



FEDERAL RESERVE

press release

For Use at 4:00 p.m.

December 23, 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 November 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 November 15, 1977

Domestic policy directive

The information reviewed at this meeting suggested that growth in real output of goods and services--which had slowed to an annual rate of 3.8 per cent in the third quarter, according to preliminary estimates of the Commerce Department--was picking up in the current quarter. At the same time the rise in average prices, as measured by the fixed-weighted price index for gross domestic business product, appeared to be stepping up somewhat from the annual rate of 5.2 per cent estimated for the third quarter. Staff projections suggested that growth in real GNP would continue at a moderate, although gradually diminishing, pace throughout 1978. It was also expected that the rate of increase in prices would remain high.

The staff estimate of a pick-up in growth of real GNP in the current quarter was attributable to expectations of accelerated expansion in final sales of goods and services, reflecting indications of renewed strength in consumer spending for both durable and nondurable goods, in business fixed

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investment, and in residential construction. It was anticipated that business inventory accumulation would remain near the rate of the second and third quarters.

The staff projections of growth in real GNP during the year ahead reflected expectations that the expansion in business capital outlays would be sustained; that growth in consumer spending would remain moderate; that increases in State and local government purchases of goods and services would continue to be sizable; that the expansion in residential construction activity would taper off as the period progressed; and that the rise in Federal purchases of goods and services would be smaller than over the past year. The projections implied a gradual further decline in the unemployment rate over the year ahead.

In October industrial production expanded 0.3 per cent, almost the same as in September, owing in part to an increase in automobile assemblies and to a large rise in coal output after the striking miners had returned to work. Capacity utilization in manufacturing was estimated to have remained at about 83 per cent; in both the materials-producing

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and the advanced processing industries, utilization rates were close to their levels in the second and third quarters. For the former group of industries, the rate was about 10 percentage points below the high reached in the preceding period of business expansion.

Total nonfarm payroll employment expanded in October, although by considerably less than in September. Growth in employment in the service-producing industries slowed; in manufacturing both employment and the length of the average workweek of production workers changed little. Total employment, as measured by the survey of households, also increased less than in September, and the unemployment rate edged up from 6.9 to 7.0 per cent. From April through October the unemployment rate had fluctuated between 6.9 and 7.1 per cent.

The pace of expansion in wage and salary disbursements and in total personal income picked up in September, the latest month for which data were available. In the third quarter as a whole, the gain in total personal income in current dollars was less than that in the first two quarters

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of 1977, but in real terms it was about equal to the average gain in the first two quarters.

The dollar value of retail sales had risen 1.8 per cent in October, according to the advance report. Moreover, sales estimates for August and September were revised upward substantially--resulting in an increase of 1.5 per cent from the second to the third quarter, rather than the 0.3 per cent that had been reported earlier.

Unit sales of new autos--domestic and foreign models--rose about 5 per cent in October, after having declined more than 10 per cent in September. At an annual rate of 10.9 million units, the level of sales in October was the same as in the third quarter but somewhat less than in the second quarter.

Private housing starts were at an annual rate of slightly more than 2 million units in September, virtually unchanged from August. For the third quarter as a whole, starts were almost 8 per cent more than for the second quarter and at the highest level since 1973. Nearly three-fourths of the gain in the third quarter was accounted for by starts of multifamily units.

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The latest Department of Commerce survey of business plans, taken in late July and August and published in early September, suggested that spending for plant and equipment would be 13.3 per cent greater in 1977 than in 1976 and that the expansion in spending would be somewhat less in the second half of the year than in the first half. Private surveys suggested a somewhat smaller increase in capital outlays in 1978 than in 1977.

Manufacturers' new orders for nondefense capital goods advanced sharply in September, bringing the total for the third quarter up to the second-quarter level. The machinery component of such orders--generally a better indicator of underlying trends in demand for business equipment--expanded about 5 per cent in the third quarter. At the same time contract awards for commercial and industrial buildings--measured in terms of floor space--rose about 10 per cent to a level 30 per cent higher than in the third quarter of 1976.

The index of average hourly earnings for private nonfarm production workers advanced at a fast pace in October.

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The rate of increase over the first 10 months of the year was about 8 per cent, compared with a rise of about 7 per cent over the 12 months of 1976.

The wholesale price index for all commodities, which had turned up in September after 3 months of little change, rose sharply in October. Average prices of farm products and foods advanced appreciably, after having declined over the preceding 4 months. The rise in average prices of industrial commodities in October was a little less than in September but about equal to the rate of increase over the past year.

In September the consumer price index rose at an annual rate of about 4 per cent, the same as over the preceding 2 months but considerably less than during the first half of 1977. From June to September retail prices of foods increased only about 0.4 per cent, in contrast with a rise of nearly 7 per cent over the first 6 months of the year. The rise in average prices of commodities other than foods and of services also slowed during the third quarter.

