FEDERAL RESERVE press release

For Use at 4:30 p.m. July 15, 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 May 24, 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 May 24, 1983

Domestic policy directive

The information reviewed at this meeting suggested that growth in real GNP would accelerate, perhaps rather substantially, in the current quarter, after an increase at an annual rate of about 2-1/2 percent in the first quarter. To a considerable extent, the expected pickup in growth reflected an apparently marked further slowing in the rate of inventory liquidation, with an ending of liquidation possible during the quarter. At the same time final demands for goods and services, which had strengthened in late 1982, were being relatively well maintained. The rise in average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be continuing at about the moderate pace recorded over the past year.

The index of industrial production rose 2.1 percent in April, the largest monthly increase since the summer of 1975, to a level about 6 percent above its recent trough in November. Gains in output were spread across a broad range of industries, and were particularly strong for consumer durable goods and durable goods materials. Production of business equipment, which had contracted sharply since late 1981, also rose substantially in April after turning up in March. Rates of capacity utilization in manufacturing and at materials producers increased from record lows late in 1982 to around 71 percent in April.

Nonfarm payroll employment increased more than 250,000 in April, after an increase of about 200,000 in March. Employment gains in manufacturing and service industries accounted for the bulk of the rise in both months. The civilian unemployment rate edged down further to 10.2 percent in April.

The dollar value of retail sales advanced 1.6 percent in April, about the same as in March. Outlays at apparel and furniture and appliance stores were brisk, but a major factor in the April gain was increased spending on new cars. Sales of new domestic automobiles, which had held at an annual rate of slightly over 6 million units since November, rose to a rate of 6.4 million units in April and strengthened somewhat further in early May.

Total private housing starts declined somewhat in both March and April, but at an annual rate of 1.5 million units in April, they were still about 40 percent above the depressed 1982 average. Newly issued permits for residential construction picked up in April, reflecting a marked increase in permits for multifamily units. Sales of new and existing homes increased substantially in the first quarter of 1983.

The producer price index for finished goods edged down in both March and April; prices of energy-related items, which are lagged one month in this index, declined considerably further while prices of consumer foods increased. The consumer price index rose 0.6 percent in April, after having edged up 0.1 percent in March; more than one-third of the April increase reflected the rise in gasoline prices associated with implementation of the higher federal excise tax. Thus far in 1983 the consumer price index has increased little, and the index of average hourly earnings has risen at a considerably slower pace than in 1982.

Since late March the trade-weighted value of the dollar in foreign exchange markets had remained in a narrow range near its recent high level. The U.S. foreign trade deficit in the first quarter was about one-third less than in the preceding quarter, as oil imports dropped sharply, reflecting a decline in price and a considerable reduction in volume.

At its meeting on March 28-29, 1983, the Committee had decided that open market operations in the period until this meeting should be directed at maintaining generally the existing degree of restraint on reserve positions, anticipating that such a policy would be consistent with a slowing from March to June in growth of M2 and M3 to annual rates of about 9 and 8 percent respectively. The Committee expected that growth in M1 at an annual rate of about 6 to 7 percent over the three-month period would be associated with its objectives for the broader aggregates. The Committee members agreed that lesser restraint on reserve positions would be acceptable in the context of more pronounced slowing in the growth of the monetary aggregates (after taking account of any distortions relating to the introduction of new deposit accounts) or of evidence of a weakening in the pace of economic recovery. If monetary expansion proved to be appreciably higher than expected, without being clearly explained by the effects of ongoing institutional changes, it was understood that the Committee would consult about the desirability under the prevailing circumstances of any substantial further restraint on bank reserve positions. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

Growth in M2, which had slowed to an annual rate of about 11 percent in March, decelerated further in April to an annual rate of about 3 percent.

The deceleration reflected, in part, substantial shifts of funds into individual retirement and Keogh accounts before the April 15 tax date. Growth in M3 slowed to an annual rate of about 4-1/2 percent, after expanding at an 8-1/4 percent pace in March. Partial data suggested that expansion in both M2 and M3 had picked up in early May, but growth to date still appeared to be below the annual rates of 9 and 8 percent respectively expected by the Committee for the period from March to June.

