FEDERAL RESERVE press release

For Use at 4:10 p.m. November 19, 1982

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 October 5, 1982.

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 October 5, 1982

Domestic policy actions

The information reviewed at this meeting suggested that real GNP had changed little in the third quarter, following an increase at an annual rate of about 2 percent in the second quarter. Average prices, as measured by the fixed-weight price index for gross domestic business product, were continuing to rise more slowly than in 1981.

The nominal value of retail sales fell nearly 1 percent in August, according to the advance report, returning to the sharply reduced June level. Sales declines were particularly marked at automotive outlets and at general merchandise, apparel, and furniture and appliance stores. Sales of new domestic automobiles increased slightly in August to an annual rate of 5.3 million units; sales rose further to an annual rate of 6 million units in the first 20 days of September, apparently in response to purchase incentives offered by manufacturers in an effort to reduce excess stocks of 1982 models.

After having changed little in July, the index of industrial production declined 0.5 percent in August to a level about 1 percent below its second-quarter average and more than 10 percent below its prerecession level in July 1981. Production of consumer goods fell in August, following a sizable advance over the preceding four months, and output of business equipment continued to drop at a rapid rate. Output of defense and space equipment expanded further. Limited information currently available for September was generally indicative of some further decline in production.

Nonfarm payroll employment fell further in August, mainly reflecting sizable job losses in the manufacturing and trade sectors. In contrast to the payroll data, the survey of households indicated an increase in employment, and the unemployment rate was unchanged at 9.8 percent. But initial claims for unemployment insurance rose to a new high in mid-September, suggesting further deterioration in the labor markets.

The Department of Commerce survey of business spending plans taken in late July and August suggested that businesses had again reduced their spending plans for 1982. The survey results indicated that current-dollar expenditures for plant and equipment would rise only 3/4 of a percent in 1982, compared with an estimated 2-1/4 percent in the May survey and 7-1/4 percent in the February survey. Actual expansion in 1981 was about 8-3/4 percent.

Private housing starts fell in August to an annual rate of 1.0 million units, reversing much of the substantial increase in July. While starts in August were above the average in the second quarter, they remained quite low by historical standards. Sales of existing homes declined 5 percent in August to the lowest monthly pace since 1970, while sales of new homes continued at the sluggish pace of recent months.

The producer price index for finished goods rose 0.6 percent in August, the same as in July. The consumer price index rose only 0.3 percent in August; food prices declined for the second consecutive month and energy prices leveled off after increasing sharply over the preceding three months. So far this year the producer price index and the consumer price index had risen at annual rates of about 3-3/4 percent and 5 percent respectively. In recent months the advance in the index of average hourly earnings had remained considerably less rapid than during 1981.

In foreign exchange markets the trade-weighted value of the dollar had risen about 5 percent over the period since the last FOMC meeting. The dollar's strength reflected in part a continuing concern in the market about economic and financial difficulties abroad and also some firming of U.S. interest rates relative to foreign rates after a considerable drop earlier. The U.S. foreign trade deficit rose sharply in August, reflecting primarily a substantial rebound in nonpetroleum imports. The deficit on average in July and August was at a rate well above that for the first half of the year, mainly because of increased imports of oil.

At its meeting on August 24, the Committee had agreed to continue seeking behavior of reserve aggregates consistent with growth of M1 and M2 from June to September at annual rates of about 5 percent and about 9 percent respectively. It had also agreed that somewhat more rapid growth in the monetary aggregates would be acceptable depending upon evidence that economic and financial uncertainties were leading to exceptional liquidity demands and changes in holdings of financial assets. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultations of the Committee, was set at 7 to 11 percent.

Following three months of weakness, M1 grew at an annual rate of about 10-1/2 percent in August and appeared to have grown more rapidly in September. Much of the strength of M1 was accounted for by rapid growth in other checkable deposits, but demand deposits also expanded in both months, after contracting on average since early in the year. The expansion in checkable deposits may have reflected in part the early impact on take-home pay of the tax cut as well as unusual liquidity demands in the face of continued economic uncertainties. Moreover, the lower level of short-term market interest rates had reduced the earnings disadvantage of keeping funds in checkable accounts. Growth in M2 accelerated to an annual rate of about 14-1/4 percent in August, but was estimated to have slowed substantially in September as expansion in its nontransaction component decelerated markedly.