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The trade-weighted value of the dollar--which had declined about 1-1/2 per cent from late September to mid-October--depreciated about 1 per cent further over the period to mid-November, reflecting mainly appreciation of the Japanese yen, of the Swiss franc, and of the U.K. pound. Over the period, moreover, foreign central banks purchased a substantial amount of dollars, even though on October 31 the U.K. authorities allowed the pound to float upward. The downward pressure on the dollar was associated with continuing concern about the deficit in the U.S. current account, especially as compared with the surpluses in the current accounts of several other industrial countries.

The U.S. foreign trade deficit declined somewhat in September, reflecting a sharp increase in exports that was attributable in large part to temporary factors--specifically, anticipation of the strike by longshoremen that began on October 1 and a rebound in shipments of coal from a strike-depressed level in August. For the third quarter as a whole, the deficit was about the same as for the second quarter.

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At U.S. commercial banks, growth in total credit accelerated in October from the relatively slow pace recorded in September. The pick-up reflected a vigorous expansion in bank lending that was offset only in part by a further reduction in holdings of Treasury securities.

Growth in business loans at banks was especially strong in October, following little change in September. To some extent the monthly changes appeared to reflect a shift in the seasonal pattern that had not yet been captured in adjustment factors; the average increase over the 2 months represented a continuation of relatively strong growth. The outstanding volume of commercial paper issued by nonfinancial corporations declined in October by the same amount that it had in September. Nevertheless, business credit expansion through these two sources was brisk over the 2-month period.

Growth in the narrowly defined money stock (M-1) accelerated in October to an annual rate of 12 per cent. However, data for early November suggested a sharp slowing of growth.

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Growth in M-2 also picked up during October and then slowed again in early November. In October expansion in the total of interest-bearing deposits included in M-2 was maintained at about its September pace, although the key components of this total showed divergent changes. Inflows of savings deposits to banks slowed appreciably as yields on competitive market securities rose further above the ceiling rate on savings deposits, and the rate of expansion in small-denomination time deposits changed little. However, the rate of expansion accelerated for nonnegotiable, large-denomination time deposits, which are not subject to interest rate ceilings. In association with the increase in loan demand, banks also expanded the outstanding volume of negotiable, large-denomination CD's (not included in M-2) by the largest amount for any month in nearly 3 years.

Growth in M-3 changed little in October. Inflows of funds to nonbank thrift institutions slowed somewhat from the strong pace of the preceding 2 months, offsetting the effect on M-3 of the acceleration of the expansion in M-1.

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At its October meeting the Committee had 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 6-1/2 per cent, provided that M-1 and M-2 appeared to be growing over the October-November period at annual rates within ranges of 3 to 8 and 5-1/2 to 9-1/2 per cent, respectively. However, the members also had agreed that if growth in the aggregates appeared to approach or move beyond the limits of their specified ranges, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 6-1/4 to 6-3/4 per cent.

Immediately following the meeting, incoming data had suggested that over the October-November period M-1 and M-2 would grow at rates within their specified ranges. Accordingly, the Manager of the System Open Market Account sought to maintain the Federal funds rate at around 6-1/2 per cent. In late October, however, additional data suggested that M-1 and M-2 were growing at rates approaching

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or moving beyond the upper limits of their ranges. Therefore, the Manager sought a slight firming in the funds rate. Still later, available data again suggested that growth in both aggregates would be within the ranges; hence the Manager's objective for the funds rate was returned to 6-1/2 per cent. During the inter-meeting period the funds rate generally fluctuated between 6-1/2 and 6-5/8 per cent, and it was at the lower rate in the last few business days before this meeting of the Committee.

Fluctuations in other market interest rates were larger than those in the funds rate, owing chiefly to changes in the perceptions of market professionals concerning the probable course of monetary policy. But on balance over the period, changes in interest rates were quite small; short- and medium-term rates generally declined a little, and changes in bond yields were mixed. In late October most large commercial banks raised the rate on loans to prime business borrowers from 7-1/2 to 7-3/4 per cent. A few major banks, located chiefly on the West Coast, held their prime rate at 7-1/2 per cent.

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On October 25 the Board of Governors announced its approval of actions by directors of all 12 Federal Reserve Banks raising the discount rate from 5-3/4 to 6 per cent, effective October 26. In announcing the approval, the Board stated that the action was taken in recognition of increases that had occurred in other short-term interest rates and that it would bring the discount rate into closer alignment with short-term rates generally. The Board also stated that the increase would reduce the incentive for member banks to borrow from the Federal Reserve. Member bank borrowing had increased to a daily average of more than \$1.8 billion during the week ending October 19, compared with an average of \$337 million 5 weeks earlier. In the week ending November 9 daily-average borrowings were down to \$887 million.