M1 declined at an annual rate of about 3 percent in April but, according to preliminary data, strengthened markedly in early May. Thus far in the second quarter, growth in M1 appeared to be running substantially above the annual rate of 6 to 7 percent deemed consistent with the Committee's expectations for the broader aggregates.

Growth in debt of domestic nonfinancial sectors appeared to have continued in April at about the same pace as in the first quarter. Over the first four months of the year, debt expansion was estimated at an annual rate of about 9-1/2 percent, well within the Committee's range of 8-1/2 to 11-1/2 percent for the year. Funds raised by the U.S. Treasury grew at about twice the rate of total debt expansion, while private debt rose at a moderate pace. Growth in total credit outstanding at U.S. commercial banks slowed somewhat in April, as banks continued to acquire sizable amounts of Treasury securities but reduced substantially their holdings of business loans.

Growth in total and nonborrowed reserves slowed appreciably in April and early May, as weakness in transaction deposits over much of March and in April was reflected with a lag in reduced demand for required reserves. Apart from large borrowings around the end-of-quarter statement date early in the intermeeting period, adjustment borrowing from the Federal Reserve discount window, including seasonal borrowing, fluctuated within a range of about $200 million to $675 million. Special factors, such as relatively sizable weekend borrowing associated with wire transfer problems, contributed at times to increased demands for borrowing. Excess reserves also continued to be volatile and were relatively high on average. Federal funds generally traded in a range of 8-1/2 to 8-3/4 percent during the intermeeting interval.

Market interest rates changed little on balance over the intermeeting interval. Short-term interest rates declined about 1/4 percentage point while most long-term rates were slightly lower or up only marginally. Market rates had fallen considerably in the early part of the period but had risen again most recently, as growth in the monetary aggregates seemed to be strenthening, signs of economic recovery became more widespread, and prospects increased that private credit demands would strengthen while Treasury borrowing remained exceptionally large. Average rates on new commitments for fixed-rate conventional home mortgage loans at savings and loan associations fell about 30 basis points further.

The staff projections presented at this meeting indicated that growth in real GNP in the second half of the year would be a little higher than had been expected, though probably slowing somewhat from the second-quarter pace. Recent evidence, including increased spending for business equipment, strength in new orders at durable goods manufacturers, and survey reports of marked improvement in consumer attitudes, suggested somewhat stronger private final demands from businesses and consumers than had been anticipated previously. The unemployment rate was projected to decline only modestly from its recent high level, and the rise in the average level of prices was expected to remain moderate.

In the Committee's discussion of the economic situation and outlook, a number of members expressed general agreement with the staff projection, but several emphasized that economic activity might well prove to be stronger than projected, especially during the quarters immediately ahead. Members observed that consumer sentiment appeared to have improved considerably, and that retail sales should benefit from the increased market value of financial asset portfolios as well as from the federal tax cut at midyear. A turnaround from sharp inventory liquidation to little change, or possibly even some accumulation, was seen as likely and would have a pronounced positive impact on GNP and on income flows, at least for a quarter or two. Members also commented that an increasingly stimulative fiscal policy would add strength to the recovery over the period ahead, and an unduly large federal deficit was likely to create problems later as private credit demands expanded.

While all Committee members anticipated continuing and possibly substantial improvement in economic activity over the months ahead, a number also questioned the balance and sustainability of the recovery. They noted that, though business capital spending was showing signs of reviving, it would need to improve markedly further to foster an extended recovery. Such spending could be inhibited if a continuing need to finance large federal deficits engendered rising interest rates as the recovery proceeded. The outlook for exports was also thought to be relatively weak, although exports should eventually improve if the foreign exchange value of the dollar were to decline substantially and if major disturbances in international financial markets were averted. One member commented that housing activity could be less strong than was widely anticipated and another observed that consumer spending could prove to be disappointing, particularly if consumers did not react more positively to the approaching tax cut than they had to the 1982 reduction. Another member commented that recent indications of a more vigorous recovery might reflect mainly a short-lived inventory adjustment.

