FEDERAL RESERVE

press release

For Use at 4:00 p.m. April 22, 1977

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 March 15, 1977.

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 March 15, 1977

1. Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the first quarter of 1977 had increased from the pace in the fourth quarter of 1976--now indicated by revised estimates of the Commerce Department to have been at an annual rate of 2.4 per cent, compared with 3.9 per cent in the third quarter and 4.5 per cent in the second. The rise in average prices--as measured by the fixed-weighted index for gross domestic business product--appeared to have been faster than the annual rate of 4.9 per cent estimated for the fourth quarter of last year, in part because of the adverse effects of severe winter weather on prices of foods.

Staff projections suggested that real GNP would grow at a considerably better rate in the current quarter than had appeared likely a month earlier. The rate of inventory investment--which had fallen sharply in the fourth quarter of 1976, according to the revised estimates--was now expected to increase, whereas a month earlier it had been projected to decline further. Moreover, the gain in business fixed investment was now anticipated to be larger. On the other hand, the new projections suggested less growth in residential construction and in government purchases of goods and services.

The staff projections for subsequent quarters, like those of a month earlier, incorporated assumptions that rebates of Federal income taxes and one-time payments to recipients of social security would be disbursed in the second quarter; that both personal income taxes and corporate taxes would be reduced; and that Federal spending for job-creating programs would be expanded. Reflecting these assumptions as well as expectations of continuing recovery from the effects of the severe weather, real GNP was projected to grow at a rapid rate in the second quarter and at a more moderate--but still rather substantial--pace in succeeding quarters. It was expected that the fixed-weighted price index for gross business product would rise less rapidly than in the first quarter.

During February economic activity rebounded following the disruptions caused by the severe winter weather and shortages of natural gas. The index of industrial production for the month as a whole rose 1 per cent and recovered to about the December level--reflecting widespread gains among consumer goods, business equipment, and industrial materials.

Retail sales also rebounded in February, recovering almost to the advanced level reached in December. The number of new automobiles sold was at an annual rate of about 10-3/4 million, compared with 10-1/2 million in January and about 11 million in December; during those 3 months sales were higher than for any other 3-month period in the current business expansion.

Payroll employment in nonfarm establishments expanded considerably further in February, even though plant shutdowns and energy-related layoffs were still numerous in the week ending February 12--the reference week in the month for the labor market surveys. Increases in employment were reported by three-fifths of the industries in the establishment survey. Employment in manufacturing was unchanged, after having expanded appreciably over the month ending in early January, but the average workweek increased much more than it had declined in

January. In the household survey, the unemployment rate rose from 7.3 to 7.5 per cent, as the civilian labor force more than recovered its decrease in January; however, the rate remained below the 7.8 per cent of December.

Personal income increased little in January, following 3 months of sizable gains. The slowing of growth was attributable to three main causes: a weather-related loss of wages and salaries; a drop in disbursements of corporate dividends from an unusually large December volume; and an increase in deductions for social security taxes levied on employees. For February, the labor market surveys and other information suggested a strong gain in over-all personal income.

Indicators of residential construction had been strong in the closing months of 1976, but activity was curtailed in January by the severe weather, especially in the Northeast and North Central regions of the country. In January private housing starts were more than one-fifth below the advanced average for the fourth quarter, and according to estimates of the Bureau of the Census, residential construction outlays were nearly one-tenth below the December level. At the same time, however, sales of new and existing houses remained strong, mortgage commitments outstanding at savings and loan associations at the end of January were close to the record high level of a month earlier, and through the end of 1976 rental markets continued to tighten in most areas.

Businesses were planning to spend 11.7 per cent more for plant and equipment in 1977 than in 1976--according to the latest Department of Commerce survey, conducted in late January and early February. The Department's first survey for 1977, conducted in December, had suggested a rise of 11.3 per cent. Current indicators suggested improvement in business demands for fixed capital. New orders for nondefense capital goods rose substantially more in December than had been estimated earlier, and a further modest increase was reported for January. Contract awards for commercial and industrial buildings--measured in terms of floor space--declined somewhat in January, but they were still slightly above the monthly average for the fourth quarter of 1976.

The index of average hourly earnings for private nonfarm production workers was essentially unchanged in February, after having risen sharply in January. Over the first 2 months of 1977, the index advanced at an annual rate of about 5-3/4 per cent, compared with a rise of about 7 per cent over the 12 months of 1976.

