FEDERAL RESERVE
press release

For Use at 4:00 p.m. September 24, 1976

The Board of Governors of the Federal Reserve System and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on August 17, 1976.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS
OF THE FEDERAL OPEN MARKET COMMITTEE

Meeting held on August 17, 1976

1. Domestic Policy Directive

Preliminary estimates of the Commerce Department indicated that growth in real output of goods and services had slowed to a rate of 4.4 per cent in the second quarter from the rate of 9.2 per cent to which it had accelerated in the first quarter. The preliminary estimates also indicated that the fixed-weighted price index for gross domestic business product[1/] had risen at an annual rate of 4.6 per cent in the second quarter, up from the relatively low rate of 3.7 per cent in the first quarter. Staff projections continued to suggest that real GNP would expand at a moderate pace in the current quarter and that moderate growth in output would continue well into 1977. The projections also suggested that average prices in the current quarter and in subsequent quarters would rise somewhat faster than they had during the second quarter.

1/ Gross domestic business product (GDBP) includes product originating in farm and nonfarm businesses. It excludes product originating in government, in households and non-profit institutions, and in the rest of the world (and accruing to U.S. residents).

Retail sales, which had declined in May and then rebounded in June, fell again in July and in current dollars were no higher than in March. In July sales were particularly weak at automobile outlets and at food and general merchandise stores. Sales of automobiles apparently picked up in early August, owing in part to special sales incentives provided by manufacturers.

In contrast with the recent behavior of consumer demands, business demands for plant and equipment appeared to be gaining some momentum. New orders for nondefense capital goods rose in June for the sixth consecutive month. While orders in real terms were still below the pre-recession peak in the summer of 1974, they were up substantially from the level of last December. Unfilled orders for nondefense capital goods, which had declined persistently since the summer of 1974, stabilized in May and June. In addition, contract awards for commercial and industrial buildings (measured in terms of floor space) advanced in June. More significantly, from the first to the second quarter contract awards expanded sharply to the highest level since the first quarter of 1975.

The index of industrial production increased only a little in July. As in June, output of both durable and non-durable consumer goods was about unchanged. The expansion in production of business equipment slowed more in June than had been indicated at first, and the rise continued at a reduced rate in July. Over-all output of materials increased slightly, reflecting further gains among durable goods materials. Capacity utilization in the materials-producing industries registered 81 per cent, the same as in May and June.

Over the 4-month period April through July the rise in industrial production slowed to an annual rate of about 5 per cent from a rate of about 12 per cent over the first 3 months of the year. This retardation apparently was in response to an accumulation of nondurable goods inventories beyond desired levels as well as to the easing in consumer demands. Over-all output of nondurable goods grew no further after March. Output of durable goods continued to advance, but the rise was somewhat less rapid than earlier in the year and was concentrated in production of steel and other durable goods materials.

In manufacturing, both employment (adjusted for strikes) and the average workweek continued to change little in July. However, employment gains were large in State and local government, trade, and services. In consequence, total nonfarm payroll employment rose substantially after 2 months of little change. The civilian labor force, as well as total employment, apparently increased sharply, and the unemployment rate rose further--to 7.8 per cent in July from 7.5 per cent in June. From May to July unemployment rates for adult males and for household heads rose along with the rate for females.

The employment gains in July suggested that wage and salary disbursements had risen, after having fallen in June for the first time in 16 months. In addition, a large increase in transfer payments was anticipated, owing to a cost-of-living increase of 6.4 per cent in social security payments. As a result, the expansion in total personal income--which had slowed in June--was estimated to have accelerated considerably in July.

Private housing starts were little higher in the second quarter than in the first, as had been reported at the time of the July meeting of the Committee; data for July were not yet available at the time of the August meeting. In June, the latest month for which figures were reported, total mortgage debt financed by savings and loan associations reached a new high, and their outstanding mortgage commitments were near a record level at the end of the month. The ready availability of mortgage credit was helping to keep mortgage interest rates from rising significantly even though demands for such credit were increasing.

The index of average hourly earnings for private nonfarm production workers advanced more in July than in June. Over the first 7 months of this year, however, the rise in the index was somewhat below the rapid rate of increase during 1975. In the second quarter, productivity in the private business sector of the economy continued to improve at a good pace, and the rate of increase in labor costs per unit of output remained moderate.

The wholesale price index for all commodities continued to rise at a moderate rate in July. Prices of industrial commodities, which had risen more in June than on the average during the first 4 months of the year, rose at a somewhat higher rate in July. The advance was accounted for in large part by increases in prices for three major groups of commodities: fuels and power, metals and metal products, and lumber and plywood. At the same time, average prices of farm products and foods declined, reflecting mainly decreases in prices of livestock and meats.

