

FEDERAL RESERVE press release



For Use at 4:15 p.m.

February 11, 1983

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 December 20-21, 1982. This record also includes policy actions taken during the period between the meeting on December 20-21, 1982, and the next regularly scheduled meeting held on February 8-9, 1983.

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 December 20-21, 1982

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP, which had increased at an annual rate of 0.7 percent in the third quarter, declined in the fourth quarter, although final sales apparently were maintained. The rise in average prices, as measured by the fixed-weight price index for gross domestic business product, remained much less rapid than in 1981.

The nominal value of retail sales rose about 2-1/4 percent in November, after having increased 1-1/2 percent over the preceding two months. Although gains in November were recorded for all major categories of stores, the rise was attributable mainly to a sharp increase in sales at automotive outlets. Unit sales of new domestic automobiles increased to an annual rate of 6-3/4 million, as buyers responded to interest rate concessions and other special promotions offered primarily on 1982 models. In the first 10 days of December, however, sales fell back to an annual rate of 5-3/4 million units.

Private housing starts, both single-family and multifamily, rose substantially in November, and at an annual rate of 1.4 million units, were nearly 500 thousand units higher than the rate in the first half of the year. Newly issued permits for residential construction also strengthened, rising 6 percent in November after increasing 17 percent in October.

Business fixed investment spending appeared to be continuing the downtrend that began in mid-1981 as shipments and orders for nondefense capital goods declined in October, the latest month for which data were available. According to the Department of Commerce survey taken in late October and November, plant and equipment spending would rise only 2 percent in the first half of 1983 from the level in the second half of this year; in real terms, the survey results implied a decline of more than 2 percent. Along with capital spending, inventory investment was exerting a dampening influence on economic activity, as businesses continued their efforts to reduce inventories.

The index of industrial production fell again in November, but the decline of 0.4 percent was half that in each of the preceding two months. Most major sectors registered reductions in output, with cutbacks especially pronounced in durable goods industries. Defense and space equipment continued to be the only major category of final products showing strength. Capacity utilization in manufacturing declined to 67.8 percent, a new postwar low.

Nonfarm payroll employment fell 165,000 in November, about the same as the average monthly decline earlier in the year. Job losses were concentrated in the manufacturing sector, particularly durable goods manufacturing. The unemployment rate rose 0.4 percentage point to 10.8 percent. Initial claims for unemployment insurance, although down from the peaks in early autumn, remained relatively high.

The producer price index for finished goods rose 0.6 percent in November. More than half of the rise was attributable to sharp increases in prices of energy-related items; prices of consumer foods declined somewhat,

while prices of other consumer goods rose moderately. Over the first 11 months of the year the index increased at an annual rate of about 3-3/4 percent. The consumer price index edged up only 0.1 percent in November, as homeownership costs declined and price increases for most other major expenditure categories slowed. Thus far in 1982 the index had risen at an annual rate of about 4-1/2 percent, half the pace in 1981. The advance in the index for average hourly earnings slowed appreciably to an annual rate of 4-1/2 percent from June to November, compared with an annual rate of 6-1/2 percent over the first half of 1982 and about 8-1/2 percent during 1981.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had declined about 4-1/2 percent from peaks reached in early November. A major factor in the decline apparently was the market's reassessment of prospects for the U.S. foreign trade and current accounts. In October the U.S. foreign trade deficit rose sharply further: agricultural exports declined somewhat from the reduced third-quarter rate, and nonagricultural exports fell substantially while imports rose.

At its meeting on November 16, the Committee had agreed that 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 of around 9-1/2 percent. The Committee also decided that somewhat slower growth in M2 and M3, to the extent of reducing their expansion for the year to nearer the upper part of the ranges set for 1982, would be acceptable and desirable if such growth were associated with

declining interest rates. On the other hand, somewhat more rapid growth would be tolerated if continuing economic and financial uncertainties should appear to be reflected in exceptional demands for liquidity. The Committee had also decided that it would continue to place much less than the usual weight on the movements of M1 during the period from September to December and would not set a specific objective for its growth over the fourth quarter. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 6 to 10 percent.

The demand for reserves remained strong in November, reflecting particularly the continuing rapid growth of transaction balances. Nonborrowed reserves grew rapidly, although less so than in October, and adjustment borrowing (including seasonal borrowing) rose to an average of \$433 million in November from an average of \$337 million in October.

