

FEDERAL RESERVE press release



For Use at 4:10 p.m.

December 28, 1981

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 November 17, 1981. This record also includes a policy action taken during the period between the meeting on November 17, 1981, and the next regularly scheduled meeting held on December 21-22, 1981.

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 17, 1981

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP was declining appreciably in the current quarter, following a slight decline in the third quarter indicated by preliminary estimates of the Commerce Department. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be rising somewhat less rapidly than on the average in the first three quarters of the year.

The nominal value of retail sales in October was down 1-1/2 percent from September and about 1 percent from the third-quarter average; although the nominal value had risen about 2-1/4 percent from the second to the third quarter, sales in real terms had changed little. In October sales of automotive products were particularly weak; unit sales of new automobiles fell nearly one-fifth from September, even though some rebates and special financing arrangements remained in effect.

The index of industrial production fell 1.5 percent in October, following a decline of 1.2 percent in September. Reductions in both months were widespread among market groupings, with declines particularly large in durable materials, construction supplies, and consumer durable goods.

Total nonfarm payroll employment declined sharply in October. Job losses in manufacturing were sizable, overwhelming moderate gains in trade

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and service industries, and the average factory workweek remained at a reduced level. The unemployment rate rose from 7.5 to 8.0 percent.

Private housing starts edged down in September from an already depressed level. At an annual rate of less than 1 million units, starts in the third quarter were one-fourth below the rate in the first half. Sales of new houses in September were at their lowest level in the 18-year history of the series, and sales of existing homes continued to decline.

The producer price index for finished goods rose on the average in September and October at about the reduced rate of the preceding four months. The consumer price index rose at a much faster pace in September and during the third quarter as a whole than in the first half of the year. Much of the acceleration reflected the behavior of the homeownership component and food prices. Over the first 10 months of 1981, the rise in the index of average hourly earnings was less rapid than it was during 1980.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had fluctuated over a wide range since early October. On balance, it declined only a little over the intermeeting interval although U.S. short-term interest rates fell substantially more than foreign short-term rates. The U.S. trade deficit in September was substantially lower than the extraordinarily large one in August. For the third quarter, the deficit was little changed from that in the second quarter. A decline in the value of exports about offset a reduction in imports, which was accounted for largely by oil.

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At its meeting on October 5-6, the Committee had decided that open market operations in the period until this meeting should be directed toward behavior of reserve aggregates consistent with growth of M1-B from September to December at an annual rate of 7 percent (after allowance for shifts into NOW accounts) and with growth of M2 at an annual rate of around 10 percent or slightly higher. If it appeared to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting was likely to be associated with a federal funds rate persistently outside a range of 12 to 17 percent, the Chairman might call for a Committee consultation.

By late October, incoming data began to indicate shortfalls in growth of the monetary aggregates, especially M1-B, from the rates that the Committee had specified for the three-month period from September to December. Subsequently, money market conditions eased: the federal funds rate in the days just before this meeting was about 13-1/4 percent, compared with an average of about 15 percent in the four weeks ending October 28. In the statement week including the day of the meeting, borrowings from Federal Reserve Banks for purposes of adjusting reserve positions were running \$300 million to \$400 million below the average of the preceding weeks of the intermeeting period.

M1-B (adjusted for shifts into NOW accounts) expanded at an annual rate of about 3-3/4 percent in October, following a contraction of 4 percent in September, and M2 grew at an annual rate of about 9-1/4 percent. In October the level of shift-adjusted M1-B remained well below

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the lower end of the Committee's range for growth over the year from the fourth quarter of 1980 to the fourth quarter of 1981, while the level of M2 was at the upper end of its range for the year.

Expansion in total credit outstanding at U.S. commercial banks slowed to an annual rate of about 8-1/2 percent in October, following expansion at annual rates of 10 and 10-1/2 percent in August and September respectively. The slowing reflected in part a moderation in the growth of business loans from the brisk pace in the third quarter. Bank holdings of Treasury securities were unchanged in October, while acquisitions of other securities increased. Net issues of commercial paper by nonfinancial corporations slowed substantially, following expansion at exceptionally rapid rates in August and September.

Short-term market interest rates declined about 2-1/2 to 3-1/2 percentage points over the intermeeting period. Yields on longer-term securities generally reached record levels around the end of September but had declined in recent weeks, apparently in response to incoming evidence of weakness in economic activity and reduced pressures in short-term markets. During the intermeeting period, the prime rate charged on short-term business loans was reduced by 2 percentage points to 17 percent by most commercial banks, and to 16-1/2 percent by a few banks. On October 30, against the background of the declines in short-term rates, the Board of Governors announced a reduction in Federal Reserve basic discount rates from 14 to 13 percent. The surcharge on frequent borrowings of large depository institutions had been reduced from 3 to 2 percentage points on October 9,

and on November 16 it was removed altogether. In home mortgage markets, average interest rates on new commitments for fixed-rate conventional loans at savings and loan associations had eased a bit in recent weeks after reaching a record level in early October.