Total credit outstanding at U.S. commercial banks grew at an annual rate of about 6-1/2 percent in August, the same as in July but well below the pace in the first half of the year. Partial data for September suggested that growth slowed somewhat despite a pickup in growth of business loans from the sharply reduced August pace; a significant part of the strengthening in business loans appeared to have been associated with merger activity. Other short-term borrowing by nonfinancial businesses generally was weak: the volume of commercial paper outstanding edged down in August and dropped further in September. However, the weakness in short-term borrowing was largely offset by increased long-term financing in the bond market.

Total reserves expanded quite rapidly in September, after having grown relatively little on average over the preceding several months. A little less than half of the September growth in total reserves was supplied by nonborrowed reserves, and adjustment borrowing (including seasonal borrowing) by depository institutions increased from an average of about $420 million in August to about $815 million in September.

Most short-term market interest rates rose somewhat on balance over the intermeeting interval. Rates had declined substantially over the preceding two months, and decreases were particularly marked around the time of the August 24 meeting of the Committee, when expectations of continued declines in short-term market rates were strong. Effective August 27, the Federal Reserve discount rate was reduced from 10-1/2 to 10 percent. Subsequently federal funds traded at rates somewhat above the discount rate, as compared with a trading level of around 9 percent in the last statement week of August, and rates on private short-term instruments also rose by about 1 to 2 percentage points from their late August lows. At the same time, rates on Treasury bills moved up only slightly, partly reflecting the increased preference for quality on the part of investors. The well-publicized problems in recent months of a few banks here and abroad, the acute external financing difficulties of Mexico, and emerging financing problems in other developing countries led to a more cautious atmosphere in private credit markets and a widening of yield spreads between U.S. government securities and some private credit instruments. Bond yields continued to decline over the intermeeting period, falling 1/4 to 3/4 percentage point. Average rates on new commitments for fixed-rate conventional home mortgage loans declined about 1 percentage point.

The staff projections presented at this meeting suggested that real GNP would grow moderately in the course of 1983, but that any recovery in economic activity in the months just ahead was likely to be quite limited. The projections for the year ahead also suggested that unemployment would remain at a high level. The rise in prices, as measured by the fixed-weight price index for gross domestic business product, was expected to slow gradually from a rate in the third quarter of 1982 that was estimated to be somewhat higher than that in the first half of the year.

In the Committee's discussion of the economic situation and policy, it was generally agreed that growth in real GNP over the next year at about the relatively restrained pace projected by the staff was a reasonable expectation. Expansion in output at a somewhat faster pace might occur, if consumer and business confidence in the outlook improved during the next few months. So far, however, the widely held expectations of recovery beginning in the spring or summer had been disappointed, and there were still no signs of a strengthening in the economy. The projected expansion in consumer demands associated with the midyear cut in federal income taxes had not yet developed; prospects for business plant and equipment spending and for commercial construction had deteriorated; and agricultural income and expenditures had remained depressed. In September industrial output and employment most likely had declined further, and the unemployment rate had almost surely risen from the July-August level of 9.8 percent. Against that background, it was recognized that there were risks of a shortfall from the projection of moderate growth in real GNP over the quarters ahead.

At the same time, progress in reducing the rate of inflation had been substantial, exceeding expectations of many, even after allowance for the influence of volatile prices of energy products and foods. Moreover, further moderation in labor cost and price pressures and also in inflationary expectations was a reasonable anticipation, given an environment of moderate expansion in output and employment, relatively low levels of resource utilization, and prospects for improvement in productivity.

Domestic problems were being intensified because the recession in economic activity was worldwide; it had affected every major industrial country and, through its impact on foreign trade and commodity prices, the developing countries as well. Many of the latter countries had accumulated large external debts over a number of years, and they now faced difficult financing and adjustment problems. Altogether, these circumstances had been contributing to an atmosphere of nervous uncertainty, which was reflected in, among other things, the foreign exchange value of the dollar. Over recent months, the dollar had risen against other major currencies even when dollar interest rates were declining relative to foreign rates, and the high exchange value currently had serious implications both for U.S. export industries and for efforts abroad to pursue flexible monetary policies.