M2 grew at annual rates of about 8-1/4 percent and 11-3/4 percent in October and November respectively, and M3 grew at an annual rate of about 9-1/4 percent in both months. On average, expansion in these broader aggregates had remained at about or somewhat below the rates of earlier in the year. On the basis of partial data, however, it was estimated that expansion in M2 and M3 had slowed substantially in recent weeks. Growth of M1 had remained rapid in recent months, influenced by shifts of funds associated with the maturing in early October of a large volume of all savers certificates and possibly with the recent and prospective introduction of new deposit accounts at depository institutions.

Expansion in total credit outstanding at U.S. commercial banks slowed to an annual rate of 1-1/2 percent in November. Banks again acquired a sizable

volume of U.S. Treasury securities, but their total loans outstanding fell. Business loans contracted at an annual rate of nearly 8 percent and security loans declined markedly, while real estate and consumer loans remained sluggish. The outstanding volume of commercial paper of nonfinancial businesses contracted substantially for the third successive month, as firms continued to raise funds in the longer-term capital markets.

Short-term market interest rates declined about $3/8$ to $3/4$ percentage point on balance over the intermeeting period, while bond yields rose a little in response to unusually heavy borrowing by businesses and governments. The Federal Reserve announced reductions in the discount rate from $9-1/2$ to 9 percent on November 19 and to $8-1/2$ percent on December 13. In recent weeks federal funds had traded in the area of $8-1/2$ to 9 percent, compared with about $9-1/2$ percent over the previous intermeeting interval. The prime rate charged by most commercial banks on short-term business loans was reduced $1/2$ percentage point to $11-1/2$ percent in late November. Average rates on new commitments for fixed-rate conventional home mortgage loans had edged down further in recent weeks.

The staff projections presented at this meeting continued to suggest that real GNP would grow moderately during 1983. The projections also suggested that unemployment would remain at a high level. The rate of increase in prices, as measured by the fixed-weight price index for gross domestic business product, was expected to drift down.

The views of Committee members with respect to the economic situation and outlook had changed little in the period since the Committee meeting in mid-November. Moderate growth in real GNP over the year ahead accompanied by

some further improvement in the performance of prices continued in general to be regarded as a reasonable expectation.

Since mid-November, it was observed, additional signs of a near-term strengthening in activity had appeared, particularly in markets for housing and consumer goods, and there were indications of some improvements in business confidence in many parts of the country. At the same time, conditions in the industrial sector remained severely depressed, reflecting the sustained downtrend in business fixed investment, the ongoing efforts to pare business inventories, and the continued weakness in export markets. In some industries, the expansion in orders for defense equipment was providing at least a partial offset to the weakness in demands for nondefense equipment, but the translation of such orders into production and employment often involved extended lags. On balance, an upturn in economic activity appeared to be in the offing, although the evidence was not conclusive and some Committee members stressed that there were substantial risks of a shortfall from the staff projection.

As in mid-November, it was noted that financial market conditions had eased significantly since midyear, and fiscal policy over the second half of 1982 had become highly stimulative. In fact, some members continued to express concern that an overly expansive combination of fiscal and monetary policies might reinvigorate inflationary expectations, thereby fostering a rise in long-term interest rates that would limit or abort the expected recovery.

At a meeting in July 1982, the Committee had reaffirmed the monetary growth ranges for the period from the fourth quarter of 1981 to the fourth

quarter of 1982 that it had set at its meeting in early February. 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 had 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 uncertainties. The Committee had also indicated in July that it was tentatively planning to continue the current ranges for 1983. That decision will be reviewed at the Committee meeting scheduled for February 8-9, 1983, taking into account the latest economic developments and institutional changes associated with the new deposit accounts authorized by the Depository Institutions Deregulation Committee (DIDC).

In the Committee's discussion of policy for the near term, the period from December 1982 to March 1983, the members considered objectives for monetary growth against the background of the tentative ranges for 1983 as a whole. In the discussion, it was recognized that the behavior of the aggregates would continue to be distorted by institutional developments relating to deregulation of interest rates on deposits. Depository institutions had begun to offer the new money market deposit account that had been authorized by the DIDC, effective December 14, 1982. This account had limited transaction features and, while included in M2, was excluded from M1. The DIDC had also authorized a minimum

balance NOW account free of interest rate ceilings, effective January 5, 1983, which would be included in M1.

The impact of the new accounts on the behavior of the monetary aggregates was highly uncertain, especially in the case of M1 for which even the direction of the impact was currently unclear. A staff analysis referred to the large pool of liquid assets that could be shifted into the new accounts, possibly during a relatively short period of time. The magnitude of such shifts and the allocation of funds between the two new accounts would depend on the competitive pricing and promotion of the accounts by depository institutions and on the response of depositors to interest rate relationships and to the elements of convenience.