The consumer price index rose at an annual rate of about 6 per cent in June and also over the second quarter, compared with a rate of only 3 per cent over the first quarter and more than 7 per cent over the second half of 1975. The sharp first-quarter deceleration and the subsequent acceleration were attributable in large part to prices of foods and petroleum products: Foods advanced throughout the second quarter after having declined throughout the first, and gas and oil increased in May and June after having declined for 5 months.

Staff projections for the second half of 1976 differed little from those of 4 weeks earlier; they continued to suggest that the slackening in economic growth in recent months would prove to be temporary. It was expected that expansion in business fixed investment would accelerate and that business investment in inventories would increase further as manufacturers and distributors endeavored to maintain stocks in line with rising sales. It was anticipated that disposable personal income and personal consumption expenditures would grow at faster rates than they had in the second quarter and that residential construction activity would continue to recover. Projected growth in State and local government expenditures for goods and services was a little stronger now than a month earlier.

The U.S. foreign trade balance--which had remained in deficit in May, according to revised figures--was in still larger deficit in June, reflecting an upsurge in imports of fuels from a reduced level. In the second quarter as a whole, however, the deficit in the trade balance was slightly below that in the first quarter. Exports of agricultural products rose considerably in the latest quarter, and exports of other commodities continued their upward trend in response to further recovery in economic activity abroad. However, the gain in exports was offset by an expansion in imports of fuels, which reflected rising business activity in this country and declining domestic production of fuels. Imports of other commodities were about unchanged after having risen sharply in the first quarter.

The average value of the dollar against leading foreign currencies changed little in the interval between the July and August meetings of the Committee. On balance, the dollar remained close to the level reached in April following the rise of some 15 per cent during the previous 12 months.

Late in the inter-meeting period, a rise in the German mark, triggered by substantial orders for marks just before the month-end, revived market expectations that the relatively low rate of inflation in Germany would eventually require a revaluation of the mark. The mark's rise exerted pressure on the exchange rate margins maintained among certain European currencies; this pressure subsided in the wake of significant increases in interest rates in Belgium and the Netherlands.

Total loans and investments at U.S. commercial banks increased further during July. For the first time in many months, most of the gain in the total was accounted for by an increase in loans. Outstanding business loans rose, on a seasonally adjusted basis, and with outstanding commercial paper of nonfinancial businesses continuing to expand, total short-term business credit advanced for the third consecutive month.

Bank holdings of securities changed little during July. While holdings of U.S. Government securities declined--in contrast to the preceding 18 months when acquisitions of Treasury securities had accounted for the bulk of the expansion in total bank credit--holdings of other securities, chiefly short-term State and local government notes, increased.

The narrowly defined money stock (M_1) grew at a seasonally adjusted annual rate of nearly 7 per cent in July, after the mild contraction in June that had resulted in part from a large increase in U.S. Treasury cash balances. Much of the renewed growth in July appears to have reflected a reversal of the earlier build-up in Treasury balances. Over the first 7 months of this year the annual growth rate of M_1 averaged about 5-3/4 per cent.

Growth of M_2 and M_3 accelerated in July--to annual rates of 12.5 and 13.2 per cent, respectively--reflecting not only the rebound in M_1 but also increased flows into savings and consumer-type time deposits at commercial banks and thrift institutions. Savings accounts at commercial banks, which had held steady in June after several months of rapid growth, expanded rapidly in July. Inflows at thrift institutions, which had fallen off somewhat in June, resumed the strong growth evident over the first 5 months of the year.

The bank credit proxy expanded at a much slower rate in July, following the surge that had developed in June when banks, partly to increase deposit totals on their midyear statements, raised the outstanding amount of negotiable CD's by nearly $2.5 billion. In July banks resumed net redemptions of CD's, reducing their amounts outstanding by about $1 billion.

System open market operations since the July meeting had been guided by the Committee's decision to seek bank reserve and money market conditions consistent with moderate growth in the monetary aggregates over the period ahead. As the inter-meeting period progressed, incoming data suggested that in the July-August period growth in M_1 and M_2 would be close to the midpoints of the ranges specified by the Committee. In these circumstances, System open market operations were directed toward maintaining conditions of reserve availability consistent with a Federal funds rate of about 5-1/4 per cent--the rate prevailing at the time of the July meeting and the midpoint of the operating range that the Committee had specified for the inter-meeting period.

With the Federal funds rate holding at about 5-1/4 per cent, with money growth remaining moderate, and with other data suggesting less economic strength than had been generally anticipated, interest rates declined somewhat further during the inter-meeting period. In short-term markets these declines ranged from about 10 to 20 basis points; the market yield on 3-month Treasury bills was 5.14 per cent on the day before this meeting compared with 5.23 per cent on the day before the July meeting. In early August major commercial banks responded to the further declines in short-term market rates by cutting the rate on their prime business loans from 7-1/4 to 7 per cent.

