of 1978. Labor cost pressures in the nonfarm business sector had remained intense in the third quarter, reflecting a sharp increase in total hourly compensation and virtually no improvement in productivity.

On October 6 the Federal Reserve announced a series of complementary actions directed toward assuring better control over the expansion of money and bank credit and toward curbing speculative excesses in commodity and financial markets, including foreign exchange markets. The actions included an increase in Federal Reserve Bank discount rates from

11 percent to 12 percent; establishment of a marginal reserve requirement of 8 percent on increases in certain managed liabilities of member banks, Edge corporations, and U.S. agencies and branches of foreign banks; and a shift in the conduct of open market operations to an approach placing greater emphasis in day-to-day operations on the supply of bank reserves and less emphasis on confining short-term fluctuations in the federal funds rate.

At its meeting on October 6, the Committee had decided that over the remainder of 1979 the Manager for Domestic Operations should place primary emphasis on restraining expansion of bank reserves in pursuit of the objective of decelerating growth of M-1, M-2, and M-3 to rates that would hold growth of these monetary aggregates from the fourth quarter of 1978 to the fourth quarter of 1979 within the Committee's ranges for that period. Specifically, the Committee instructed the Manager to restrain expansion of bank reserves to a pace consistent with growth from September to December at an annual rate on the order of 4-1/2 percent in M-1 and 7-1/2 percent in M-2 and M-3, provided that in the period before the next regular meeting the weekly average federal funds rate remained generally within a range of 11-1/2 to 15-1/2 percent. Because such rates of expansion would result in growth of the monetary aggregates in the upper part of their ranges for the year, the Committee also had agreed that over the three-month period somewhat slower growth would be acceptable. The Committee had anticipated that the shift to an operating approach that placed primary emphasis on the volume of reserves

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would result in both a prompt increase and greater fluctuations in the federal funds rate.

Over the first half of October, measures of bank reserves in general grew faster than had been anticipated at the time of the meeting on October 6, both because demands for reserves were unexpectedly strong and because System operations provided more reserves than had been expected. Subsequently, System operations were directed more firmly at restraining growth of reserves. As such operations limited growth of nonborrowed reserves while demands for reserves remained strong, member bank borrowings rose to a daily average of about \$3 billion in the last two statement weeks of October and the federal funds rate rose to an average a little above 15-1/2 percent in the final week. In the first half of November, demands for reserves eased, and member bank borrowings subsided to a daily average of about \$2 billion and the federal funds rate declined to an average of about 13-1/2 percent.

From September to the first half of November, total member bank reserves expanded at an annual rate of about 11-1/2 percent, slightly faster than over the three months from June to September. However, expansion of the monetary base and of nonborrowed reserves slowed sharply over the period from September to the first half of November, to annual rates of about 8 percent and 2-1/4 percent respectively.

Growth of M-1, which had accelerated in September and had been exceptionally rapid in the third quarter as a whole, slowed to an

annual rate of 2-1/2 percent in October. Growth of M-2 slowed less than that of M-1, to a rate of about 8-1/2 percent in October, as overall expansion in the interest-bearing components remained strong. A marked rise of net flows into money market certificates and other time deposits at commercial banks, fostered by substantially higher deposit yields, offset a sharp reduction in savings deposits.

At nonbank thrift institutions, inflows into money market certificates and large-denomination time deposits also accelerated in October, but total net inflows slowed somewhat. High interest returns attracted near-record inflows into shares of money market mutual funds.

Growth in loans and investments at commercial banks moderated appreciably in October. With demand deposits and savings deposits weak or declining, however, banks increased their reliance on money market certificates and on the managed liabilities that became subject to marginal reserve requirements in the statement week beginning October 11.

Since early October interest rates had risen sharply in both short- and long-term markets and had been unusually volatile. In this period, banks had raised their loan rate to prime business borrowers from 13-1/2 percent to a new high of 15-3/4 percent. Since the latter part of October, however, short-term market rates had declined from their peaks in apparent reaction to evidence of reduced monetary growth and to some easing of pressure in the federal funds market as bank demands for reserves moderated.

In foreign exchange markets the downward pressure on the dollar that had developed in September was reversed in early October, and by the end of the month, the trade-weighted value of the dollar against major foreign currencies had risen about 3-1/2 percent. Around mid-November, however, the dollar came under renewed downward pressure and lost a portion of its October gain, in part reflecting developments relating to Iran. The U.S. trade deficit increased in September, as the cost of oil imports rose considerably further. For the third quarter as a whole the deficit was somewhat lower than that for the second quarter, however, as strong gains in agricultural and other exports more than offset the large rise in the value of petroleum imports.