The wholesale price index for all commodities rose 0.9 per cent in February, compared with an average increase of about 0.6 per cent in the preceding 5 months. Average prices of farm products and foods rose sharply in February, in part because of the effects of the cold weather on supplies of fresh fruits and vegetables and of drought on prospective supplies of grains and cotton. The price index for industrial commodities continued upward at about the average pace of recent months, reflecting mainly a sizable increase in the index for fuels and power following decreases in the preceding 2 months. The advance was especially large for natural gas; because of a 2-month lag in reporting natural gas prices, the February index reflected increases that had been effected last December.

The consumer price index rose 0.8 per cent in January, compared with 0.4 per cent in December and also with 0.4 per cent on the average during the second half of 1976. Retail prices of foods rose substantially, even though the prices in the index were recorded early in January and did not show in full the effects of the bad weather. Among nonfood items, increases were reported for used automobiles, fuel oil, medical care services, property taxes, and water and sewage rates.

The average value of the U.S. dollar against leading foreign currencies, on a trade-weighted basis, changed little over the period between the February and March meetings of the Committee, continuing the relative stability that dated from April 1976. In the latest 4-week period it appreciated against the Canadian dollar, the Italian lira, and the Swiss franc and depreciated against the Japanese yen and the currencies associated in the European "snake" arrangement.

The U.S. foreign trade deficit increased further in January to a record rate. Exports declined a little from the rate in the fourth quarter of 1976 because shipments of coal and perhaps of other commodities were slowed by the weather, and exports of wheat were reduced by expectations of ample supplies; exports of other agricultural commodities expanded.

Imports were up substantially from the fourth-quarter rate, reflecting increases for iron and steel products and a number of finished industrial products. Imports of foods also expanded, owing to price increases for coffee and cocoa.

Total credit at U.S. commercial banks rose more in February than in any other month since the summer of 1974. Acquisitions of U.S. Treasury securities were especially large, holdings of other securities rose somewhat for the first time since November, and total loans continued to expand.

Business demands for short-term credit strengthened further in February, both at banks and in the commercial paper market, but business financing in the capital market slowed. Over the January-February period the combined total of business loans at banks (excluding bankers acceptances) and the outstanding volume of commercial paper issued by nonfinancial corporations expanded at an annual rate of about 16-1/2 per cent, compared with a rate of 7 per cent in the fourth quarter of 1976 and a small decline over the preceding three quarters. In the most recent period, business demands for short-term credit may have been swelled temporarily by the weather-induced disruptions to production and distribution and by "bridge" financing associated with advance refundings of some high-yielding issues of corporate bonds.

Growth in the narrowly defined money stock (M-1) slowed sharply to an annual rate of a little less than 1 per cent in February from the revised rate of about 5-1/2 per cent in January. Nevertheless, M-1 had grown at an annual rate of about 5 per cent over the latest 6 months and by about 5-3/4 per cent over the past year.

Expansion in M-2 and M-3 also slowed sharply in February--to annual rates of about 6-1/2 and 8-3/4 per cent, respectively, from rates of about 9-1/4 and 11-1/4 per cent in January. In addition to the weakness of growth in M-1, flows into savings and small-denomination time deposits at both banks and nonbank thrift institutions continued to moderate. Over the 6 months ending in February, M-2 and M-3 grew at annual rates of about 11 and 13 per cent, respectively.

The continuing slowdown in growth of savings and small-denomination time deposits at banks and other thrift institutions was attributable in part to reductions in interest rates offered on these deposits by some institutions and to the firming of market interest rates after the turn of the year. In addition, deposit inflows may have been adversely affected by the weather-related reductions in wage and salary payments and by increases in fuel bills of households.

At its February meeting the Committee had decided that growth in M-1 and M-2 over the February-March period at annual rates within ranges of 3 to 7 per cent and 6-1/2 to 10-1/2 per cent, respectively, would be appropriate, and it had judged that such growth rates were likely to be associated with a weekly-average Federal funds rate in the area of 4-5/8 to 4-3/4 per cent. The Committee also had agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4-1/4 to 5 per cent.

Throughout the interval since the February meeting, the Manager of the System Open Market Account had continued to aim for a Federal funds rate in the area of 4-5/8 to 4-3/4 per cent. In the early weeks of the interval, incoming data had suggested that growth in both M-1 and M-2 over the February-March period would be close to the midpoints of the specified ranges. Estimates of the 2-month growth rates subsequently were revised downward, but they remained reasonably well within their specified ranges.