In markets for longer-term securities, rate declines during the inter-meeting period also ranged up to nearly 20 basis points. Investor demand was strong for the new securities offered in the Treasury's large mid-August refinancing. Three new Treasury issues were involved: $2 billion of a 3-year note, auctioned on August 3 to yield 6.91 per cent; $1 billion of a 25-year bond, auctioned on August 6 to yield 8.01 per cent; and $4 billion--or more, at the discretion of the Treasury--of an 8 per cent, 10-year note, sold at par on subscriptions accepted through August 4. Subscriptions for the 10-year note were heavy, and the Treasury announced that it had made allotments totaling $7.6 billion. Accordingly, new cash raised in the refinancing amounted to $6.1 billion, instead of the $2.5 billion originally announced. Even so, prices of the new Treasury securities--particularly the two longer-term issues--rose to a premium in the secondary market. Prices also rose in the markets for corporate and municipal bonds. The volume of new debt offerings in those markets declined about seasonally in July and was expected to remain relatively modest in August.

The unexpectedly large sale of 10-year notes by the Treasury boosted its net cash borrowing in July and the first half of August to $11.5 billion. As a result, Treasury cash needs for the remainder of the third quarter were expected to be covered with no difficulty.

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

In the discussion of current policy at this meeting, it was brought out that the accelerated expansion in M_1 since early this year, taken in conjunction with the reduced rate of growth in nominal GNP and with relatively little change in interest rates, could indicate that the downward shift in the demand for money that was so evident in the latter part of 1975 was proceeding much more slowly. It was also suggested that M_1 and M_2 might grow at moderate rates over the August-September period, although wide fluctuations in Treasury deposits could have an impact on the rate of monetary growth from month to month. With respect to M_2, inflows to banks of time and savings deposits other than money market CD's might be temporarily restrained in August by payments for the new 8 per cent, 10-year note sold by the Treasury.

It was anticipated that demands in credit markets would be modest in the weeks ahead. The monthly volume of corporate and of State and local government bonds offered to the public in the August-September period was expected to be well below the average in the first 6 months of this year. However, dealers in Government securities held a large volume of U.S. Government and Federal agency issues that had yet to be distributed to ultimate holders.

During the Committee's discussion at this meeting no member expressed substantial disagreement with the staff projection of moderate growth in real GNP, although several members did stress the elements of weakness that had developed in the past few months. It was felt that uncertainty about the precise course of economic developments had increased, and a few members who earlier had viewed the outlook as somewhat stronger than suggested by the staff projections no longer did so. One member who had been concerned about the possibility of a boom during the next 12 months--with attendant shortages, bottlenecks, and intensified upward price pressures--now regarded that as unlikely.

While agreeing that moderate growth in the economy was the most likely outcome, a few members suggested that one could place more emphasis on the elements of current and potential weakness in the situation. With respect to consumer demands, for example, one could note that retail sales of automobiles had been stimulated to a degree by extension of maturities on instalment credit, which could not be counted on as a continuing stimulus; that sales of other consumer goods had not been especially buoyant; and that the rapid rise in prices of various consumer services might be dampening growth in sales of goods.

It was also noted that questions could be raised about the outlook for residential construction, for purchases of goods and services by State and local governments, and for business fixed investment. With respect to the last, while the expansion in new orders for nondefense capital goods was promising, one member noted that it did not seem to be confirmed by reports from machine tool producers. Moreover, one member observed that business attitudes toward both fixed and inventory investment might be more conservative in this expansion than in the past because of the severe impact of the preceding recession on many businessmen who had forgotten about the business cycle.

It was repeatedly pointed out, however, that the current lull in the expansion had not lasted long enough to suggest that a decline in economic activity was imminent. In this connection it was stressed that detailed studies of business cycles in the United States and other industrial countries had revealed that the expansion phase was frequently characterized by retardation in growth of activity or even a brief minor decline at some time during its second year. Afterwards growth accelerated again. In large part, those subcyclical movements reflected minor and transitory inventory adjustments. The notion that a business cycle expansion is a continuous upward movement at a constant or gradually diminishing rate does not conform to experience.

In general, Committee members felt that the pace of expansion in over-all economic activity would soon pick up again. Business fixed investment was seen to be recovering, even if at a slower pace than had been anticipated. It was noted that, in addition to the rise in new orders for nondefense capital goods over the first 6 months of the year, the physical volume of contracts for commercial and industrial buildings was increasing for the first time in this business expansion, and that construction of pipelines, power plants, and refineries for some time had been an expansive force. Moreover, corporate profits had experienced a considerable recovery. It was observed that business confidence had been badly shaken by the severity of the recession--especially because many businessmen had come to believe that fluctuations in business activity could be prevented or at least minimized--but that now confidence was gradually reviving and business fixed investment was again becoming the driving force of the economy. The caution that now existed, it was noted, assured avoidance of excesses and promised continuance of the expansion.