Major indexes of stock prices declined to new lows for 1977 during the initial weeks of the inter-meeting period, but then rallied in early November. At the time of the November meeting the indexes were about 5 per cent above their 1977 lows.

In November, in connection with its quarterly refinancing, the U.S. Treasury refunded \$2.4 billion of maturing debt held by the public; sold \$4.1 billion of

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additional securities to the general public for cash; and sold \$700 million of new securities directly to foreign central banks for cash. Securities issued to the public in this operation included \$3.3 billion of 3-year notes, sold at an average yield of 7.24 per cent; \$2.0 billion of 10-year notes, sold at an average yield of 7.69 per cent; and \$1.3 billion of 30-year bonds, sold at an average yield of 7.94 per cent. At the time that plans for the November refinancing were announced, the Treasury reported that its cash-borrowing needs in the fourth quarter were expected to total \$18-3/4 billion.

Gross public bond offerings by nonfinancial corporations declined in October. However, the total volume of new corporate bond issues was sustained by unusually large offerings by financial firms, including several large issues of mortgage-backed bonds.

In October the volume of mortgage lending apparently remained close to its unprecedented third-quarter pace. The increase in mortgage loans at commercial banks was almost as large as the record

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monthly-average gain in the third quarter; and net acquisitions of mortgage loans at savings and loan associations were probably about maintained, even though inflows of deposits to these institutions slowed somewhat. Outstanding mortgage commitments of the associations had risen to a record level at the end of September, and in October these institutions increased their reliance on borrowings from the Federal home loan banks and on the sale of mortgage-backed bonds. Between mid-October and mid-November the average interest rate on new commitments for conventional home mortgages at savings and loan associations changed little.

In the Committee's discussion of the economic situation, the members agreed that the staff projections--suggesting that growth in real GNP would continue at a moderate, although gradually diminishing, pace throughout 1978--were reasonable. There were, however, some shadings of view about prospects for the economy.

Two members suggested that the outlook was potentially stronger than that implied by the staff's

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projections. One of these members remarked that some of the uncertainties that had plagued this business expansion were being cleared up. In his judgment a reasonably good fourth quarter, which he was inclined to expect, could have a favorable influence on business and consumer attitudes; and that development, in turn, could affect business activity in 1978. The other member observed that there was a real possibility that 1978 would prove to be a very good year, particularly if administration statements were of a kind that tended to strengthen business confidence. In a related comment, another member observed that business decisions were being influenced by uncertainty generated not only by Federal tax and energy policies but also by expectations of further inflation.

Two members expressed the view that while the staff projections were not unreasonable, any deviations from them were more likely to be in the direction of shortfalls than of overshoots--particularly in the latter part of the projection period. One of these

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members remarked that economic policy-makers, including the Federal Reserve, would need to act if any marked slowing in the rate of economic growth appeared likely to develop. However, in his judgment it was too early to reach such a conclusion. In this connection, he noted that there seemed to have been a general tendency among economic forecasters in recent years to underestimate growth rates by progressively larger amounts for more distant periods. The other member who thought the staff's projections were on the high side of the range of possibilities observed that there was ample time for new developments to lead to improved prospects for the second half of 1978. At the moment, however, he did not find such developments to be clearly in prospect.

It was noted during the discussion that, according to projections of the Federal budget on a "high employment" basis, fiscal policy would move from a highly stimulative stance in the second half of 1977 to approximate neutrality by the end of 1978, unless some new fiscal initiatives were undertaken. It was also noted that sustained growth in

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spending by State and local governments was likely to contribute to the strength of the expansion, but that the foreign trade sector would probably be a source of weakness.

It was suggested that prospects for business capital spending were a key element in the economic outlook. One member observed that the underlying need for additions to capacity might soon have an increasing impact on spending for plant and equipment--a greater impact than implied by the recent private surveys of business spending plans--especially if proposals for reductions in taxes should prove to be reasonable and if business confidence should improve. Another member remarked that enough time had elapsed since the culmination of the recession in early 1975 for businessmen to conclude that profit opportunities had been neglected and for them to become more willing to take risks on longer-term commitments. This member added, however, that he expected uncertainties to persist throughout 1978, in part because of a bulge in the rate of inflation

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early in the year that in his opinion would be produced mainly by recent and prospective Federal legislation.

Other comments about the outlook included the observation by one member that the rate of economic growth projected by the staff for late 1978, although somewhat below the rates projected for earlier in the year, was still quite satisfactory. Another member remarked that he expected the growth rate to be lower in the first quarter of 1978 and higher in the second quarter than the staff's projections suggested. In his judgment it was too early to arrive at any firm view about prospects for the second half of next year.