At one extreme, shifts of funds could be dominated by flows into the new NOW accounts, thereby causing M1 to rise sharply during some transition period. At the other extreme, money market deposit accounts might attract most of the shifted funds, including those from deposits in M1, retarding the growth of M1 if not actually reducing its level.

The shifts of funds would clearly work in the direction of expanding M2, although the magnitude of the effect was very uncertain. A large part of the shifts would probably represent a redistribution of funds among the components of M2, but in addition funds would shift into M2 from market instruments and from large-denomination certificates of deposit. Growth in M3 was expected to be affected the least because depository institutions would probably curtail their issuance of large-denomination certificates of deposit in response to the availability of funds through the new accounts. The timing

of the various shifts was also subject to a great deal of uncertainty, although earlier experience with the introduction of NOW accounts suggested that a large part of the transition to the new accounts would be concentrated in a relatively short period of time.

At its meetings held in October and November, the Committee had decided to place much less weight than usual on M1 in the fourth quarter and not to set a specific objective for its growth, because of the difficulties of interpreting its behavior in a period of major institutional changes. At this meeting, the members generally favored continuance of that reduced attention to M1 during the first quarter. Thus, the Committee focused on setting objectives for growth of M2 and M3.

Reference was made to the fact that, despite some evidence of a deceleration in the growth of these broader aggregates most recently, their expansion over the year ending in the current quarter would be somewhat above the growth ranges that had been set by the Committee. At recent meetings, however, most Committee members had endorsed the view that monetary growth somewhat above those ranges was appropriate in light of the indications of strong demands for liquidity during a period of relatively weak economic activity. The income velocity of the broader aggregates, and also of M1, appeared to have declined at an unusually sharp rate over the year.

With respect to M2, most Committee members indicated a preference for setting a first-quarter growth rate that would allow for some modest shift of funds into components of that aggregate from market instruments and large-denomination certificates of deposit. They were prepared, however, to accept greater growth if analysis of incoming data and other evidence from depository

institutions and market reports indicated that the new money market accounts were generating substantial shifts of funds into those aggregates from outside sources.

During the Committee's discussion, the observation was made that the uncertainties that had generated unusual demands for liquidity in relation to GNP during 1982--and the accompanying decline in the velocity of the monetary aggregates--could be expected to abate as economic activity strengthened and consumer and business confidence improved. Thus, abstracting roughly from the impact of the new deposit accounts, the velocity of money could be expected to show much less weakness in 1983 than in 1982, though whether it might continue to be affected by strong liquidity demands was open to question.

At the conclusion of the discussion, the Committee decided to seek to maintain expansion in bank reserves consistent with growth of M2 at an annual rate of around 9-1/2 percent and growth of M3 at an annual rate of about 8 percent for the period from December to March. The objective for M2 would allow for a modest amount of growth resulting from shifts into the newly authorized money market deposit accounts from large-denomination certificates of deposit or market instruments. For both M2 and M3, the Committee indicated that greater growth would be acceptable if analysis of incoming data and other evidence from banking and market reports indicated that the new money market deposit accounts were generating more substantial shifts of funds into these broader aggregates from market instruments. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 6 to 10 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 declined in the fourth quarter, although final sales apparently were maintained, and that the rise in prices remained much less rapid than in 1981. Retail sales and housing activity have strengthened in recent months, but business fixed investment apparently has weakened further and efforts to reduce inventories have continued. In November industrial production and nonfarm payroll employment declined further, and the unemployment rate rose 0.4 percentage point to 10.8 percent. Initial claims for unemployment insurance, although down from the early autumn peaks, have remained relatively high. In recent months the advance in the index of average hourly earnings has slowed appreciably further.

The weighted average value of the dollar against major foreign currencies has declined from peaks reached in early November. The U.S. merchandise trade deficit rose sharply further in October.

Growth of M1 has remained rapid in recent months, while growth of M2 and M3 has continued at about or somewhat below the rates of earlier in the year. On balance short-term market interest rates have declined since mid-November, while bond yields have risen somewhat in response to unusually heavy borrowing by businesses and governments; mortgage rates have edged down further. The Federal Reserve announced reductions in the discount rate from 9-1/2 percent to 9 percent on November 19 and to 8-1/2 percent on December 13.