As to policy for the period immediately ahead, Committee members in general advocated continuation of the current stance. Most members favored directing operations toward maintaining about the current Federal funds rate. Accordingly, they preferred to give more weight than usual to money market conditions in formulating the operating instructions contained in the last paragraph of the domestic policy directive, and they advocated specifying a relatively narrow range for the Federal funds rate centered on the prevailing rate of 5-1/4 per cent. A range of 5 to 5-1/2 per cent was suggested.

Some members preferred to specify a somewhat wider range for the Federal funds rate and to continue to base operating decisions in the period immediately ahead primarily on the behavior of the monetary aggregates. However, the range they favored--4-3/4 to 5-3/4 per cent--also was centered on the prevailing rate of 5-1/4 per cent.

One or two members indicated that, whereas a case might be made for a slight easing in money market conditions in reaction to the elements of weakness in the business expansion, they were not prepared to urge that case. A number of reasons were advanced by various members against such a course at this time: Liquidity already was ample to finance a good rate of expansion; the degree of easing that was being contemplated was too slight to have a beneficial effect in the short run, and the pace of expansion in activity probably would have picked up long before the easing would have had much effect; and any easing at this time might be misinterpreted--perhaps increasing rather than allaying uncertainties and making business attitudes still more cautious.

There was near unanimity in the preferences expressed for ranges of growth in the monetary aggregates over the August-September period. The members favored a 2-month range of 4 to 8 per cent for M_1 and either 7-1/2 to 11-1/2 or 7 to 11 per cent for M_2.

At the conclusion of the discussion the Committee decided to seek to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appeared to be growing at about the rates now expected. Specifically, the Committee concluded that growth in M_1 and M_2 over the August-September period at annual rates within ranges of 4 to 8 per cent and 7-1/2 to 11-1/2 per cent, respectively, would be appropriate. As at other recent meetings, the Committee decided that, in assessing the behavior of the aggregates, approximately equal weight should be given to M_1 and M_2.

It was agreed that System operations until the next meeting would be directed toward maintaining the weekly average Federal funds rate at about its current level of 5-1/4 per cent. The members also agreed that, if growth in the aggregates should appear to be deviating significantly from the rates expected, the weekly average Federal funds rate might be expected to vary in an orderly fashion within a range of 5 to 5-1/2 per cent. As customary, it was understood that the Chairman might call upon the Committee to consider the need for supplementary instructions before the next scheduled meeting if significant inconsistencies appeared to be developing among the Committee's various objectives.

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

> The information reviewed at this meeting suggests that growth in real output of goods and services is remaining moderate in the current quarter. In July industrial production changed little, but total employment expanded by a substantial amount. The civilian labor force also increased sharply, and the unemployment rate rose from 7.5 to 7.8 per cent. Retail sales declined in July, following the rebound in June. The rise in the wholesale price index for all commodities remained moderate, as average prices of farm products and foods declined. However, average prices of industrial commodities rose more than in other recent months. So far this year the advance in the index of average wage rates has been somewhat below the rapid rate of increase during 1975.

The average value of the dollar against leading foreign currencies has remained relatively steady in recent weeks, despite some disturbances in exchange markets for European currencies. In June the U.S. foreign trade deficit increased, but the deficit for the second quarter as a whole was somewhat smaller than that for the first quarter.

M_1, which had declined slightly in June, expanded appreciably in July. Inflows of the time and savings deposits included in the broader aggregates were considerably stronger than in June, and growth in M_2 and M_3 was rapid. Market interest rates have declined somewhat further in recent weeks.

In light of the foregoing developments, it is the policy of the Federal Open Market Committee to foster financial conditions that will encourage continued economic expansion, while resisting inflationary pressures and contributing to a sustainable pattern of international transactions.

To implement this policy, while taking account of developments in domestic and international financial markets, the Committee seeks to maintain prevailing bank reserve and money market conditions over the period immediately ahead, provided that monetary aggregates appear to be growing at about the rates currently expected.

Votes for this action: Messrs. Burns, Volcker, Black, Coldwell, Gardner Jackson, Kimbrel, Lilly, Partee, Wallich, Winn, and Guffey. Absent and not voting: Mr. Balles. (Mr. Guffey voted as alternate for Mr. Balles.)

2. <u>Open Market Operations in Federal Agency Issues</u>

At this meeting the Committee reviewed its current practices with regard to System operations in Federal agency issues. In the discussion it was noted that operations in such securities had proved to be useful in achieving the Committee's reserve objectives. At the conclusion of the discussion, the members agreed to continue the System's participation in the markets for the securities of the various agencies.