The U.S. banking system had been subjected to pressures, owing in part to well-known problems of particular institutions but also to a more general uneasiness about the possibility of further credit problems domestically or internationally. An unusually cautious attitude in private credit markets had led to a widening of risk premiums, with the result that private interest rates had declined less than rates on Treasury securities since mid-summer, and in recent weeks private short-term market rates had tended to move up. Altogether, these circumstances appeared to have been associated with business efforts to generate and conserve cash, with market participants' concerns about the quality of credit, and with a general increase in precautionary demands for money and liquidity. In financial markets and elsewhere, a sense of disarray could develop, which could increase the atmosphere of uncertainty.

With respect to the period ahead, the Committee continued to face uncertainties about the interpretation of the behavior of the monetary aggregates in general, arising from the impact of the current economic environment on precautionary demands for money and liquidity. Moreover, the behavior of M1 in particular during the final three months of the year would inevitably be distorted by two institutional developments. First, a very large volume of all savers certificates would mature in the first part of October, and disposition of the proceeds could be expected to induce temporary bulges in both the demand deposit and NOW account components of M1. Second, later in the quarter, as the Depository Institutions Deregulation Committee (DIDC) implemented recent legislation, depository institutions would be authorized to offer a new account (or accounts) that would be free from interest rate ceilings, would be usable to some degree for transaction purposes, and would be competitive with money market mutual funds. The new account was likely to have a substantial impact on the behavior of M1, but no basis existed for predicting its magnitude. While the new account seemed likely to have a depressing effect on currently defined M1 as it drew money from NOW accounts, the direction of the overall effect was in some doubt since that would depend in part on the exact characteristics of the instrument or instruments authorized by the DIDC. The new instrument could include even more transaction features than the account specifically provided for in the legislation. The new instrument could also be expected to affect the composition of M2 and perhaps in some degree its total as well. It seemed clear, however, that the new instrument would affect the behavior of M2 and other broader aggregates to a much smaller extent than that of M1.

Because of these difficulties in interpreting the behavior of M1 during the fourth quarter, the Committee decided that it would place much less than the usual weight on that aggregate's movements during this period and that it would not set a specific objective for its growth. In the view of most members, against the background of prevailing economic and financial developments, added pressures on bank reserve positions and money markets in response to a bulge in M1 related to the maturing of all saver certificates were not justified; indeed, some easing of the pressures of recent weeks in some sectors of the private credit markets would be desirable, if that could be consistent with growth in the broader aggregates in line with longer-term objectives.

The Committee agreed that in all the circumstances, it would seek to maintain expansion in bank reserves needed for an orderly and sustained flow of money and credit, consistent with growth of M2 (and M3) from September to December at an annual rate in a range of around 8-1/2 to 9-1/2 percent, and taking account of the desirability of somewhat reduced pressures in private credit markets in the light of current economic conditions. Growth of M2 from the fourth quarter of 1981 to the fourth quarter of 1982 might be somewhat above the range for the year that the Committee had reaffirmed in July; the Committee had also agreed then that for a time it would tolerate growth somewhat above the target range, in the event of unusual precautionary demands for money and liquidity, and that such growth would be consistent with longer-term objectives. Recent and prospective market and economic conditions appeared consistent with that approach. Somewhat slower growth over the period from September to December, bringing those aggregates around the upper part of the ranges for the year ending in the fourth quarter of 1982, would be acceptable and desirable in a context of declining interest rates. Should economic and financial uncertainties lead to still stronger liquidity demands, somewhat more rapid growth in the broader aggregates would be tolerated. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 7 to 10-1/2 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 changed little in the third quarter, following a small increase in the second quarter, while prices on the average continued to rise more slowly than in 1981. In August the nominal value of retail sales fell back to the sharply reduced June level, while industrial production and nonfarm payroll employment also declined. Housing starts fell, reversing much of the substantial July increase. The unemployment rate was unchanged at 9.8 percent in August, but claims for unemployment insurance have

risen further in recent weeks and there are indications of some further decline in production. In recent months the advance in the index of average hourly earnings has remained considerably less rapid than during 1981.