Short-term market interest rates in general changed little during the inter-meeting period, in part because of the continued relative stability in the Federal funds rate and in part because money market participants inferred--on the basis of the behavior of the aggregates--that a near-term rise in the funds rate was unlikely. However, yields on most longer-term bonds edged higher, apparently in response to signs that economic activity was rebounding from the weather-induced slowdown more vigorously than had been anticipated, and also to greater apprehension about prospects for the rate of inflation engendered in part by the price indexes released during the period.

In February the U.S. Government borrowed $9.1 billion of new money from the public, including $7.5 billion through auctions of marketable notes and bonds. No additional market financing occurred during the first half of March, but a 2-year note auction involving $450 million of new money had been announced for later in the month. In congressional testimony Treasury officials reported a sizable downward revision in their estimate of near-term cash needs based on evidence of a continuing substantial shortfall of Federal spending from projected levels.

In the corporate bond market the volume of new securities offered publicly in February was less than half that in each of the two preceding months. Some potential issuers, particularly those with higher bond ratings, had apparently been discouraged by the January rise in bond yields. In addition, underwriters reported that some lesser-rated corporations were electing to place debt issues privately rather than publicly--an option that was apparently facilitated by the continued availability of a large supply of investible funds at life insurance companies.

Offerings of new long-term State and local government securities rose to an estimated volume of about $3 billion in February--a record for the month and about 15 per cent above the volume sold in February 1976. A significant part of this supply was attributable to the issuance of bonds in advance of refundings of issues bearing higher interest rates. To preserve the tax-exempt status of such new bonds under current Treasury regulations, many of the issuers place the proceeds in special Treasury obligations until the existing State and local issues are called. Accordingly, these financings accounted for a large proportion of the sales of nonmarketable securities by the Treasury.

Yields in secondary mortgage markets increased a little during February along with bond yields, but interest rates on new commitments for conventional home mortgages continued to edge down. Takedowns of mortgages by savings and loan associations slowed during January, probably due in part to the weather, but the volume was still relatively large.

It appeared likely that over-all credit demands would remain strong in the period immediately ahead. The forward calendars of new issues suggested that offerings of corporate bonds would rise substantially in March from the reduced level in February and that offerings of State and local government bonds would continue to be large. In addition, the Treasury was expected to raise a sizable amount of new money during the period up to the mid-April date for payment of taxes, although a significant share of the required funds was expected to be raised through short-term instruments. It appeared likely that business demands for bank credit would remain moderately strong but that the over-all expansion in outstanding business loans might be held down for a time by repayments with proceeds from capital market financings.

At its January meeting the Committee had agreed that from the fourth quarter of 1976 to the fourth 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 6-1/2 per cent; M-2, 7 to 10 per cent; and M-3, 8-1/2 to 11-1/2 per cent. The associated range for growth in the bank credit proxy was 7 to 10 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 the economic situation at this meeting, members of the Committee were in general agreement with the staff projection that real GNP would expand at a rapid rate in the second quarter of 1977 and at a more moderate, but still rather substantial, rate in subsequent quarters. However, one member expressed the opinion that the strength in the outlook derived from factors other than the expected fiscal policy measures; in his view, the stimulative effects of those measures would be largely offset over the longer run by their tendency to raise interest rates and to increase inflationary expectations. Another member reported that in some parts of the West economic prospects were viewed with pessimism as a result not only of declines in prices of some farm products and increases in farm costs but also of the severe winter and drought.

One or two members expressed the belief that the behavior of real GNP during the second half might differ somewhat from that portrayed by the staff projections: specifically, expansion might be somewhat more rapid than that projected for the third quarter but then might taper off. Another member suggested that throughout the second half of the year the pace of economic activity might be stronger than projected by the staff, reflecting a larger rise in business investment in both fixed capital and inventories, stimulated in part by growing confidence in the economic outlook. Moreover, he thought that some of the shortfall in Federal expenditures that had developed in the first 2 months of 1977 might well be made up in the months ahead.

Several members expressed concern about the recent and prospective behavior of prices. It was noted that over the past few months price increases had been relatively large for a number of commodities, and that the extent to which increases seemed to be spreading among industrial materials might well be intensifying upward pressures on prices of industrial products in general. Moreover, businessmen appeared to have become more concerned about inflation within the past month or so.