At its October meeting the Committee had agreed that from the third quarter of 1977 to the third 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 to 6-1/2 per cent; M-2, 6-1/2 to 9 per cent; and M-3, 8 to 10-1/2 per cent. The associated range for the rate of growth in commercial bank credit was 7 to 10 per cent. It was agreed that the longer-run ranges,

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as well as the particular aggregates for which such ranges were specified, would be subject to review and modification at subsequent meetings.

In the discussion of policy for the period immediately ahead, members noted that growth in the monetary aggregates appeared to be slowing sharply in November. It was observed that for a number of reasons growth rates for December were particularly difficult to project, but even if they also proved to be low, two consecutive months of slow growth would be acceptable in view of the rapid monetary expansion of recent months. The comment was made that the sharp slowing in early November suggested that the aggregates might grow at reasonably satisfactory rates over the November-December period, assuming continuation of a Federal funds rate at about its current level. Many members indicated that they would like to maintain stable conditions in the money market for a time and that they were willing to accept a rate of growth in M-1 over the November-December period within a somewhat wider range than usual, encompassing relatively low growth.

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Most members expressed a preference for continuing to give greater weight than usual to money market conditions in conducting open market operations in the period until the next meeting of the Committee. However, a number of members were in favor of basing operating decisions primarily on the behavior of the monetary aggregates.

The members did not differ greatly in their preferences for operating specifications for the period immediately ahead. Most members favored a range of 1 to 6 or 1 to 7 per cent for the annual rate of growth in M-1 over the November-December period and a range of 5 to 9 per cent, or a slightly lower one, for growth in M-2. With respect to M-1, some sentiment was also expressed for a range of 2 to 7 per cent. And one member suggested a range of 2-1/2 to 7-1/2 per cent because he was concerned that the velocity of M-1 would not tend to increase so much in the period ahead as he thought was implied by the lower range.

With respect to the Federal funds rate, almost all members favored an operating range of 6-1/4 to 6-3/4 per cent for the period until the next meeting. However, one

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member who preferred to base decisions for operations primarily on the behavior of the monetary aggregates suggested a wider range, one of 6 to 7 per cent.

At the conclusion of the discussion the Committee decided that operations in the period immediately ahead should be directed toward maintenance of prevailing money market conditions, as represented by the current level of the Federal funds rate. However, the members agreed that if growth in the aggregates should appear to approach or move beyond the limits of their specified ranges, the operational objective for the weekly-average Federal funds rate should be varied in an orderly fashion within a range of 6-1/4 to 6-3/4 per cent. With respect to the annual rates of growth in M-1 and M-2 over the November-December period, the Committee specified ranges of 1 to 7 per cent and 5 to 9 per cent, respectively. It was also agreed that in assessing the behavior of the aggregates, the Manager should give approximately equal weight to the behavior of M-1 and M-2.

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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 picking up in the current quarter from the reduced pace in the third quarter. The dollar value of total retail sales, which had been unchanged in September, rose substantially in October. Industrial production and employment increased somewhat. The unemployment rate, at 7.0 per cent, remained in the narrow range prevailing since April. The wholesale price index for all commodities rose sharply in October, as average prices of farm products and foods increased after having declined appreciably over the preceding 4 months. Prices of industrial commodities rose at about the average rate of the preceding 12 months. The index of average hourly earnings increased sharply in September and has advanced at a somewhat faster pace so far this year than it had on the average during 1976.

The trade-weighted value of the dollar against major foreign currencies has declined further since mid-October. In September the U.S. foreign trade deficit was reduced somewhat, in part as a result of temporary factors.

M-1 and M-2 increased substantially in October, but growth slowed sharply in early November. In October inflows to banks of the total of savings deposits and small-denomination time deposits fell off, but banks expanded the outstanding volume of large-denomination CD's substantially as credit demands strengthened. Inflows to nonbank thrift institutions slowed somewhat in October from the strong pace of the preceding 2 months. Following a substantial rise in member bank borrowings, Federal Reserve discount rates were increased from 5-3/4 to 6 per cent in late October. Market interest rates have fluctuated moderately since mid-October and most recently have tended to decline.

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 October 18, 1977, the Committee agreed that growth of M-1, M-2, and M-3 within ranges of 4 to 6-1/2 per cent, 6-1/2 to 9 per cent, and 8 to 10-1/2 per cent, respectively, from the third quarter of 1977 to the third 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 the current level, so long as M-1 and M-2 appear to be growing over the November-December period at annual rates within ranges of 1 to 7 per cent and 5 to 9 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 6-1/4 to 6-3/4 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, Coldwell, Gardner,
Guffey, Jackson, Lilly, Mayo, Morris,
Partee, Roos, and Wallich. Votes
against this action: None.