Other members expressed a differing view and emphasized that the prospects for an extended recovery were relatively favorable. In support of this view it was observed that substantial improvements in consumer spending and inventory investment were likely to be followed by increasing capital investment, in the pattern characteristic of earlier cyclical expansions. In this connection some members stressed that the expansion might well gather momentum and prove to be much stronger than the staff was projecting, partly because the recovery would follow a relatively long and severe recession.

At this meeting the Committee reviewed the monetary growth ranges that it had established in February for the year 1983. It decided not to change any of the ranges or the relative importance of the various aggregates for policy, pending a further review at the July meeting. Growth of the broader aggregates appeared to be within the Committee's ranges for the year. Earlier in the year, growth of M2 had been affected to a major extent by large shifts of funds associated with the introduction of money market deposit accounts; such shifts had slackened substantially, although MMDAs were still expanding at a somewhat faster rate than the staff had projected earlier. M1 had grown substantially in excess of the Committee's expectations in the latter part of 1982 and the first quarter of 1983. Staff analysis based on recent research suggested that this earlier growth reflected to a substantial extent lagged responses to the decline in interest rates that began during the summer of 1982. That decline had enhanced the attractiveness of NOW accounts, which serve as a vehicle for savings as well as for transactions. The performance of M1 would continue to be affected by substantial uncertainties relating to the interest and income sensitivity of fixed-ceiling NOW accounts and also by the growing importance in M1 of the more recently introduced Super NOW accounts, which bear a market-related rate of interest. While the effects of earlier declines in interest rates should now be diminishing, given the relative stability of rates over recent months, some time would be needed to evaluate the evolving role of M1 as a vehicle for savings.

Turning to policy for the short run, the members noted a staff analysis which suggested that maintenance of the existing degree of restraint on reserve positions might be associated with second-quarter growth of M2 and M3 marginally below the rates established by the Committee at the previous meeting, but with expansion of M1 above the level anticipated by the Committee, given the surge in M1 growth during the first part of May. The staff analysis also indicated that, within limits, alternative policy courses would have relatively little impact on the second-quarter growth of the monetary aggregates in light of the limited time remaining in the quarter, but would affect their growth more substantially over the months ahead.

In the course of their discussion, Committee members expressed differing views with regard to the appropriate course for policy in the weeks immediately ahead. The members were narrowly divided between those who favored some increase in reserve restraint over the next few weeks and others who preferred to maintain the degree of reserve restraint contemplated at the March meeting. This divergence reflected varying assessments of the strength and sustainability of the economic recovery; differing views with regard to the interpretation of the monetary aggregates; and different opinions concerning the risks associated with the likely impact of alternative policy courses on domestic interest rates. Members also noted the potential sensitivity of international financial conditions and the foreign exchange value of the dollar to firmer credit conditions in the United States, suggesting for some a dilemma for monetary policy stemming in substantial part from the budgetary situation.

Members who supported retention of the current short-run policy emphasized that the growth of the broader monetary aggregates, on which the Committee had focused, was within the Committee's 1983 ranges for the year to date. Moreover, such growth seemed to be falling a bit short of the second-quarter targets that the Committee had set at the previous meeting. Expansion in total domestic nonfinancial debt also appeared to be within the range for 1983 that the Committee had established for monitoring purposes. M1 clearly was growing at a pace well above the Committee's expectations, but many members continued to view that aggregate as an unreliable guide for policy and they preferred to give little or no weight to its performance, at least for the present.

A number of members were also concerned that under current circumstances even a modest tightening of reserve conditions might have a disproportionate impact on sentiment in domestic and international financial markets and lead to sizable increases in domestic interest rates. In their view increases in interest rates would have adverse consequences for interest-sensitive sectors of the economy and possibly for the sustainability of the economic recovery. Indeed, one member believed that lower interest rates were likely to be needed to ensure continued economic expansion. Moreover, appreciably higher U.S. interest rates might have particularly damaging consequences internationally by raising the foreign exchange value of the dollar and intensifying the severe pressures on countries with serious external debt problems.