In the Committee's discussion of the economic situation and outlook, the consensus was that the downward drift in economic activity apparent when the Committee met in early October had clearly developed into a recession. Weakness in output and employment was intensifying in those industries and regions that had already been seriously affected, and it was spreading. As usual, considerable uncertainty existed about the likely severity and duration of the recession. It was generally thought, however, that the scheduled reductions in federal income taxes, the projected increases in defense spending along with other elements in the federal fiscal outlook, and the decline in interest rates most likely would generate an upturn in economic activity by the middle of 1982, although some difference of opinion existed about the timing of recovery.

At the same time, concern about inflationary tendencies remained strong. Some encouraging signs of an easing in inflationary expectations were noted, but it was also emphasized that such expectations tended to change slowly; they would be sensitive to judgments about federal budgetary developments, to the nature of the newly negotiated collective bargaining agreements, and to perceptions of the course of monetary policy. Inflationary expectations, as well as the budgetary outlook, would have a major effect on

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long-term interest rates and thus on business financial positions and the sustainability of the projected recovery in activity.

At its meeting on July 6-7, 1981, the Committee reaffirmed the monetary growth ranges for the period from the fourth quarter of 1980 to the fourth quarter of 1981 that it had set at its meeting in early February. These ranges were 3 to 5-1/2 percent for M1-A and 3-1/2 to 6 percent for M1-B, abstracting from the impact of NOW accounts on a nationwide basis; 6 to 9 percent for M2; and 6-1/2 to 9-1/2 percent for M3. The associated range for bank credit was 6 to 9 percent. The Committee recognized that a shortfall in M1-B growth in the first half of the year partly reflected a shift in public preferences toward other highly liquid assets and that growth in the broader aggregates had been running somewhat above the upper end of the ranges. In light of its desire to maintain moderate growth in money over the balance of the year, the Committee expected that growth in M1-B for the year would be near the lower end of its range. At the same time, growth in the broader monetary aggregates might be at the higher end of their ranges. For the period from the fourth quarter of 1981 to the fourth quarter of 1982, the Committee tentatively agreed that growth of M1, M2, and M3 within ranges of 2-1/2 to 5-1/2 percent, 6 to 9 percent, and 6-1/2 to 9-1/2 percent respectively would be appropriate.

In reviewing the objectives that it had established in early October for growth of M1-B and M2 over the final three months of the year, the Committee continued to face uncertainties with respect to the forces affecting the behavior of the monetary aggregates, including the apparent

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decline in the public's desire to hold transaction balances in the forms included in M1-B and the expansive effect on M2 of growth in money market mutual funds and of shifts into deposit forms that either bear a market interest rate or are subject to variable ceilings closely related to market rates. Growth of M1-B in October had fallen below the 7 percent annual rate that the Committee had adopted for growth over the final three months of the year. M2, meanwhile, had grown at an annual rate only slightly less than the 10 percent that had been specified for the final three months and remained close to the upper end of its range for the year.

Committee members continued to agree on the desirability of seeking somewhat more rapid growth in M1-B, while taking account of the relative strength of the broader monetary aggregates. At the same time, however, questions were raised about how aggressively more rapid growth in M1-B should be pursued in the short period before the end of the year. The view was expressed that objectives for growth of M1-B over that interval should take account of the desirability of a smooth transition to the targets for monetary growth tentatively established for 1982 as well as the relatively rapid growth in the broader aggregates. While recognizing the variability of demands for money over the short run, many members thought that an aggressive effort to stimulate M1-B growth over November and December at a pace sufficiently rapid to compensate for the shortfall in October would interfere with achievement of longer-term economic goals and would risk overly rapid expansion of money and credit in later months, particularly if the effort were accompanied

by a precipitous decline in short-term interest rates to levels that might not be sustainable. Such a decline in short-term rates could exacerbate inflationary expectations and abort a desirable downtrend in bond yields and mortgage interest rates.

Committee members in general believed that additional weakness in economic activity could well be accompanied by further declines in interest rates, which would be constructive in supporting economic activity. In that light, they wished to set objectives for monetary growth over the period ahead consistent with achieving further progress in reducing inflationary expectations and with minimizing the risk of destabilizing swings in both monetary growth and interest rates. Their view was reinforced by the concern that projection of large budgetary deficits in the years ahead, combined with inflationary sensitivities, could generate anticipations of a reversal of favorable interest rate trends as recovery in activity got under way.

