FEDERAL RESERVE press release

For Use at 4:30 p.m. February 3, 1984

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 19-20, 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 19-20, 1983

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP was growing at a relatively rapid pace in the current quarter, although the rate of expansion appeared to have moderated from the third-quarter pace. Strength in personal consumption expenditures and in business spending--particularly for inventories and equipment--is apparently contributing to the continued expansion in economic activity. Price and wage increases generally have remained moderate, though advances in some indexes have been somewhat larger than in the spring and summer.

The index of industrial production increased 0.8 percent in November, the same as in October. Output of business equipment continued to rise briskly, registering average increases of nearly 1-1/2 percent in each of the two months. Output of materials also continued to increase rapidly, but production of consumer goods and construction supplies rose only slightly. The rate of capacity utilization in manufacturing increased 0.5 percentage point further in November to 79.4 percent, well above its recession low of 68.8 percent a year earlier.

Nonfarm payroll employment, adjusted for strike activity, advanced about 345,000 further in November; the rise was larger than in October but about the same as the average monthly increase in the second and third quarters. Employment gains were widespread, and were particularly marked in manufacturing and service industries. The civilian unemployment rate fell 0.4 percentage point further to 8.4 percent, nearly 2-1/2 percentage points below its peak in December 1982.

The nominal value of retail sales rose 1.9 percent in November, after increases of 1.4 percent in each of the preceding two months. Sales increased at most major categories of stores in November, including a substantial rise in purchases of discretionary items, as indicated by strong outlays at general merchandise and apparel stores. Sales at automotive outlets also rose markedly. While sales of new domestic automobiles, at an annual rate of about 7 million units in both October and November, were up only slightly from the average selling pace in the third quarter, the annual rate of imported car sales averaged about 350,000 units higher in those months than in the third quarter.

Private housing starts rose about 6-1/2 percent in November, to an annual rate of about 1-3/4 million units, and newly issued permits for residential construction increased marginally. For both series, the levels in November were close to the averages in the third quarter. In October, sales of existing homes fell about 5-1/2 percent below their average in the third quarter, while sales of new homes rose for the second consecutive month.

Indicators of business capital spending have moved somewhat erratically in recent months, but generally suggest continued relatively strong expansion in that sector. Shipments of nondefense capital goods surged in September but fell somewhat in October. New orders, however, recorded strong gains in September and October, and the backlog of unfilled orders rose sharply in both months.

The producer price index for finished goods had changed little on average over the previous two months, rising 0.3 percent in October and falling 0.2 percent in November. Thus far in 1983 the index had increased at an annual rate of less than 1/2 percent. The consumer price index rose 0.4 percent in October, about the same as in the preceding three months; over the first ten months of the year, consumer prices had increased at an annual rate of about 4 percent. The index of average hourly earnings was little changed in November, after rising somewhat faster in September and October than in previous months. Thus far in 1983 the index had increased at an annual rate of about 3-1/2 percent, compared with a rise of 6 percent in 1982.

In foreign exchange markets the trade-weighted value of the dollar had risen more than 3 percent since the FOMC meeting in mid-November, surpassing the peak recorded in August. Increasing international tensions apparently contributed to the dollar's strength, as investors viewed dollar assets as a "safe haven" in the face of concerns about the security of financial assets in some other parts of the world. Evidence of continued strong expansion in U.S. economic activity also fueled the dollar's rise. News of a record trade deficit for October, at a rate markedly higher than that in the third quarter, slowed the appreciation of the dollar only temporarily. The rise in the deficit reflected a sharp increase in imports, as exports were about unchanged.

At its meeting on November 14-15, 1983, the Committee had decided that in the short run, open market operations should be directed toward maintaining the existing degree of reserve restraint. The members anticipated that such a policy would continue to be associated with growth of M2 and M3 at an annual rate of around 8-1/2 percent for the period from September to December, consistent with the growth ranges established for those aggregates for the year. Those ranges were 7 to 10 percent at an annual rate for M2 for the period from February-March of 1983 to the fourth quarter of 1983; and 6-1/2 to 9-1/2 percent for M3 for the period from the fourth quarter of 1982 to the fourth quarter of 1983. It was agreed that over the coming intermeeting period the need for greater or lesser restraint on reserve conditions should be evaluated on the basis of evidence about the continuing strength of the economic recovery and other factors bearing on the business and inflation outlook. Depending on such evidence, somewhat greater restraint would be acceptable should the aggregates expand more rapidly, while lesser restraint might be acceptable in the context of a significant shortfall in growth of the aggregates from current expectations.

Growth in M2 and M3, after slowing substantially over the summer months, strengthened in October and November. M2 was growing at a pace close to the annual rate of 8-1/2 percent specified by the Committee for the September-to-December period; M3 grew at an annual rate of 8-1/2 percent in October but increased at a faster pace in November, as banks relied more on managed liabilities, partly to offset a massive runoff of U.S. Treasury balances associated with the temporary delay in raising the federal debt limit. M1 continued to expand at a sluggish pace in November but increased substantially in early December. Through November, M2 was in the lower portion of the Committee's longer-run range for the year 1983, M3 was close to the upper limit of its range, and M1 was near the lower end of the

Committee's monitoring range of 5 to 9 percent for the period from the second quarter of 1983 to the fourth quarter of 1983.

The debt of domestic nonfinancial sectors was estimated to have continued expanding at a moderate pace in November, and its level remained well within the Committee's monitoring range of 8-1/2 percent to 11-1/2 percent for the year. Growth in credit at U.S. commercial banks rose to an estimated annual rate of about 14 percent in November, reflecting an acceleration in growth of total loans and continued heavy acquisitions of Treasury securities. Real estate and consumer lending, while moderating somewhat in November, remained strong. Borrowing by businesses picked up, as issuance of commercial paper slowed considerably from the brisk pace of previous months and financing in long-term debt markets remained light.

