FEDERAL RESERVE
press release

For Use at 4:00 p.m. July 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 June 21, 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 June 21, 1977

### Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services in the current quarter had been close to the pace in the first quarter, now indicated by revised estimates of the Commerce Department to have been at an annual rate of 6.9 per cent. The rise in average prices--as measured by the fixed-weighted price index for gross domestic business product--appeared to have been somewhat faster than the annual rate of 6.5 per cent estimated for the first quarter, owing in large part to substantial increases in prices of foods. Staff projections suggested that in the second half of 1977 and in early 1978 the rate of growth in real GNP would be fairly rapid, although significantly less so than in the first half of this year. The projections also suggested that the rate of increase in prices would moderate from that in the first half but would remain comparatively high.

In the current quarter, according to staff estimates, growth in personal consumption expenditures had slowed somewhat from the high rate in the first quarter. The expansion in business fixed investment also had moderated--from an especially rapid pace in the first quarter induced by recovery from strikes. On the other hand, residential construction activity had expanded sharply in the current quarter, after having been adversely affected in the first quarter by severe winter weather; State and local government purchases of goods and services had turned up; and business inventory investment had increased moderately further.

Staff projections for the second half of the year suggested that growth in consumption expenditures would slow somewhat further and that the pace of expansion in residential construction would moderate. At the same time, however, it was expected that increases in Federal purchases of goods and services would be substantial; that growth in State and local government purchases would be sustained at a high rate; that expansion of business investment would remain relatively strong; and that the rate of inventory accumulation would continue to increase.

In May economic activity continued to expand at a rapid pace. Industrial production rose by 1.1 per cent, following gains of 1.5 per cent and 0.8 per cent in March and April, respectively. As in other recent months, increases in output were widespread among both final products and materials; such increases were especially large for business equipment and for some durable goods materials. However, assemblies of automobiles declined slightly for the second consecutive month.

Rates of capacity utilization rose in May to about 83 per cent both for manufacturing as a whole and for the materials-producing industries. These utilization rates were significantly above those of last autumn and winter, but they remained well below the peaks in the previous business expansion when capacity constraints in a number of materials-producing industries limited growth in output and contributed to upward pressures on prices.

Private housing starts--which had risen sharply in March to an annual rate of 2.1 million--were at a rate of about 1.9 million in both April and May. At that level, starts were about 10 per cent above the average for both the first quarter of 1977 and the fourth quarter of 1976. Mortgage lending activity had remained strong in recent months. At savings and loan associations, outstanding commitments to acquire mortgage loans reached a new high in April--the latest month for which data were available--and holdings of mortgage loans increased by a record amount during the month.

Developments in labor markets continued to reflect the strength in economic activity. Payroll employment in nonfarm establishments increased by 190,000 persons in May--bringing the cumulative increase in the first 5 months of the year to almost 1.5 million, about one-third of which was in manufacturing. The unemployment rate edged down from 7.0 to 6.9 per cent. During the second half of 1976 it had fluctuated between 7.8 and 8.0 per cent.

Personal income expanded considerably less in April and May than in the preceding 2 months when increases had been especially large owing to the rebound in wage and salary payments from the weather-reduced level in January and to disbursements by the Federal Government of earned-income credits to low-income families. Wage and salary payments rose about 1 per cent in both

April and May, close to the average monthly increase for the first quarter.

Gains in employment and income continued to strengthen consumer demands. In May total retail sales increased further to a level about 3-1/4 per cent above the monthly average for the first quarter. Sales of new automobiles--at a relatively high annual rate of 11.7 million units--were unchanged from April and were moderately above the first-quarter pace. Sales of foreign models, at an annual rate of 2.6 million units in May, set a record for the third successive month. Data available for domestic models indicated an appreciable rise in sales in the first 10 days of June.

Data reflecting business commitments to spend for certain kinds of plant and equipment suggested a vigorous expansion in outlays over the near term. New orders for nondefense capital goods rose nearly 2 per cent further in April, and the average for the first 4 months of the year was about 6-1/2 per cent above the average for the last 3 months of 1976. Unfilled orders for such goods at the end of April were 3 per cent above the level at the end of 1976. Contract awards for commercial and industrial buildings--measured in terms of floor space--declined in April, but the March-April average was sharply above the averages for the first 2 months of the year and for the last 3 months of 1976.

However, the latest Commerce Department survey of business plans, taken in May, suggested that in the third and fourth quarters of the year increases in spending for plant and equipment would be small and perhaps no more than the rise in prices for such goods. The survey suggested that for 1977 as a whole, businesses would spend 12.3 per cent more than in 1976, only 0.6 of a percentage point above the year-to-year increase suggested by the survey taken in February.

