

FEDERAL RESERVE press release



For Use at 4:10 p.m.

March 21, 1980

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on February 4-5, 1980. This record also includes policy actions taken during the period between the meeting on February 4-5, and the next regularly scheduled meeting held on March 18.

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 February 4-5, 1980

Domestic policy directive

Growth in real output of goods and services moderated to an annual rate of about 1-1/2 percent in the fourth quarter of 1979, according to preliminary estimates of the Commerce Department. Real gross national product had grown at a rate of about 3 percent in the third quarter, buttressed by strength in consumer spending. Average prices, as measured by the fixed-weight price index for gross domestic business product, increased at an annual rate of about 9-1/4 percent in the fourth quarter, after having risen at an average annual rate of about 10 percent in the first three quarters. Over the year ending with the fourth quarter of 1979, real GNP and nominal GNP grew about 3/4 percent and 10 percent respectively.

Total retail sales strengthened in November and December, after a sharp decline in October. From the third to the fourth quarter, however, sales changed little in constant-dollar terms as consumer buying of new automobiles and some other durable goods weakened.

The index of industrial production rose somewhat in December, offsetting the decline in November. In the fourth quarter, industrial production was up about 1 percent from a year earlier.

Nonfarm payroll employment, which had expanded moderately during the fourth quarter, rose substantially further in January. However, the rate of unemployment rose from 5.9 to 6.2 percent in January, its highest level in well over a year.

The Department of Commerce survey of business spending plans taken in late November and December suggested that expenditures for plant and equipment would rise about 11 percent from 1979 to 1980, after having expanded about 14-3/4 percent in 1979. After allowance for expected increases in prices, however, the rise projected for 1980 was negligible.

In December private housing starts were at an annual rate of 1.5 million units, unchanged from November but down from an average rate of 1.8 million units in both the second and the third quarters of the year. Combined sales of new and existing single-family homes fell in November for the second consecutive month, and preliminary indications suggested a further decline in December.

Producer prices of finished goods and consumer prices continued to rise rapidly in late 1979, in part because of the continuing spread of the effects of earlier increases in energy costs. In December producer prices and consumer prices were about 12-1/2 percent and 13-1/4 percent, respectively, above a year earlier. Both measures had risen around 9 percent during 1978.

The rise in the index of average hourly earnings of private nonfarm production workers moderated in January, following sharp

increases in November and December. For the year 1979 the index was up 8.3 percent, about the same as in 1978.

In foreign exchange markets, pressures on the dollar were relatively slight in January. The trade-weighted value of the dollar against major foreign currencies changed little on balance despite increased international political tensions. The U.S. trade deficit rose considerably in December from a relatively low November level, in large part because of an increase in oil imports. For the fourth quarter as a whole, the trade deficit was close to the second- and third-quarter levels.

At its meeting on January 8-9, 1980, the Committee had agreed that open market operations in the period until this meeting should be directed toward expansion of reserve aggregates consistent with growth of M-1 during the first quarter of 1980 at an annual rate between 4 and 5 percent and expansion of M-2 on the order of 7 percent, provided that in the intermeeting period the weekly average federal funds rate remained generally within a range of 11-1/2 to 15-1/2 percent. The Committee had also agreed that if the constraint on the federal funds rate appeared to be inconsistent with the objective for the expansion of reserves, the Manager for Domestic Operations was promptly to notify the Chairman who would then decide whether the situation called for supplementary instructions from the Committee.

Expansion in the major monetary aggregates, which had subsided in the final months of 1979, remained at reduced rates in January. M-1 and M-2 were estimated to have expanded in January at annual rates of

about 1-1/2 percent and 5-1/4 percent respectively, compared with rates of about 3 percent and 6-3/4 percent over the preceding three months. M-3 was estimated to have grown at an annual rate of about 4-1/2 percent in January, after having expanded at a rate of about 6 percent during the fourth quarter.

With the demand for money moderate, the federal funds rate declined from an average of about 14 percent in late December and early January to about 13-1/2 percent in the statement week ending January 30 and to a somewhat lower average in the remaining days preceding this meeting. Growth in total reserves decelerated sharply in January to an annual rate of 4 percent. Nonborrowed reserves expanded at an annual rate of about 11 percent, as average member bank borrowings declined somewhat further in January from the reduced level in December.

