FEDERAL RESERVE press release

For Use at 4:10 p.m. July 11, 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 May 20, 1980.

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 May 20, 1980

1. Domestic policy directive

The information reviewed at this meeting suggested that real output of goods and services was declining markedly in the current quarter after increasing at an annual rate of 0.6 percent in the first quarter. However, average prices, as measured by the fixed-weight price index for gross domestic business product, were continuing to rise at a rapid pace following increases at an annual rate of about 11 percent in the first quarter and nearly 10 percent during 1979.

The dollar value of total retail sales fell substantially further in April after declining sharply in February and March. Unit sales of new automobiles slowed markedly further in April to the lowest level since the spring of 1975 and apparently remained exceptionally weak in early May.

The index of industrial production fell 1.9 percent in April, following small reductions in February and March. The April decline reflected widespread cutbacks in output. The rate of capacity utilization in manufacturing fell 2 percentage points further in April to 81 percent, 6 percentage points below the recent peak in March 1979.

In April nonfarm payroll employment declined substantially following a moderate reduction in March, and the rate of unemployment rose from 6.2 to 7.0 percent. Decreases in employment were especially pronounced in automobile- and construction-related industries. The length of the average workweek fell for the third successive month.

Private housing starts declined throughout the first quarter and edged down further in April to an annual rate of about 1 million units. Building permits for new units were down substantially further in April. In March sales of single-family homes fell for the sixth consecutive month.

The rise in producer prices of finished goods moderated appreciably in April, reflecting a large drop in prices of consumer foods and a less rapid advance in prices of energy-related items than in earlier months. In the first quarter both producer prices and consumer prices had risen at accelerated rates following rapid advances in 1979. The index of average hourly earnings of private nonfarm production workers rose at an annual rate of about 8 percent over the first four months of the year, compared with an increase of 8-1/2 percent during 1979.

In foreign exchange markets the dollar had remained under downward pressure over most of the previous four weeks. Such pressure, which had emerged in early April, reflected primarily a sharp decline in interest rates on dollar assets in relation to those on foreign-currency assets.

The trade-weighted value of the dollar against major foreign currencies had fallen about 3-1/2 percent since the Committee's meeting on April 22 and about 7-1/2 percent since early April.

The U.S. foreign trade deficit increased substantially from the fourth quarter of 1979 to the first quarter of 1980 despite a considerable reduction in March from the average in January and February. For the quarter as a whole, imports, including both petroleum and nonpetroleum products, rose at a much faster rate than exports even though nonagricultural exports exhibited considerable strength.

At its meeting on April 22, the Committee had agreed that open market operations in the period until this meeting should continue to be directed toward expansion of reserve aggregates consistent with growth over the first half of 1980 at annual rates of 4-1/2 percent for M-1A and 5 percent for M-1B, or somewhat less, provided that in the intermeeting period the weekly average federal funds rate remained within a range of 13 to 19 percent. In the Committee's view, this short-run policy should be consistent with growth in M-2 at an annual rate of about 7-3/4 percent over the first half of the year. 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.

Immediately after the meeting, required reserves and thus member bank demands for reserves began to fall substantially in relation to the supply being made available through open market operations, reflecting a sharp weakening of the monetary aggregates during April. Consequently, member bank borrowings for adjustment purposes and the federal funds rate both declined sharply. On May 6, after the funds rate had fallen below the 13 percent lower limit of the Committee's intermeeting range and available data had suggested that the demand for money and for reserves had remained weak, the Committee voted to reduce the lower limit of the intermeeting range for the funds rate to 10-1/2 percent. In the statement week ending May 14, the funds rate averaged 10-7/8 percent, down from an average of about 18-3/8 percent in the statement week ending April 16.

In April M-1A and M-1B contracted at annual rates of 18-1/2 and 14-1/2 percent respectively following small declines in March, while M-2 fell at an annual rate of about 3 percent after increasing moderately in March. As a result, expansion of the monetary aggregates--especially M-1A and M-1B--over the first four months of the year averaged well below the growth paths set by the Committee for the first half; M-1A declined at an annual rate of 1-1/2 percent over that period; M-1B was unchanged; and M-2 expanded at an annual rate of 4-1/2 percent. In early May, however, there were substantial increases in demand deposits and money market mutual funds.

Total credit outstanding at U.S. commercial banks contracted in April after expanding at a substantially reduced pace during March.