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 should unusual precautionary demands for money and liquidity be evident in the light of current economic uncertainties. The Committee had also earlier indicated that it was tentatively planning to continue the current ranges for 1983, but it will review that decision carefully at its February 1983 meeting in light of economic developments and institutional changes associated with the new deposit accounts authorized by the Depository Institutions Deregulation Committee.

Specification of the behavior of M1 over the months ahead remains subject to substantial uncertainty because of special circumstances in connection with the public's response to the new deposit accounts available at depository institutions. The difficulties in interpretation of M1 continue to suggest that much less than usual weight be placed on movements in that aggregate during the coming quarter. The institutional changes also add a degree of uncertainty to the behavior of the broader monetary aggregates.

In all the circumstances, the Committee seeks to maintain expansion in bank reserves consistent with growth of M2 of around 9-1/2 percent at an annual rate, and of M3 at about an 8 percent rate, from December to March, allowing in the case of M2 for modest shifting into the new money market accounts from large-denomination CD's or market instruments. The Committee indicated that greater growth would be acceptable if analysis of incoming data and other evidence from bank and market reports indicate that the new money market accounts are generating more substantial shifts of funds into broader aggregates from market instruments. 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 6 to 10 percent.

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

Mr. Black dissented because he preferred to direct policy in the weeks immediately ahead toward ensuring that the growth of M1, abstracting from temporary effects of the introduction of new money market deposit accounts, would moderate from the extremely rapid rate of recent months. While recognizing the difficulties in interpreting M1 currently, he was concerned that excessive underlying growth in that aggregate might reverse the progress achieved in reducing inflation and inflationary expectations and lead to substantially weaker markets for long-term securities.

Mr. Ford dissented from this action because he continued to prefer a policy for the current period that was more firmly directed toward restraining monetary growth, after allowance for the short-run impact of the introduction of the new money market deposit accounts. He remained concerned that rapid expansion in the supply of money together with very large budget deficits would produce an overly stimulative combination of policies that could rekindle inflation and inflationary expectations and lead to higher interest rates during 1983 and 1984.

The Committee subsequently, on several occasions, discussed the extraordinarily rapid growth in money market deposit accounts (MMDAs) that has taken place since they became available in mid-December and the implications of this growth for behavior and interpretation of the monetary aggregates. At a telephone conference on January 28, 1983, it was noted that these accounts had risen to a level of about \$185 billion on average by the week ending January 19, leading to a very sharp expansion in M2. Estimates of sources of MMDA inflows at this time were inevitably subject to considerable

uncertainty. Growth of M2 seemed clearly to be on a track well above the 9-1/2 percent annual rate for the December to March period set at the December meeting, but staff analysis--based on assessment of incoming data as well as various reports on sources of MMDA inflows--suggested it was possible that virtually all of the greater M2 growth might be attributed to unexpectedly large shifts into MMDAs out of instruments not included in M2. Effects on M3 were more problematical, but actual growth of this aggregate in December and January on average appeared to have been modest. Expansion of M1 had remained on the strong side; while there may have been some diversion from M1 to MMDAs, its growth very recently had been raised by the introduction of Super Now accounts. It was the Committee consensus for the time being to maintain the existing degree of reserve restraint but not to increase this restraint further in response to the recent reported over-target growth of the broader monetary aggregates because that growth appeared to be primarily related to the massive redistribution of funds currently under way. The situation will be reviewed at the FOMC meeting on February 8-9.

2. Authorization for domestic open market operations

At this meeting 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 February 9, 1983.

Votes for this action: Messrs. Volcker
Solomon, Balles, Black, Ford, Gramley, Mrs. Horn,
Messrs. Martin, Partee, Rice, Mrs. Teeters, and
Mr. Wallich. Votes against this action: None.

This action was taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that substantial net sales of securities were likely to be required during January in order to absorb reserves that had been provided over recent weeks to meet seasonal needs for currency in circulation.

On January 25-26, 1983, the Committee voted to approve an additional increase to \$5.5 billion in the intermeeting limit on changes in holdings of U.S. government and federal agency securities, effective immediately, for the period ending with the close of business on February 9, 1983. This action was taken after the Manager had advised that the seasonal need to absorb reserves in association with the return flow of currency would be greater than anticipated earlier.

Votes for this action: Messrs. Volcker
Solomon, Balles, Black, Ford, Gramley, Mrs.
Horn, Messrs. Martin, Partee, Rice, Mrs.
Teeters, and Mr. Wallich. Votes against this
action: None.