One member noted that large increases over recent months in prices for some commodities--such as coffee, cocoa, and fuels--reflected special problems having little to do with more general influences on the behavior of prices. With respect to the influence of aggregate demand, he noted that the substantial margin of unused capacity and the high rate of unemployment at this time should tend to limit the rate of increase in wage rates and in the broad measures of prices.

It was observed during the discussion that, given the longer-run ranges for growth in the monetary aggregates adopted at the January meeting, the projected rates of increase in nominal GNP implied a rise in the income velocity of money that was large for this stage of a business expansion. In that connection it was noted that significant upward pressures on interest rates might develop later in the year, particularly if prices should rise more rapidly than projected or if inflationary expectations should strengthen. On the other hand, one member remarked that, while interest rates played a role, the predominant determinant of velocity changes was the state of confidence. On the basis of his judgment that confidence was improving, he thought it was likely that the rate of increase in velocity would be quite high. Another member observed that in almost every business expansion since World War II, the rate of increase in velocity had reached a primary peak, then dropped back before reaccelerating to a secondary peak not quite so high as the first one.

As to policy for the period immediately ahead, members of the Committee did not differ greatly in their preferences for ranges of growth for the monetary aggregates over the March-April period. It was suggested that the forces that had contributed to particularly slow growth in the monetary aggregates in February might be reversed and might contribute to rapid growth in March, and that such a development should not necessarily cause concern. It was also observed that the upward momentum of economic activity in the weeks ahead would tend to expand demands for transactions balances and thus to exert some upward pressure on growth rates for the monetary aggregates. For M-1, most members favored a range of 4-1/2 to 8-1/2 per cent; some sentiment was expressed for ranges of 4 to 8 per cent and 4 to 9 per cent. For M-2, most members favored a range of 7 to 11 per cent, but some preferences were expressed for 6-1/2 to 10-1/2 per cent and 6 to 10 per cent.

The members in general favored directing initial operations during the coming inter-meeting interval toward the objective of maintaining the Federal funds rate in the area of 4-5/8 to 4-3/4 per cent. A few members suggested that the Federal funds rate should be permitted to drift up over coming weeks to 4-3/4 or 4-7/8 per cent even if the aggregates appeared to be growing at rates near the midpoints of their specified ranges, but the majority did not favor this course. The members also differed somewhat with respect to the degree of leeway that should be provided for System operations during the inter-meeting period in the event that growth in the aggregates appeared to be deviating significantly from the midpoints of the specified ranges. The largest number of members preferred to specify an inter-meeting range for the Federal funds rate of 4-1/4 to 5-1/4 per cent; a few favored retaining the range of 4-1/4 to 5 per cent that had been specified at the preceding two meetings; and some sentiment was expressed for a range of 4-1/2 to 5-1/4 per cent.

At the conclusion of the discussion the Committee decided that growth in M-1 and M-2 over the March-April period at annual rates within ranges of 4-1/2 to 8-1/2 per cent and 7 to 11 per cent, respectively, would be appropriate. It was understood that in assessing the behavior of the aggregates, the Manager should continue to give approximately equal weight to the behavior of M-1 and M-2.

In the judgment of the Committee, such growth rates of the aggregates were likely to be associated with a weekly-average Federal funds rate in the area of 4-5/8 to 4-3/4 per cent. The Committee agreed that if growth rates of the aggregates over the 2-month period appeared to be deviating significantly from the midpoints of the indicated ranges, the operational objective for the weekly-average Federal funds rate should be modified in an orderly fashion within a range of 4-1/4 to 5-1/4 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 has increased in the current quarter from the reduced pace in the fourth quarter of 1976. In February industrial output and retail sales expanded substantially after being held down for a time by the effects of unusually severe weather. Employment rose considerably further; the unemployment rate increased somewhat to 7.5 per cent--as the labor force more than recovered the decline of January--but it remained below the 7.8 per cent of December.

The wholesale price index for all commodities rose substantially in February, reflecting large increases for farm products and foods and for fuels and power. The index of average wage rates rose more moderately over the first 2 months of 1977 than it had on the average during 1976.

The average value of the dollar against leading foreign currencies has changed little over the past month. In January the U.S. foreign trade deficit increased further; exports were down a little from the fourth-quarter rate and imports were substantially higher.