The April decline reflected reductions in both investments and loans, which included a drop in business loans. Net issues of commercial paper by nonfinancial corporations moderated in April from an exceptionally strong pace during the first quarter.

Interest rates fell sharply further during the intermeeting period as market participants reacted to accumulating signs of a slowdown in economic activity, to sustained weakness in the money stock, and to the decline in the federal funds rate. The rate declines were especially pronounced in short-term debt markets, but bond yields also moved substantially lower. Commercial banks reduced their loan rate to prime business borrowers from 19-1/2 to 16-1/2 percent over the interval. In primary markets for home mortgages, average rates on new commitments at sampled savings and loan institutions fell more than 2 percentage points to about 14-1/8 percent. On May 6 the Federal Reserve announced the removal of the surcharge of 3 percentage points on frequent borrowings from the Federal Reserve Banks by member banks with deposits of $500 million or more. This surcharge had been imposed in mid-March as part of a broad program of credit restraint.

Staff projections prepared for this meeting suggested a larger decline in real GNP in the current quarter than had been anticipated a month earlier. Further declines were expected in subsequent quarters, and unemployment was projected to increase substantially. Prices of goods and services were projected to continue under substantial upward pressure, although the rate of increase was not expected to be so rapid as in the first quarter.

Committee members agreed that a marked contraction in real GNP was under way in the current quarter. The rapidity of the decline, reflecting in part the abrupt weakening in consumption expenditures, suggested a risk that the contraction would prove to be deeper than was widely expected. At the same time, inflation remained a serious problem. The rise in prices appeared likely to remain rapid, even though there were grounds for anticipating some moderation of the rise over the months ahead.

At its meeting on February 4-5, 1980, the Committee had agreed that from the fourth quarter of 1979 to the fourth quarter of 1980 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: 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 the rate of growth in commercial bank credit was 6 to 9 percent. It had also been agreed that the longer-run ranges, as well as the particular aggregates for which such ranges were specified, would be reconsidered in July or at any other time that conditions might warrant, and also 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.

In contemplating policy for the period immediately ahead, the Committee took note of a staff analysis indicating that growth of M-1A and M-1B over the first four months of the year had fallen considerably short of the rates consistent with the objectives for the first half of the year that the Committee had established at its meeting in March and re-affirmed at its meeting in April. Some rebound in growth of these aggregates was likely to occur over the May-June period, assuming interest rates at around current levels and given the staff projection of expansion in nominal GNP during the second quarter and the public's likely need to rebuild depleted cash balances. It still seemed likely, however, that growth of these aggregates over the first half of 1980 would fall considerably short of the rates consistent with the Committee's ranges for the year from the fourth quarter of 1979 to the fourth quarter of 1980. Growth of M-2 and M-3 appeared to be less weak relative to the Committee's longer-run ranges than that of the narrowly defined aggregates.

In the Committee's discussion of policy, the members agreed that operations in the period immediately ahead should be directed toward expansion of monetary aggregates at rates high enough to promote achievement of the Committee's objectives for monetary growth over the year, recognizing that a number of months might well be required in the process. They differed to some extent in their views concerning the speed with which that goal should be sought and about the further near-term decline in the federal funds rate that might be tolerated in its pursuit.

Several members believed that if the demand for money were to remain weak, the Committee should move in a relatively gradual fashion over the balance of the year to restore the desired longer-run rates of money growth. Concern was expressed that a more aggressive approach would lead to such sharp declines in the federal funds rate and other short-term interest rates in the period immediately ahead that there could be a perverse impact on long-term interest rates by exacerbating inflationary expectations, and there could also be strong adverse effects on the value of the dollar in foreign exchange markets. Moreover, aggressive efforts to promote monetary growth might have to be reversed before long, perhaps leading to significant increases in interest rates in a period of substantial weakness in the economy. The possibility was also suggested that the demand for money had shifted downward once again, so that vigorous efforts in the short run to bring monetary growth into line with the Committee's longer-run objectives could result in excessive creation of money.

Other members of the Committee preferred efforts to bring monetary growth more promptly into line with the Committee's objectives for the year. Such an approach, which they regarded as more consistent with the operating procedures the Committee had been following since early October 1979, could make an important contribution to moderating the severity of the recession.