The index of average hourly earnings for private nonfarm production workers--which had advanced at an annual rate of 7.6 per cent in April, according to revised data--rose at a rate of 5.7 per cent in May. Over the first quarter the index had increased at a rate of 7.4 per cent, including the effects of the January increase in the minimum wage. In addition, labor costs had been raised in the first quarter by an increase in taxes on employers for social security and unemployment insurance.

The rise in the wholesale price index slowed to 0.4 per cent in May from about 1.0 per cent in each of the preceding 3 months. Average prices for farm products declined in May while those for processed foods rose further, and the average for the two groups changed little following 3 months of large increases. In May average prices of industrial commodities also rose less than in the immediately preceding months; increases continued to be substantial for fuels and power and were larger than in the preceding months for machinery and equipment, but prices of scrap metals and some other materials either declined or rose less rapidly than earlier.

The consumer price index rose 0.8 per cent in April, and the average increase over the first 4 months of the year also was 0.8 per cent--considerably larger than the average increase during the second half of 1976. Average prices of foods jumped 1.5 per cent in April, reflecting relatively large increases in almost all categories. Over the first 4 months of the year, food prices rose 5 per cent, after having changed little on balance over the 12 months of 1976. It was reported during the course of this meeting that the consumer price index for May--which had just been released--was 0.6 per cent above the index for April.

The U.S. foreign trade deficit, which had increased sharply in each month of the first quarter, was about the same in April as in March (estimated on the international accounts basis). Over the 5 weeks between the May and June meetings of the Committee, the average value of the dollar against leading foreign currencies had changed little on balance--despite the publication in late May of the U.S. trade deficit for April, which was larger than had been expected. The impact on exchange rates of the large deficit was moderated in part by declines in interest rates abroad relative to those in the United States. On balance over the 5-week period, moreover, foreign central banks purchased dollars in the exchange markets.

At U.S. banks, growth in total credit slowed somewhat in May from the relatively rapid pace of April, but the rate was close to the average for the January-April period. The slowing of growth in May was attributable almost entirely to a drop in the expansion of business loans to less than half the high rate of April. Over the first 5 months of the year, growth in business loans (excluding bankers acceptances) was substantially faster than over the fourth quarter of 1976.

The narrowly defined money stock (M-1) increased at an annual rate of only 1.1 per cent in May, after having grown at a record rate of nearly 20 per cent in April. Typically, in recent years rapid monetary growth in one month has been followed by slow growth for a month or two. For April and May combined, growth was at an annual rate of 10.4 per cent, compared with a rate of 4.8 per cent in the first quarter.[1/]

Growth in the more broadly defined measures of money (M-2 and M-3) also slowed sharply in May--to annual rates of 4.6 and 6.9 per cent, respectively--mainly as a result of the slowing in M-1. However, inflows of the time and savings deposits included in M-2 continued to slacken in response to earlier increases in market interest rates relative to offering rates on deposits. Inflows to nonbank thrift institutions, on the other

1/ Revised measures of the monetary aggregates, reflecting new benchmark data for deposits at nonmember banks, were published on June 23, 1977. On the basis of these revised figures, the annual rate of growth in M-1 was 0.8 per cent in May; 19.4 per cent in April; and 4.2 per cent in the first quarter.

hand, remained at about the pace of recent months. Over the first 5 months of 1977, M-2 grew at an annual rate of 8.3 per cent; and M-3, at a rate of 9.6 per cent.[2/]

At its May meeting the Committee had decided that growth in M-1 and M-2 in the May-June period at annual rates within ranges of 0 to 4 per cent and 3-1/2 to 7-1/2 per cent, respectively, would be appropriate. It had judged that these growth rates were likely to be associated with a weekly-average Federal funds rate of about 5-3/8 per cent. The Committee had agreed that if growth rates in 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 5-1/4 to 5-3/4 per cent.

In the days immediately preceding the May meeting the Manager of the System Open Market Account had aimed for a Federal funds rate of around 5-1/4 per cent, and the rate

2/ Revised figures for M-2 and M-3, respectively, were 4.7 and 7.1 per cent for May, and 8.7 and 9.8 per cent for the first 5 months of 1977.

actually had fluctuated between 5-1/4 and 5-3/8 per cent. In the days just after the meeting the Manager began to implement the Committee's directive by seeking a weekly-average rate of 5-3/8 per cent for Federal funds. Throughout the inter-meeting period, incoming data suggested that over the May-June period M-1 and M-2 on the average would grow at rates well within the specified ranges. Accordingly, the Manager continued to aim for a weekly-average funds rate of about 5-3/8 per cent, and the rate remained close to that level during the period.