Newly available data confirmed a weakening of bank credit extensions to nonfinancial businesses in the fourth quarter. However, incomplete data for January suggested a rise in bank lending to such borrowers. In addition, the issuance of commercial paper by non-financial corporations rebounded in December and January.

Most market interest rates, especially longer-term rates, rose over the intermeeting period despite the decline in the federal funds rate. Advances in Treasury bill rates appeared to reflect large Treasury issues to raise new cash. Longer-term debt markets were influenced by an intensification of inflationary expectations,

which seemed to reflect data indicating stronger business activity than anticipated and the prospect of enlarged defense spending in response to international tensions. The home mortgage market remained exceptionally tight in January, but there were a few reports of liberalization in lending policies in the primary market.

Staff projections prepared for this meeting suggested that growth of nominal GNP would slow much less in the current quarter than had appeared likely a month earlier, and growth over the remaining quarters of 1980 was expected to vary relatively little from the first-quarter pace. The projections continued to suggest that real GNP would contract moderately during the year and that the rate of unemployment would increase substantially. Price prospects for the current year were similar to those of a month earlier: the rise in average prices was projected to accelerate somewhat during the early part of the year from the annual rate of about 9-1/4 percent in the fourth quarter of 1979, mainly because of increases in energy costs, but to subside later. In view of international conditions and an apparent strengthening of inflationary psychology, however, the projections were subject to greater uncertainties than usual, especially with regard to consumer and defense spending.

In the Committee's discussion of the economic situation and outlook, the members in general stressed the unusual uncertainties affecting forecasts of both output and prices. Most members thought that a moderate contraction in real GNP was likely in 1980, bringing

a substantial increase in unemployment, and they expected the rise in prices to remain very rapid. The view was also expressed, however, that real GNP would decline little if at all during the year, that the unemployment rate would increase less than generally anticipated, and that the rise in prices could well accelerate further.

One major uncertainty for the immediate future was the probable behavior of consumer spending for goods and services. Such spending had been unexpectedly strong in the latter part of 1979 despite weak growth in disposable personal income, and the saving rate had fallen to an exceptional low of about 3-1/4 percent in the fourth quarter. Interpretations of the phenomenon and its implications for the future differed: it might result primarily from inflation's squeeze on household budgets and thus foreshadow a sudden retrenchment in consumer spending; or it might represent primarily a consumer adaptation to high current and prospective rates of inflation and so could persist. Near-term prospects for consumer spending were clouded, in addition, by more than the usual uncertainty about the effects of federal income tax refunds, which were expected to be unusually large in March and April this year.

A second major element of uncertainty in projecting output and prices was the course of defense expenditures in the light of the heightened international tensions provoked by the Soviet Union's invasion of Afghanistan. Opinions differed concerning the speed with which a buildup of defense spending could be accomplished and,

consequently, about whether federal spending would contribute more or less to overall demand and output than suggested by the administration's budget. In this connection, it was observed that business outlays could be expected to expand in anticipation of the defense buildup. On the receipts side of the federal budget, tax reductions this year generally were regarded as unlikely--in the absence, at least, of considerably greater weakness in economic activity than was commonly foreseen at this time.

Committee members continued to express great concern about the inflationary environment and its role in generating distortions and instability. It was suggested that the recent international developments, including the further substantial increases in oil prices, were counteracting the progress that had been made in the latter part of 1979 in dampening expected rates of increase in prices.