Other Committee members, however, weighed the risks associated with alternative policy courses differently. They felt that at least limited tightening of reserve conditions was desirable in light of the very rapid growth in M1 against the background of accumulating evidence that the economic recovery was accelerating. While, consistent with previous decisions, M1 was not given so much weight as a monetary policy target as it had had earlier, a number of members nonetheless saw a need to move toward restraining its growth, which clearly was running well above the pace for the second quarter that the Committee had expected would be consistent with the behavior of the broader aggregates.

Several members commented that slightly greater restraint on reserves would be desirable at this point to minimize the possible need for more substantial restraint later, reducing the interest rate impact on financial markets over time and helping to sustain the expansion. Reference was made to the favorable effect such a move might have on market perceptions about monetary policy and the outlook for containing inflation, with the consequence that prospects for stable or declining interest rates in long-term debt markets would be enhanced as the recovery proceeded. The view was also expressed that the external debt difficulties of a number of foreign countries were continuing problems. The Federal Reserve could best contribute to the resolution of those problems by following policies that would foster sustained, noninflationary economic growth. Deferring any action could well pose a greater dilemma at a later time.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored marginally more restraint on reserve positions for the near term. Although these members differed on the precise degree of additional restraint that they preferred, they indicated their acceptance of a directive calling for only slightly more restraint on reserve positions than had been approved at the previous meeting. It was understood that at this point M2 and M3 seemed to be on courses that would bring their growth to slightly below the rates of 9 and 8 percent respectively that had been set at the March meeting for the second quarter, but that M1 would probably expand at a rate well above the growth that had been anticipated for the quarter. The members agreed that lesser restraint would be appropriate in the context of more pronounced slowing in the growth of the broader monetary aggregates within their 1983 ranges and deceleration of M1 growth, or of indications that the pace of the economic recovery was weakening. It was understood that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee, would remain at 6 to 10 percent.

At the conclusion of its discussion, the Committee issued the following domestic policy directive to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that growth in real GNP has accelerated in the current quarter following a moderate increase in the first quarter. Industrial production increased sharply in April after rising at a moderate pace in previous months; nonfarm payroll employment and retail sales rose considerably in March and April. Housing starts declined somewhat in both months but were still well above depressed 1982 levels. Data on new orders and shipments suggest that the demand for business equipment is reviving. The civilian unemployment rate edged down to 10.2 percent in April. Average prices have changed little and the index of average hourly earnings has risen at a much reduced pace in the early months of 1983.

The weighted average value of the dollar against major foreign currencies has remained in a narrow range near its recent high level since late March. The U.S. foreign trade deficit fell substantially in the first quarter, reflecting a sharp drop in the value of oil imports.

Growth in M2 and M3 decelerated further in April to relatively low rates but appears to have picked up recently. M1 declined in April but has strengthened markedly in early May. Growth in debt of domestic nonfinancial sectors appears to have been moderate over the first four months of the year. Interest rates have changed little on balance since late March.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote a resumption of growth in output on a sustainable basis, and contribute to a sustainable pattern of international transactions. At its meeting in February the Committee established growth ranges for monetary and credit aggregates for 1983 in furtherance of these objectives. The Committee recognized that the relationships between such ranges and ultimate economic goals have been less predictable over the past year; that the impact of new deposit accounts on growth ranges of monetary aggregates cannot be determined with a high degree of confidence; and that the availability of interest on large portions of transaction accounts, declining inflation, and lower market rates of interest may be reflected in some changes in the historical trends in velocity. A substantial shift of funds into M2 from market instruments, including large certificates of deposit not included in M2, in association with the extraordinarily rapid buildup of money market deposit accounts, distorted growth in that aggregate during the first quarter.