Short-term market rates changed little on balance over the inter-meeting period. Rates rose somewhat early in the period, but later they fell back partly in response to the steadiness of the Federal funds rate and to the indications of slow monetary growth after the April surge. In addition, demands for short-term credit by State and local governments as well as by businesses moderated, and the Treasury continued to redeem bills in its regular auctions. In late May most major banks raised their prime rate on business loans from 6-1/2 to 6-3/4 per cent, but one of these banks later cut the rate back to 6-1/2 per cent.

Bond yields declined 10 to 20 basis points over the inter-meeting period, in part because short-term rates did not rise as market participants had expected. In addition, the volume of public offerings of new corporate bonds declined in May and appeared likely to be much lower for the second quarter as a whole than for the first quarter. Moreover, the Federal budget registered a surplus during the second quarter, permitting not only a decrease in the volume of Treasury bills outstanding but also a reduction in offerings of new bonds. Offerings of new State and local government bonds rose to a record volume in May and appeared likely to be much larger for the second quarter than for the first. However, demands for tax-exempt bonds remained strong.

The volume of mortgage lending remained large in May, at commercial banks as well as at savings and loan associations. Moreover, issues of GNMA-guaranteed, mortgage-backed securities and net mortgage acquisitions by FNMA were considerably above the average for the first 4 months of the year. Average interest rates on new commitments for conventional home mortgages continued to edge higher in May, and in the secondary mortgage market, yields in FNMA commitments auctions also rose slightly further.

At its April meeting the Committee had agreed that from the first quarter of 1977 to the first quarter of 1978 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 9-1/2 per cent; and M-3, 8-1/2 to 11 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 and outlook, the suggestion was made that it was reasonable to expect growth in real GNP for a number of quarters ahead to be fairly rapid, although less rapid than in the current quarter. Members differed somewhat in the emphasis placed on the favorable versus the unfavorable elements in the outlook for prices and costs.

It was observed that the expansion in personal consumption expenditures was likely to slow--and the rate of personal saving to increase--as consumer purchases of new automobiles leveled off or declined following their large gains in recent quarters. It was also observed, however, that strength in other sectors should be sufficient to sustain over-all expansion at a reasonably good rate. Specifically, it was suggested that the outlook for State and local government purchases of goods and services had strengthened because of higher tax revenues and enlarged transfers of funds from the Federal Government resulting from recent legislation; that expansion in business fixed investment in the second half of the year was likely to be stronger than portrayed by the latest Commerce Department survey; and that, in association with the expansion in fixed investment, business inventory investment would continue to increase.

Several members reported that businessmen were disturbed by an atmosphere of uncertainty about Government policies and regulations--in particular, those affecting taxes, energy, and environmental pollution. Moreover, businessmen were reported to be deeply concerned about inflation. In contrast with earlier times, inflation was now viewed as a cause of deterioration in profits, in part because of sharp increases in wage rates and in prices of raw materials and in part because of the taxation of profits that to some degree were unreal. Such considerations were seen as retarding the expansion in business fixed investment--which so far had been slower than might have been expected on the basis of earlier business expansions. Some members observed that business confidence nevertheless has been improving and that the behavior of new orders for nondefense capital goods and of other indicators pointed to continuing expansion in outlays for plant and equipment.

It was also suggested that confidence has been enhanced by System policies--specifically, by the promptness with which open market operations during the period between the April and May meetings responded to the April surge in monetary growth. The magnitude of recent declines in yields on long-term bonds was cited as partial evidence for this view.

In the discussion of the outlook for prices, it was observed that the second-quarter acceleration in the over-all measures was attributable in large part to substantial increases in prices of farm products, which had been influenced more by the severe winter weather and the early-spring drought than the initial estimates indicated they would be. It was noted that in the past few months supply prospects had improved considerably for both grains and meats. It was noted also that prices of a number of basic industrial materials had declined over the past 2 months.

With respect to wages and costs, the recent behavior of the index of average hourly earnings for private nonfarm production workers was described as an indication that the rise in labor costs per unit of output had not been accelerating, and it was noted that this was a favorable development for the present stage of the business expansion. On the other hand, there had been some pick-up during the past year in the rate of increase in the broader measure of compensation per manhour in the private business sector. It was suggested, moreover, that the accelerated increase in the consumer price index during the first 4 months of 1977 may well be reflected in the pace of wage advances later on, that a rapid rate of inflation by itself tended to reduce industry's resistance to granting large wage increases, and that the rate of gain in productivity was likely to slow.

In considering policy for the period immediately ahead, the members of the Committee took account of the likelihood that growth in M-1 would remain relatively slow in June--continuing to respond to the April surge--but that growth from the first to the second quarter would nevertheless exceed the Committee's longer-run range for that aggregate. In July, according to staff analysis, expansion of M-1 was likely to be magnified by a purely technical factor--namely, distribution of social security checks earlier in the month than usual, thereby causing demand deposits to be larger than they otherwise would be over the 3-day weekend including July 4.