At this meeting, the Committee completed the review, begun a month earlier, of the ranges for growth of monetary aggregates over the period from the fourth quarter of 1979 to the fourth quarter of 1980 within the framework of the Full Employment and Balanced Growth Act of 1978. The act, which amended section 2A of the Federal Reserve Act, requires the Board of Governors to transmit to the Congress by February 20 and July 20 of each year written reports concerning the objectives and plans of the Board and the Committee with respect to the ranges of growth or diminution of the monetary and credit aggregates for the calendar year during which the report is transmitted and,

in the case of the July report, the objectives and plans with respect to ranges for the following calendar year as well. The act also requires that the written reports set forth a review and analysis of recent developments affecting economic trends in the nation and the relationship of the plans and objectives for the aggregates to the short-term goals set forth in the most recent Economic Report of the President and to any short-term goals approved by the Congress.^{1/}

In contemplating monetary growth for the year ahead, the Committee considered ranges for the new definitions of the monetary aggregates: M-1A, M-1B, M-2, and M-3. A description of these newly defined aggregates was announced on February 7. M-1A comprises currency plus demand deposits at commercial banks; it is the same as the displaced M-1, except that demand deposits held by foreign banks and foreign official institutions are excluded. M-1B comprises M-1A and other checkable deposits at all depository institutions; thus, NOW accounts, ATS, credit union share drafts, and demand deposits at mutual savings banks are included. M-2 contains M-1B and savings and small-denomination time deposits at all depository institutions, overnight RPs at commercial banks, overnight Eurodollars held at Caribbean branches of member banks by U.S. residents other than banks, and money market mutual fund shares. Finally, M-3 is M-2 plus large-denomination time deposits at all depository institutions and term RPs at commercial banks and savings and loan associations. From the

^{1/} The Board's third report under the act was transmitted to the Congress on February 19, 1980.

fourth quarter of 1978 to the fourth quarter of 1979, M-1A grew 5.5 percent, the same as M-1; after taking into account the amount of demand deposits apparently shifted to ATS and New York State NOW accounts, the estimated rate was 6.8 percent. M-1B grew 8.0 percent; M-2, 8.8 percent; and M-3, 9.5 percent.

In contemplating ranges for growth of the monetary aggregates over the year ahead, Committee members stressed the unusually great uncertainties concerning prospects for economic activity and prices and thus for growth of nominal GNP. The shift to new definitions of monetary aggregates introduced additional uncertainties concerning the relationships between them and nominal GNP as well as the relationships among the aggregates themselves in response to changing financial market conditions. Moreover, enactment of pending legislation to authorize NOW accounts nationally would in the short run have a significant impact on growth of some of the monetary aggregates in relation to changes in economic activity. It was noted, however, that the ranges adopted at this meeting could be modified at any time in the light of legislative or other developments and in any event would be reconsidered at midyear.

In the Committee's discussion of the ranges for the coming year, the members agreed that monetary growth should slow further in 1980, following some deceleration over 1979, in line with the continuing objective of curbing inflation and providing the basis for restoration of economic stability and sustainable growth in output

of goods and services. Committee members differed somewhat in their views concerning the particular aggregates for which longer-run ranges of growth should be specified. Most members thought that in the present circumstances it was appropriate to specify ranges for the four aggregates, M-1A, M-1B, M-2, and M-3; but some sentiment was also expressed for omitting M-1A from the list, and some for omitting M-3 as well. With respect to M-1A, its growth would be dampened in the event of enactment of nationwide NOW account legislation and, as would be expected, a large transfer of funds from demand deposits to NOW accounts. In support of retaining M-1A on the list, however, it was noted that enactment of the legislation would tend to distort growth of M-1B also--in the opposite direction as a result of transfers of funds from savings deposits to NOW accounts--and no doubt would lead the Committee to reconsider whatever ranges it adopted at this meeting.

A few members favored specification of relatively narrow ranges. In light of the difficulties of maintaining growth within a narrow range and of the uncertainties concerning both the outlook for the economy and the behavior of the newly defined aggregates, however, most members favored ranges on the order of the 3 percentage points adopted for 1979.

At the conclusion of the discussion, the Committee adopted the following ranges for growth of the monetary aggregates over the period from the fourth quarter of 1979 to the fourth quarter of 1980:

M-1A, 3-1/2 to 6 percent; M-1B, 4 to 6-1/2 percent; M-2, 6 to 9 percent; and M-3, 6-1/2 to 9-1/2 percent. The associated range for growth of commercial bank credit was 6 to 9 percent. It was understood that the longer-run ranges would be reconsidered in July or at any other time that conditions might warrant. It was also understood that short-run factors might cause considerable variation in annual rates of growth from one month to the next and from one quarter to the next.