In the Committee's discussion of the economic situation and outlook, the members in general agreed with the staff appraisal that the unexpectedly strong rebound in real gross national product in the third quarter would be followed by some contraction in activity and by a rise in unemployment, although uncertainty was expressed about the depth and duration of the anticipated downturn as well as about its precise timing. Some members cited the onset of the heating season with energy prices so much higher than a year earlier, the overall rate of inflation, the recent sharp rise in interest rates, and the developing stringency in some financial markets as influences that might cause the contraction to be relatively severe.

Continuation of the rapid rise in prices of goods and services remained a major concern of Committee members, some of whom thought that

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the risks were on the side of a rise greater than that currently anticipated. The prospects for supplies and prices of oil, which would have a substantial effect on the economy, were regarded as especially uncertain, in view of the political situation in Iran and of the meeting of petroleum-exporting countries scheduled to begin on December 17.

At its meeting on July 11, 1979, the Committee reaffirmed the ranges for monetary growth in 1979 that it had established in February. Thus the Committee 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. 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 of M-1 might vary in relation to its range to the extent of any deviation from that estimate. More recently, it appeared that expansion of such accounts would reduce measured growth of M-1 over the year by about 1-1/2 percentage points. After allowance for the deviation from the earlier estimate, the equivalent range for M-1 was 3 to 6 percent.

In contemplating policy for the period immediately ahead, the Committee took note of a staff analysis indicating that the behavior of the monetary aggregates since September had been reasonably consistent with the policy adopted on October 6, when the Committee had instructed the Manager to restrain expansion of bank reserves to a pace consistent

with annual rates of growth from September to December on the order of 4-1/2 percent in M-1 and 7-1/2 percent in M-2 and M-3 but had also stated that somewhat slower growth over the three-month period would be acceptable. The staff analysis noted that growth in M-1 at an average annual rate of 5-1/2 percent in November and December would be consistent with growth at an annual rate of 4-1/2 percent from September to December, although the pattern of change in recent weeks suggested that growth would be below the two-month average in November and above it in December. Growth of M-1 at those rates or even somewhat slower ones would probably be associated with more rapid growth of M-2 over the September-December period than the 7-1/2 percent rate specified in October, because time deposits at banks were continuing to grow faster in relation to demand deposits than had been expected.

In the Committee's discussion of policy for the period immediately ahead, the members indicated that in the present circumstances pursuit of the goal of restraining growth of the monetary aggregates from the fourth quarter of 1978 to the fourth quarter of 1979 within the ranges previously established for that period remained feasible and desirable; they agreed that in pursuit of that underlying goal, the broad objectives for monetary growth during the current quarter adopted at the meeting on October 6 were still appropriate. In contemplating objectives for rates of monetary growth over the weeks through the end of 1979 and into January 1980, the members differed somewhat in their views concerning the extent to which operations should be directed toward promoting acceleration in growth of M-1 from the

recently reduced rates. A few members favored operations consistent with the October 6 decision to seek a 4-1/2 percent annual rate of growth in M-1 over the September-December period. A few members favored acceptance of a significantly slower rate of growth for the quarter. Most members, however, advocated a compromise between those two prescriptions. It was recognized that, while the decision affecting such a short period would have quite minor implications for monetary growth over the year ending in the fourth quarter of 1979, it would affect credit and money market conditions in the weeks ahead and the path of monetary growth entering the new year.

Views with respect to an acceptable range of fluctuation for the federal funds rate did not vary greatly. It was agreed that the range should continue to be relatively wide, and most members indicated a preference for retaining the range of 11-1/2 to 15-1/2 percent adopted at the October 6 meeting. Some sentiment was also expressed for reducing the lower limit and some for both reducing the lower limit and raising the upper limit.

At the conclusion of the discussion, the Committee agreed that in the conduct of open market operations over the remainder of 1979, the Manager for Domestic Operations should continue to restrain expansion of bank reserves in pursuit of the Committee's objective of decelerating growth of M-1, M-2, and M-3 over the fourth quarter of 1979 to rates that would hold growth of these monetary aggregates from the fourth quarter of 1978 to the fourth quarter of 1979 within the Committee's ranges for that

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period; it was recognized that persistence of recent relationships might result in growth of M-2 at about the upper limit of its range. Specifically, the Committee instructed the Manager to restrain expansion of bank reserves to a pace thought to be consistent with growth on the average in November and December at an annual rate of about 5 percent in M-1 and 8-1/2 percent in M-2, provided that in the period before the next regular meeting the federal funds rate remained generally within a range of 11-1/2 to 15-1/2 percent.