The members differed little in their preferences for the ranges to be specified for the annual rates of growth in the monetary aggregates over the June-July period. For M-1, sentiment initially was about equally divided between ranges of 2-1/2 to 6-1/2 per cent and 3 to 7 per cent; the midpoint of each range was somewhat below the midpoint of the Committee's longer-run range for growth in that aggregate. However, after some discussion of the extent to which growth in M-1 in the second quarter was likely to exceed its longer-run range, sentiment in favor of the lower of the two ranges prevailed. For M-2, most members favored a range of 6 to 10 per cent, but sentiment was also expressed for a range of 5-1/2 to 9-1/2 per cent.

Most members favored giving greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting because of uncertainty about M-1 growth rates in the near term. However, a number of the members expressed a preference for continuing to have operating decisions in the period ahead based primarily on the behavior of the monetary aggregates.

Almost all members favored directing operations--at least initially--toward maintaining the Federal funds rate at about its prevailing level of 5-3/8 per cent. Most of them advocated retaining the inter-meeting range for the funds rate of 5-1/4 to 5-3/4 per cent that had been specified at the May meeting, but sentiment was also expressed for a range of 5 to 5-3/4 per cent. One of the members who expressed a preference for continuing to base operations primarily on the behavior of the aggregates favored a range of 5-1/2 to 6-1/4 per cent for the funds rate.

At the conclusion of the discussion the Committee decided that operations in the period immediately ahead should be directed toward maintaining about the prevailing money market conditions, as represented by a weekly-average Federal funds rate of 5-3/8 per cent. With respect to the annual rates of growth in M-1 and M-2 over the June-July period, the Committee specified ranges of 2-1/2 to 6-1/2 per cent and 6 to 10 per cent, respectively. The members agreed that if growth in the aggregates should appear to approach or move beyond the limits of the specified ranges, with approximately equal weight given to M-1 and M-2, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 5-1/4 to 5-3/4 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 real output of goods and services has grown in the current quarter at about the rapid rate of the first quarter. In May industrial

output and employment continued to expand at a substantial pace, and the unemployment rate edged down from 7.0 to 6.9 per cent. Total retail sales increased from the advanced March-April level. The rise in the wholesale price index for all commodities slowed substantially in May, as average prices of farm products and foods changed little after having increased sharply for three consecutive months; average prices of industrial commodities also rose less than in other recent months.

The average value of the dollar against leading foreign currencies has changed little on balance over the past month. The U.S. foreign trade deficit was nearly as large in April as in March.

M-1 increased only slightly in May, after rising at an exceptionally rapid rate in April. Reflecting mainly the behavior of M-1, growth in M-2 and M-3 also slowed sharply. Inflows to banks of time and savings deposits other than large-denomination CD's continued to slacken, but inflows to nonbank thrift institutions remained sizable. Business short-term borrowing moderated from the sharply increased pace of April, and corporate borrowing in the capital markets was reduced further. Short-term market interest rates have changed little on balance in recent weeks, while longer-term yields have declined.

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 and help resist inflationary pressures, while contributing to a sustainable pattern of international transactions.

At its meeting on April 19, 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 9-1/2 per cent, and 8-1/2 to 11 per cent, respectively, from the first quarter of 1977 to the first quarter of 1978 appears to be consistent with these objectives. These ranges are subject to reconsideration at any time as conditions warrant.

At this time, the Committee seeks to maintain about the prevailing money market conditions during the period immediately ahead, provided that monetary aggregates appear to be growing at approximately the rates currently expected, which are believed to be on a path reasonably consistent with the longer-run ranges for monetary aggregates cited in the preceding paragraph. Specifically, the Committee seeks to maintain the weekly-average Federal funds rate at about 5-3/8 per cent, so long as M-1 and M-2 appear to be growing over the June-July period at annual rates within ranges of 2-1/2 to 6-1/2 per cent and 6 to 10 per cent, respectively. If, giving approximately equal weight to M-1 and M-2, it appears that growth rates over the 2-month period are approaching or moving beyond the limits of the indicated ranges, the operational objective for the weekly-average Federal funds rate shall be modified in an orderly fashion within a range of 5-1/4 to 5-3/4 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, Gardner, Guffey, Jackson, Lilly, Mayo, Morris, Partee, Roos, and Wallich. Vote against this action: Mr. Coldwell.

Mr. Coldwell dissented from this action because he favored a funds rate range of 5 to 5-3/4 per cent, in order to provide more leeway for a reduction should the rates of growth in M-1 and M-2 appear to be near or below the lower limits of their specified ranges for the June-July period. This preference reflected his views that the April bulge in M-1 had been caused largely by special factors, that the projections of the aggregates for the June-July period were highly uncertain, and that realization of the staff projection for growth in nominal GNP would involve very large increases in the velocity of money.