The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the fourth quarter of 1979 to the fourth quarter of 1980: M-1A, 3-1/2 to 6 percent; M-1B, 4 to 6-1/2 percent; M-2, 6 to 9 percent; and M-3, 6-1/2 to 9-1/2 percent. The associated range for bank credit is 6 to 9 percent.

Votes for this action: Messrs. Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Rice, Schultz, Mrs. Teeters, Messrs. Wallich, and Timlen. Votes against this action: None. (Mr. Timlen voted as an alternate member.)

In contemplating policy for the near term, the Committee took note of a staff analysis indicating that the policy decision taken at the meeting of early January implied an annual rate of growth of about 4-1/2 percent in the new M-1A over the period from December to March. Consistent rates of growth in M-1B and the newly defined M-2 were estimated to be slightly above 5 percent and about 6-1/2 percent respectively. In January M-1A had grown at a rate of

about 4-3/4 percent; growth in M-1B and M-2, at rates of about 6 percent and 8-1/4 percent respectively, had exceeded their three-month rates by larger margins. Accordingly, monetary growth, particularly as measured by M-1B and M-2, would have to decelerate from January to March if the rates realized for the whole three-month period were to be consistent with those implied by the Committee's decision in January.

The staff analysis also noted that the transactions demand for money in the first quarter implied by projections of nominal GNP were stronger than a month earlier. At the same time, the relationship between money growth and GNP was particularly uncertain because disbursement of the exceptionally large federal income tax refunds beginning in late February could generate a temporary bulge in money demand.

In the Committee's discussion of policy for the period immediately ahead, most members favored essentially an extension of the objectives for the period from December to March that had been established in early January. The behavior of the monetary aggregates had been more or less on course since then and, it was suggested, little had occurred to warrant a change in course. On the other hand, some sentiment was expressed for a reduction in the objectives for monetary growth over the first three months of the year, on the grounds that prospects for economic activity apparently had strengthened since a month earlier and inflationary expectations had worsened.

At the conclusion of the discussion, the Committee agreed that open market operations in the period until the next meeting

should be directed toward expansion of reserve aggregates consistent with growth over the first quarter of 1980 at an annual rate of about 4-1/2 percent for M-1A and about 5 percent for M-1B, provided that in the period until the next meeting the weekly average federal funds rate remained within a range of 11-1/2 to 15-1/2 percent. Consistent with this short-run policy, in the Committee's view, the newly defined M-2 should grow at an annual rate of about 6-1/2 percent over the first quarter. If the constraint on the federal funds rate appeared to be inconsistent with the objective for the expansion of reserves, the Manager for Domestic Operations was promptly to notify the Chairman who would then decide whether the situation called for supplementary instructions from the Committee.

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 expanded somewhat in the final quarter of 1979 and that prices on the average continued to rise rapidly. In December retail sales strengthened, industrial production edged up, and nonfarm payroll employment continued to rise, while private housing starts remained at the reduced level of November. Nonfarm payroll employment rose substantially further in January, but the unemployment rate rose from 5.9 to 6.2 percent. Producer prices of finished goods and consumer prices continued to rise rapidly toward the end of 1979, in part because of the spreading effects of earlier increases in energy costs. Over the past several months the rise in the index of average hourly earnings has remained close to the rapid pace recorded earlier in 1979.

The trade-weighted value of the dollar against major foreign currencies changed little in January, and exchange market pressures were relatively slight in spite of increased international political tensions. The U.S. foreign trade deficit rose in December, in large part because of an increase in imports of petroleum.

Growth of the major monetary aggregates, which had subsided in the final months of 1979, remained at reduced rates in January. Most market interest rates, especially long-term rates, have risen since the Committee's meeting in early January.