The weighted average value of the dollar against major foreign currencies has risen strongly further over the past month, reflecting in part a continuing concern in the market about economic and financial difficulties abroad and also some firming of U.S. interest rates relative to foreign rates after a considerable drop earlier. The U.S. merchandise trade deficit rose sharply in August and on average in July and August the deficit rate was well above that for the first half.

After three months of weakness, M1 grew rapidly in August and September; growth in M2 accelerated in August from an already rapid pace but appears to have slowed markedly in September. Following large declines over the preceding two months, short-term market interest rates have risen somewhat on balance since late August, while bond yields and mortgage rates have continued to decline. The Federal Reserve discount rate was reduced from 10-1/2 percent to 10 percent in late August. Meanwhile, reflecting some well-publicized problems in recent months of a few banks here and abroad and the financing difficulties of Mexico, a more cautious atmosphere in private credit markets has been reflected in wider spreads between U.S. government and some private credit instruments.

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. In July, the Committee agreed that these objectives would be furthered by reaffirming the monetary growth ranges for the period from the fourth quarter of 1981 to the fourth quarter of 1982 that it had set at the February meeting. These ranges were 2-1/2 to 5-1/2 percent for M1, 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 agreed that growth in the monetary and credit aggregates around the top of the indicated ranges would be acceptable in the light of the relatively low base period for the M1 target and other factors, and that it would tolerate for some period of time growth somewhat above the target range should unusual precautionary demands for money and liquidity be evident in the light of current economic uncertainties. The Committee also indicated that it was tentatively planning to continue the current ranges for 1983 but that it would review that decision carefully in the light of developments over the remainder of 1982.

Specification of the behavior of M1 over the balance of the year is subject to unusually great uncertainties because it will be substantially affected by special circumstances -- in the very near term by reinvestment of funds from maturing all savers certificates and later by the public's response to the new account directly competitive with money market funds mandated by recent legislation. The probable difficulties in interpretation of M1 during the period suggest much less than usual weight be placed on movements in that aggregate during the current quarter. These developments are expected to affect M2 and other broader aggregates to a much smaller extent.

In all the circumstances, the Committee seeks to maintain expansion in bank reserves needed for an orderly and sustained flow of money and credit, consistent with growth of M2 (and M3) in a range of around 8-1/2 to 9-1/2 percent at an annual rate from September to December, and taking account of the desirability of somewhat reduced pressures in private credit markets in the light of current economic conditions. Somewhat slower growth, bringing those aggregates around the upper part of the ranges set for the year, would be acceptable and desirable in a context of declining interest rates. Should economic and financial uncertainties lead to exceptional liquidity demands, somewhat more rapid growth in the broader aggregates would be tolerated. 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 7 to 10-1/2 percent.

Votes for this action: Messrs. Volcker, Solomon, Balles, Gramley, Martin, Partee, Rice, Mrs. Teeters, and Mr. Wallich. Votes against this action: Messrs. Black and Ford and Mrs. Horn.

Mr. Black dissented from this action because he preferred to direct operations in the period immediately ahead toward restraining monetary growth. Although he was mindful of the current difficulties of interpreting the behavior of M1, he was concerned that the recent strength in M1 might be followed by still more rapid growth in lagged response to the substantial decline in short-term interest rates that had occurred in the summer, which could require even more restrictive operations later.

Mr. Ford dissented from this action because he preferred a policy for the period immediately ahead that was more firmly directed toward restraining monetary growth, although he recognized that the behavior of M1 in particular would be difficult to interpret. He was concerned that the Committee's policy directive might be misinterpreted in ways that could adversely affect pursuit of the System's longer-run anti-inflationary objectives, particularly in the context of a highly expansive fiscal policy program.

Mrs. Horn dissented from this action because she preferred to continue setting a specific objective for growth of M1, as well as for M2, over the current quarter, notwithstanding the problems of interpreting its behavior. In setting a target for M1, she would tolerate faster growth early in the period, owing to the uncertain impact of the proceeds from maturing all savers certificates, and would give greater weight to the behavior of M2 for some weeks after the introduction of the new instrument at depository institutions.