Growth in M-1 slowed sharply in February from the moderate pace in January. At banks and thrift institutions, inflows of time and savings deposits other than large-denomination CD's continued to slacken. Business demands for short-term credit appear to have strengthened further in early 1977. Since mid-February short-term market interest rates have changed little on balance, but most longer-term rates have edged higher.

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

At its meeting on January 18, 1977, the Committee agreed that growth of M-1, M-2, and M-3 within ranges of 4-1/2 to 6-1/2 per cent, 7 to 10 per cent, and 8-1/2 to 11-1/2 per cent, respectively, from the fourth quarter of 1976 to the fourth quarter of 1977 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

The Committee seeks to encourage near-term rates of growth in M-1 and M-2 on a path believed to be reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, at present, it expects the annual growth rates over the March-April period to be within the ranges of 4-1/2 to 8-1/2 per cent for M-1 and 7 to 11 per cent for M-2. In the judgment of the Committee such growth rates are likely to be associated with a weekly average Federal funds rate of about 4-5/8 to 4-3/4 per cent. If, giving approximately equal weight to M-1 and M-2, it appears that growth rates over the 2-month period will deviate significantly from the midpoints of the indicated ranges, the operational objective for the Federal funds rate shall be modified in an orderly fashion within a range of 4-1/4 to 5-1/4 per cent.

If it appears during the period before the next meeting that the operating constraints specified above are proving to be significantly inconsistent, the Manager 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. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

2. Authorization for domestic open market operations

At this meeting the Committee amended, effective immediately, paragraph 1(b) of the authorization for domestic open market operations, relating to outright purchases and sales of bankers acceptances. The words "when appropriate" were added at the beginning of the paragraph and the dollar limit on holdings of bankers acceptances specified at the end of the paragraph was reduced from $1 billion to $100 million.

As amended, paragraph 1(b) read as follows:

> (b) When appropriate, to buy or sell in the open market, from or to acceptance dealers and foreign accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the account of the Federal Reserve Bank of New York at market discount rates, prime bankers acceptances with maturities of up to nine months at the time of acceptance that (1) arise out of the current shipment of goods between countries or within the United States, or (2) arise out of the storage within the United States of goods under contract of sale or expected to move into the channels of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods; provided that the aggregate amount of bankers acceptances held at any one time shall not exceed $100 million;

> Votes for this action: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against this action: None.

This action reflected a decision by the Committee that the System should permit its existing holdings of bankers acceptances to mature and that it should no longer purchase these instruments outright under ordinary circumstances. It was noted that present System holdings were in excess of the newly established limit of $100 million, but it was anticipated that maturities within the next 2 months would reduce holdings below that level. The Committee also agreed that the Federal Reserve should remain an active participant in the market for bankers acceptances by continuing to make with dealers repurchase agreements that are secured by bankers acceptances and by continuing to serve as agent in buying and selling acceptances for the accounts of foreign central banks.

In taking this action, the Committee noted that the market for bankers acceptances was well developed and efficient and no longer in need of support through Federal Reserve participation. Also, outright purchases and sales of acceptances had not been of sufficient size to contribute materially to the needed volume of open market operations in recent years. However, repurchase agreements in acceptances had been a useful tool in meeting short-term needs for bank reserves.

3. <u>Review of continuing authorizations</u>

This being the first meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1977, the Committee followed its customary practice of reviewing all of its continuing authorizations and directives. The Committee reaffirmed the paragraphs of the authorization for domestic open market operations not affected by the preceding action, the authorization for foreign currency operations, and the foreign currency directive, in the forms in which they were presently outstanding. The Committee also reaffirmed the procedural instructions with respect to proposed or ongoing operations under the foreign currency documents, and the special authorization relating to System obligations in Swiss francs, in the forms adopted effective December 28, 1976.

Votes for these actions: Messrs. Burns, Volcker, Coldwell, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Votes against these actions: None.

In reviewing the authorization for domestic open market operations, the Committee took special note of paragraph 3, which authorizes the Reserve Banks to engage in the lending of U.S. Government securities held in the System Open Market Account under such instructions as the Committee might specify from time to time. That paragraph had been added to the authorization on October 7, 1969, on the basis of a judgment by the Committee that in the existing circumstances such lending of securities was reasonably necessary to the effective conduct of open market operations and to the effectuation of open market policies, and on the understanding that the authorization would be reviewed periodically. At this meeting the Committee concurred in the judgment of the Manager that the lending activity in question remained reasonably necessary and that, accordingly, the authorization should remain in effect subject to periodic review.