After noting the moderate shortfall in growth of M1-B in October from the 7 percent annual rate that had been adopted for growth from September to December, the Committee decided to seek behavior of reserve aggregates associated with growth of M1-B from October to December at an annual rate of about 7 percent (after allowance for the impact of flows into NOW accounts) and with growth of M2 at an annual rate of around 11 percent. It was understood that somewhat more rapid growth of M1-B, consistent with the objective for growth over the fourth quarter adopted at the previous meeting, would be accepted in the event that transaction demands for money proved to be stronger than anticipated; it was also understood that moderate shortfalls from the

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growth path would not be unacceptable, particularly if broader aggregates continued to expand rapidly. The intermeeting range for the federal funds rate that provided a mechanism for initiating further consultation of the Committee was set at 11 to 15 percent.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that real GNP is declining appreciably in the current quarter and that prices on the average are rising somewhat less rapidly than over the first three quarters of the year. In October the nominal value of total retail sales dropped; industrial production fell more than in September; and nonfarm payroll employment, especially in manufacturing, declined sharply. The unemployment rate rose from 7.5 percent to 8.0 percent. Housing starts edged down in September from an already depressed level. Over the first 10 months of 1981, the rise in the index of average hourly earnings was less rapid than during 1980.

The weighted average value of the dollar against major foreign currencies has declined only a little since early October, although U.S. short-term interest rates have declined more than foreign rates. A reduced U.S. foreign trade deficit in September brought the deficit for the third quarter close to the second-quarter rate.

M1-B (adjusted for estimated shifts into NOW accounts) expanded in October almost as much as it had declined in September, and growth of M2 picked up. The level of adjusted M1-B remained well below the lower end of the Committee's range for growth over the year from the fourth quarter of 1980 to the fourth quarter of 1981; the level of M2 was at the upper end of its range for the year. Short-term market interest rates have declined substantially since the end of September, and bond yields have also dropped from the peaks generally reached about then. On October 30 the Board of Governors announced a reduction in Federal Reserve basic discount rates from 14 to 13 percent. The surcharge on frequent borrowings of large depository institutions had been reduced from 3 to 2 percentage points on October 9, and on November 16 the Board removed the remaining 2 percentage points.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation, promote a resumption of growth in output on a sustainable basis, and contribute to a sustainable pattern of international transactions. At its meeting in early July, the Committee agreed that its objectives would be furthered by reaffirming the monetary growth ranges for the period from the fourth quarter of 1980 to the fourth quarter of 1981 that it had set at the February meeting. These ranges included growth of 3-1/2 to 6 percent for M1-B, abstracting from the impact of flows into NOW accounts on a nationwide basis, and growth of 6 to 9 percent and 6-1/2 to 9-1/2 percent for M2 and M3 respectively. The Committee recognized that the shortfall in M1-B growth in the first half of the year partly reflected a shift in public preferences toward other highly liquid assets and that growth in the broader aggregates had been running at about or somewhat above the upper end of their ranges. In light of its desire to maintain moderate growth in money over the balance of the year, the Committee expected that growth in M1-B for the year would be near the lower end of its range. At the same time, growth in the broader aggregates might be high in their ranges. The associated range for bank credit was 6 to 9 percent. The Committee also tentatively agreed that for the period from the fourth quarter of 1981 to the fourth quarter of 1982 growth of M1, M2, and M3 within ranges of 2-1/2 to 5-1/2 percent, 6 to 9 percent, and 6-1/2 to 9-1/2 percent respectively would be appropriate. These ranges will be reconsidered as warranted to take account of developing experience with public preferences for NOW and similar accounts as well as changing economic and financial conditions.

The Committee, after noting a moderate shortfall in growth of M1-B in October from the target path set at the last meeting, seeks behavior of reserve aggregates consistent with growth of M1-B from October to December at an annual rate of about 7 percent (after allowance for the impact of flows into NOW accounts) and with growth of M2 at an annual rate around 11 percent. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 11 to 15 percent.

Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Keehn, Partee, Rice, Schultz, Mrs. Teeters, and Mr. Wallich. Votes against this action: None.

2. Authorization for domestic open market operations

On December 4, 1981, the Committee voted to increase from \$3 billion to \$4 billion the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective immediately, for the period ending with the close of business on December 22, 1981.

Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Keehn, Partee, Rice, Schultz, and Mrs. Teeters. Votes against this action: None. Absent: Mr. Wallich.

This action was taken on recommendation of the Manager for Domestic Operations. The Manager had advised that since the November meeting, substantial net purchases of securities had been undertaken to provide reserves in association with a seasonal increase in currency in circulation. The leeway for further purchases had been reduced to about \$900 million, and additional purchases in excess of that amount were likely to be required before the next Committee meeting.