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 of M-1A, M-1B, and M-2 at rates high enough to promote achievement of the Committee's objectives for monetary growth for the year as a whole, provided that in the period before the next regular meeting the weekly average federal funds rate remained within a range of 8-1/2 to 14 percent.

Specifically, the Committee agreed that operations should be directed toward encouraging growth of M-1A, M-1B, and M-2 over May and June at annual rates of 7 to 7-1/2 percent, 7-1/2 to 8 percent, and about 8 percent respectively. The Committee also agreed that, in light of the recent shortfall, moderately faster monetary growth would be acceptable if that developed in response to a strengthening of the demand for money. It was understood that if the demand for money and for bank reserves proved to be weak and the federal funds rate declined significantly within its specified range, the Committee would review the situation in advance of the next regular meeting scheduled for July 9. In any case, if it appeared that the constraint on the federal funds rate was 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 a marked contraction in real GNP in the current quarter. In April the dollar value of total retail sales declined substantially for the third consecutive month. Industrial production and nonfarm payroll employment were curtailed sharply, and the unemployment rate rose from 6.2 to 7.0 percent. Private housing starts, which had declined throughout the first quarter to a relatively low rate, edged down further in April. The overall rise in prices of goods and services has remained rapid in recent months, although in April the rise in producer prices of finished goods was slowed by a large decrease in foods and by a lessening of the rapid rise in energy items. Over the first four months of the year, the rise in the index of average hourly earnings was somewhat less than the rapid pace recorded in 1979.

The downward pressure on the dollar in exchange markets that emerged in early April has continued over most of the past four weeks, in response primarily to the sharp decline in U.S. interest rates relative to foreign interest rates; the trade-weighted value of the dollar against major foreign currencies has declined about 3-1/2 percent. The U.S. foreign trade deficit was substantially larger in the first quarter of 1980 than in the preceding quarter, despite a considerable decline in March from the average in the preceding two months.

M-1A and M-1B contracted sharply further in April, and M-2 also declined. Commercial bank credit, both loans and investments, contracted in April after having slowed substantially in March. Over recent weeks, market interest rates have declined sharply further.

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. At its meeting on February 4-5, 1980, 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 3-1/2 to 6, 4 to 6-1/2, 6 to 9, and 6-1/2 to 9-1/2 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 of M-1A, M-1B, and M-2 at rates high enough to promote achievement of the Committee's objectives for monetary growth over the year, provided that in the period before the next regular meeting the weekly average federal funds rate remains within a range of 8-1/2 to 14 percent.

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, Guffey, Morris, Rice, Schultz, Solomon, Mrs. Teeters, Messrs. Wallich, and Winn. Votes against this action: Messrs. Partee and Roos.

Mr. Partee dissented from this action because he believed that it involved a risk of extending the shortfall in monetary growth relative to the Committee's growth ranges for the year. In an effort to guard against the continuation of such a shortfall, which could worsen recessionary prospects, he preferred to direct operations toward achieving somewhat higher rates of monetary growth in the May-June period. He also preferred an intermeeting range for the federal funds rate with a lower limit below 8-1/2 percent, because such a range would be less likely to interfere with reserve-supplying operations consistent with the objectives for the aggregates.

Mr. Roos dissented because in his view the annual growth rate objective of 3-1/2 to 6 percent for M-1A established by the Committee in February 1980 was consistent with reduction of inflation without aggravating recessionary pressures. He believed that the 8-1/2 to 14 percent constraint on the federal funds rate was incompatible with that agreed-upon objective and would cause money growth to remain below it. Such slow growth would unnecessarily exacerbate the current economic slowdown. Historically, deep recessions had inevitably brought about countermeasures that intensified inflation.

2. Authorization for Foreign Currency Operations

The Committee approved an increase from $300 million to $500 million in the System's swap arrangement with the Bank of Sweden and the corresponding amendment to paragraph 2 of the authorization for foreign currency operations, effective May 23, 1980, for a period of one year. With this change paragraph 2 read as follows:

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (Millions of dollars equivalent)
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico	700
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	500
Swiss National Bank	4,000
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

> Votes for this action: Messrs. Volcker, Guffey, Morris, Partee, Rice, Roos, Schultz, Solomon, Mrs. Teeters, Messrs. Wallich, and Winn. Votes against this action: None.

This action was taken to expand the short-term financing facilities available to the Bank of Sweden.