In establishing growth ranges for the aggregates for 1983 against this background, the Committee felt that growth in M2 might be more appropriately measured after the period of highly aggressive marketing of money market deposit accounts had subsided. The Committee also felt that a somewhat wider range was appropriate for monitoring M1. Those growth ranges were to be reviewed in the spring and altered, if appropriate, in the light of evidence at that time. The Committee reviewed the ranges at this meeting and decided not to change them at this time, pending further review at the July meeting. With these understandings, the Committee established the following growth ranges: for the period from February-March of 1983 to the fourth quarter of 1983, 7 to 10 percent at an annual rate for M2, taking into account the probability of some residual shifting into that aggregate from non-M2 sources; and for the period from the fourth quarter of 1982 to the fourth quarter of 1983, 6-1/2 to 9-1/2 percent for M3, which appeared to be less distorted by the new accounts. For the same period a tentative range of 4 to 8 percent was established for M1, assuming that Super NOW accounts would draw only modest amounts of funds from sources outside M1 and assuming that the authority to pay interest on transaction balances was not extended beyond presently eligible accounts. An associated range of growth for total domestic nonfinancial debt was estimated at 8-1/2 to 11-1/2 percent.

In implementing monetary policy, the Committee agreed that substantial weight would continue to be placed on behavior of the broader monetary aggregates expecting that distortions in M2 from the initial adjustment to the new deposit accounts will abate. The behavior of M1 will continue to be monitored, with the degree of weight placed on that aggregate over time dependent on evidence that velocity characteristics are resuming more predictable patterns. Debt expansion, while not directly targeted, will be evaluated in judging responses to the monetary aggregates. The Committee understood that policy implementation would involve continuing appraisal of the relationships between the various measures of money and credit and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

The Committee seeks in the short run to increase only slightly the degree of reserve restraint. The action was taken against the background of M2 and M3 remaining slightly below the rates of growth of 9 and 8 percent, respectively, established earlier for the quarter and within their long-term ranges, M1 growing well above anticipated levels for some time, and evidence of some acceleration in the rate of business recovery. Lesser restraint would be appropriate in the context of more pronounced slowing of growth in the broader monetary aggregates relative to the paths implied by the long-term ranges and deceleration of M1, or indications of a weakening in the pace of economic recovery. 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, Gramley, Keehn, Martin, Partee, Roberts, and Wallich. Votes against this action: Messrs. Solomon, Guffey, Morris, Rice, and Mrs. Teeters.

Messrs. Solomon, Guffey, Morris, Rice, and Mrs. Teeters dissented from this action because they wanted open market operations to continue being directed toward maintaining approximately the degree of reserve restraint approved at the previous meeting. In the view of these members, a firming of reserve conditions was not warranted by the performance of the monetary aggregates or by the current economic situation. M2 and M3 were expanding more slowly in the second quarter than the Committee had anticipated at its previous meeting and for the year to date these broader aggregates, along with total domestic nonfinancial credit, were growing at rates that were within the Committee's 1983 ranges. M1 had been expanding at a pace markedly in excess of the Committee's expectations in recent weeks and for the year to date, but this aggregate was not viewed as a sufficiently reliable guide for policy, at least for the present, since its performance was substantially distorted by various developments and it was not predictably related to nominal GNP.

Under current economic and financial circumstances, the implementation of firmer reserve conditions would also incur an undue risk of an exaggerated reaction in domestic and international financial markets. Substantially higher domestic interest rates would have damaging consequences for interest-sensitive industries and could limit the recovery in economic activity. These members agreed that current interest rate levels appeared to be more consistent with continuing economic expansion in the months immediately ahead, but Mrs. Teeters believed that lower interest rates might well be needed later to sustain the recovery.

These members also referred to the potentially disruptive international impact of rising U.S. interest rates. Messrs. Solomon, Guffey, and Morris in particular believed that the already strong dollar in foreign exchange markets, the tenuous situation of some of the developing countries, the still fragile economic recovery in other industrial countries, and the continuing weak outlook for U.S. exports counseled against an increase in reserve restraint.

On June 23 the Committee held a telephone conference to review recent developments in the domestic and international economy and financial markets since the May 24 meeting. Evidence suggested that economic activity was continuing to strengthen at a somewhat more rapid pace than had generally been anticipated earlier. Some interest rates had increased modestly in recent weeks. Growth in monetary aggregates, particularly M1, had been relatively rapid although growth in M2 and M3 remained close to the targets established for the quarter as a whole.

Against that background, the consensus was that a modest increase in reserve restraint, within the framework of the directive adopted at the May 24 meeting and consistent with recent reserve conditions, remained appropriate.