Taking account of past and prospective economic developments, the Federal Open Market Committee seeks to foster monetary and financial conditions that will resist inflationary pressures while encouraging moderate economic expansion and contributing to a sustainable pattern of international transactions. The Committee agreed that these objectives would be furthered by growth of M-1A, M-1B, M-2, and M-3 from the fourth quarter of 1979 to the fourth quarter of 1980 within ranges of $3\frac{1}{2}$ to 6, 4 to $6\frac{1}{2}$, 6 to 9, and $6\frac{1}{2}$ to $9\frac{1}{2}$ percent respectively. The associated range for bank credit was 6 to 9 percent.

In the short run, the Committee seeks expansion of reserve aggregates consistent with growth over the first quarter of 1980 at an annual rate of about $4\frac{1}{2}$ percent for M-1A and 5 percent for M-1B, provided that in the period before the next regular meeting the weekly average federal funds rate remains within a range of $11\frac{1}{2}$ to $15\frac{1}{2}$ percent. The Committee believes that, consistent with this short-run policy, M-2 as newly defined should grow at an annual rate of about $6\frac{1}{2}$ percent over the first quarter.

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

Votes for this action: Messrs. Volcker, Balles, Black, Kimbrel, Mayo, Partee, Rice, Schultz, Mrs. Teeters, and Mr. Timlen. Votes against this action: Messrs. Coldwell and Wallich. (Mr. Timlen voted as an alternate member.)

Messrs. Coldwell and Wallich dissented from this action because they favored a more restrictive policy for the period immediately ahead. Believing that inflationary expectations had worsened in recent weeks while prospects for economic activity had strengthened, they thought that money and credit were too readily available and current levels of interest rates were not exerting sufficient restraint.

Subsequent to the meeting, on February 22, available data suggested that M-1A and M-1B were growing at rapid rates in February, and in consequence the demand for bank reserves had strengthened considerably. The federal funds rate had risen to about 15 percent, and member bank borrowings had also increased. To provide the Manager for Domestic Operations with additional scope for operations in these circumstances, Chairman Volcker recommended that the upper limit of the range of 11-1/2 to 15-1/2 percent specified for the federal funds rate be raised to 16-1/2 percent on a temporary basis until the situation could be reassessed.

On February 22, the Committee modified the domestic policy directive adopted at its meeting on February 4-5, 1980, to raise the upper limit of the range for the federal funds rate to 16-1/2 percent.

Votes for this action: Messrs. Volcker, Balles, Black, Kimbrel, Mayo, Partee, Rice, Schultz, Mrs. Teeters, Messrs. Wallich and Timlen. Votes against this action: None. Absent: Mr. Coldwell. (Mr. Timlen voted as alternate member.)

In the statement week ending March 5, the federal funds rate rose to an average of slightly more than 16-1/8 percent and member bank borrowings expanded further to a daily average of about \$2-1/2 billion. On March 6 federal funds generally traded around 17 percent, despite sizable reserve-supplying operations by the System, and the Manager advised that in his opinion additional leeway above the existing upper limit of 16-1/2 percent was needed for operational flexibility in meeting reserve objectives. In late afternoon, Chairman Volcker recommended that the upper limit of the intermeeting range for the federal funds rate be raised to 17-1/2 percent, pending a discussion of the situation in a telephone conference of the Committee to be held in the afternoon of the following day, and the Committee voted to approve the Chairman's recommendation.

Votes for this action: Messrs.
Volcker, Guffey, Morris, Partee,
Rice, Roos, Schultz, Mrs. Teeters,
Messrs. Wallich, Winn, and Timlen.
Votes against this action: None.
(Mr. Timlen voted as alternate
member.)

In the telephone conference held in the afternoon of March 7, the Committee voted to raise the upper limit of the intermeeting range for the federal funds rate to 18 percent, to provide greater operational flexibility in meeting reserve objectives.

On March 7, the Committee further modified the domestic policy directive adopted at its meeting of February 4-5, 1980, to raise the upper limit of the range for the federal funds rate to 18 percent.

Votes for this action: Messrs.
Volcker, Guffey, Morris, Partee,
Rice, Roos, Schultz, Mrs. Teeters,
Messrs. Wallich, Winn, and Timlen.
Votes against this action: None.
(Mr. Timlen voted as alternate
member.)