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 declining in the current quarter, after the third-quarter rebound, and that prices on the average are continuing to rise rapidly. Retail sales, which had expanded sharply during the third quarter in both constant and current dollars, dropped in October. Industrial production remained near its midyear level. Nonfarm payroll employment rose considerably, after three months of little growth, but the unemployment rate increased from 5.8 to 6.0 percent. Producer prices of finished goods continued to rise rapidly in October, in part because of further sharp increases in energy items and the spreading effects of earlier increases in energy costs. The rise in the index of average hourly earnings during the first 10 months of the year was close to the rapid pace during 1978.

On October 6 the Federal Reserve announced a series of complementary actions directed toward assuring control over the expansion of money and bank credit and toward curbing speculative excesses in commodity and financial markets, including foreign exchange markets. The actions included an increase in Federal Reserve Bank discount rates from 11 percent to 12 percent; establishment of a marginal reserve requirement on increases in the total of managed liabilities of member banks, Edge corporations, and U.S. agencies and branches of foreign banks; and a shift in the conduct of open market operations to an approach placing greater

emphasis in day-to-day operations on the supply of bank reserves and less emphasis on confining short-term fluctuations in the federal funds rate.

Following the announcement on October 6, the downward pressure on the dollar in the exchange markets that had developed in September was reversed, and by the end of October the trade-weighted value of the dollar against major foreign currencies had risen about 3-1/2 percent. In mid-November, however, the value of the dollar declined, reflecting in part developments concerning Iran. The U.S. foreign trade deficit increased in September as the cost of oil imports rose, but the deficit was somewhat lower for the third quarter as a whole than for the second quarter.

Growth of M-1, which had accelerated in September and was exceptionally rapid in the third quarter as a whole, slowed sharply in October to an annual rate of 2-1/2 percent. Expansion of interest-bearing deposits included in M-2 remained strong, as a rise in net flows into time deposits at commercial banks in response to increased yields offset a contraction in savings deposits. Inflows of deposits at nonbank thrift institutions slowed somewhat. Flows into money market mutual funds accelerated. Growth of commercial bank credit moderated in October; nevertheless, banks increased their reliance on the negotiable, large-denomination CD's and other managed liabilities that became subject to the marginal reserve requirement in the statement week beginning October 11. Both short- and long-term market interest rates have risen sharply on balance since the early October announcement of the System's policy actions, although most recently rates have declined; mortgage interest rates have increased substantially further.

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. The range for M-1 had been established

originally on the basis of an assumption that expansion of ATS and NOW accounts would dampen growth by about 3 percentage points over the year. It now appears that expansion of such accounts will dampen growth by about 1-1/2 percentage points over the year; thus after allowance for the deviation from the earlier estimate, the equivalent range for M-1 is now 3 to 6 percent. 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 restrain expansion of reserve aggregates to a pace consistent with deceleration in growth of M-1, M-2, and M-3 in the fourth quarter of 1979 to rates that would hold growth of these monetary aggregates over the whole period from the fourth quarter of 1978 to the fourth quarter of 1979 within the Committee's longer-run ranges, provided that in the period before the next regular meeting the weekly average federal funds rate remains within a range of 11-1/2 to 15-1/2 percent.

If it appears during the period before the next meeting that the constraint on the federal funds rate is inconsistent with the objective for the expansion of reserves, the Manager for Domestic Operations is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

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.)

2. Authorization for domestic open market operations

On December 20, 1979, the Committee voted to increase from \$3 billion to \$4 billion the limit on changes between Committee meetings

in System Account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective immediately, for the period ending with the close of business on January 9, 1980.

Votes for this action: Messrs Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Rice, Schultz, Mrs. Teeters, Messrs. Wallich, and Timlen. Votes against this action: None. Absent and not voting: Mr. Volcker. (Mr. Timlen voted as an alternate member.)

This action was taken on recommendation of the Manager for Domestic Operations, System Open Market Account. The Manager had advised that since the November meeting large-scale purchases of securities primarily to counter the effects of seasonal increases in currency in circulation had reduced the leeway for further purchases to about \$500 million. It appeared likely that additional purchases would be required because projections indicated a need for further reserve-providing operations over the coming weeks.