Total reserves contracted in November, as required reserves declined in association with a drop in demand deposits. Nonborrowed reserves fell by more, as the average level of adjustment borrowing rose in that month. Demands for borrowing eased off in the first half of December, however. Over the intermeeting interval as a whole, adjustment plus seasonal borrowing ranged from about $440 million to $865 million, averaging about $685 million during the four statement weeks ending December 14, only slightly above the average during the previous intermeeting period.

Federal funds continued to trade in a range of about 9-1/4 to 9-1/2 percent over the period, with recent trading generally near the upper end of that range. Other short-term interest rates rose about 1/4 to 3/4 percentage point over the intermeeting period, while most long-term rates increased about 1/4 percentage point. Rates on municipal bonds rose somewhat more, as issuers marketed large volumes of such securities in advance of deadlines on some types of issuance or in anticipation of legislation in 1984 imposing restrictions on the issuance of certain tax-exempt bonds. Average rates on new commitments for fixed-rate conventional home mortgage loans changed little over the period and have fluctuated in a narrow range near 13.40 percent since late October.

The staff projections presented at this meeting continued to indicate that growth of real GNP would slow from the rapid rate of recent quarters to a more moderate pace in 1984. Consumption expenditures and housing outlays were projected to moderate after growing rapidly in 1983, and the stimulus to economic growth from inventory accumulation was likely to diminish. However, business fixed investment was expected to show continued strength, and the deterioration in net exports of goods and services was expected to slow over the course of 1984. A decline in the unemployment rate was anticipated over the projection period, and upward pressures on prices were expected to remain generally moderate.

In the Committee's discussion of the economic situation and outlook, the members commented that further expansion in economic activity remained a likely prospect for 1984 but that the rate of growth would probably slow considerably from the pace in recent quarters. At the same time, members referred to the many uncertainties that clouded the outlook, and several expressed concern that inflationary pressures might worsen during the year. Reports from around the country indicated widespread improvement in business conditions and the development of considerable optimism in the business community, although it was also noted that some industries were still operating well below capacity.

In the view of some Committee members, the expansion in economic activity during 1984 might well exceed the staff projection, given the momentum of the recovery and a stimulative fiscal policy. In particular, it was suggested that the currently high level of confidence among businessmen and large cash flows to business firms favored relatively rapid expansion in business fixed investment. Some members also referred to the possibility of a build up in inventories by firms that had been experiencing strong sales and increasing delays in obtaining new supplies of many products.

Other members were somewhat less sanguine about the prospective strength of the ongoing expansion. Some emphasized the vulnerability of the economy to a substantial rise in interest rates, should one occur, from levels that were already high in real terms. In this connection, members referred to the desirability of prompt action to reduce the federal deficit, whose size, both current and prospective, was a major factor maintaining upward pressure on interest rates. High interest rates, apart from their adverse impact on interest-sensitive sectors of the domestic economy such as housing, also would tend to exert upward pressure on the value of the dollar in foreign exchange markets, with further unfavorable consequences for U.S. exports, and would add to difficulties inherent in the current international debt situation.

Other comments about the economic outlook included the view of one member that, if very sluggish growth in M1 over the course of recent months were to continue, it could lead to a downturn in economic activity by the second or third quarter of 1984. Another member raised the possibility that sales might prove to be disappointing over the months ahead in relation to the apparently exuberant expectations of many business leaders, and such a development would tend to restrain spending on both fixed investment and inventories. One member also commented that the backlog in demand for housing appeared to have been used up, and further demand was likely to be weak under foreseeable financial conditions.

Partly because of these differences about the outlook for economic activity, the members expressed somewhat divergent views with regard to prospects for inflation over the year ahead. A number of members, while acknowledging the possibility of some rise in the rate of inflation during the second year of a recovery, believed that any such rise was likely to be moderated by sizable margins of unused capacity in many industries, by continuing strong competition from foreign suppliers, and by a still relatively high, if declining, rate of unemployment. Some of these members also observed that recent statistics on commodity and other prices did not suggest that the rate of inflation was accelerating.

Other members were less optimistic about the prospects for inflation. Several commented on indications of a strengthening in inflationary expectations among participants in financial markets and among businessmen, many of whom were reportedly looking for opportunities to raise prices. Underlying wage pressures, which had been held down by depressed conditions in many industries, were also seen by many members as likely to increase as profits continued to improve. Reference was also made to the adverse implications for costs and for inflationary pressures of a projected decline in productivity growth. One member expressed the view that large increases in M1 during the latter part of 1982 and the first part of 1983 would probably be reflected, after an expected lag, in accelerating inflation by the latter part of 1984. It was also noted that a significant decline in the foreign exchange value of the dollar, if it should occur as many observers expected, would contribute to domestic inflation. In this connection concern was expressed that, as the foreign exchange value of the dollar rose to a relatively high level, the dollar would be exposed increasingly to a precipitate drop, and if such a drop came when the economy was operating closer to full capacity, it would tend to have a much more substantial inflationary impact than otherwise.

At its meeting in July, the Committee had agreed on tentative growth ranges of 6-1/2 to 9-1/2 percent for M2 and 6 to 9 percent for M3 during the period from the fourth quarter of 1983 to the fourth quarter of 1984. The Committee believed that growth of M1 in a range of 4 to 8 percent from the fourth quarter of 1983 to the fourth quarter of 1984 would be consistent with the ranges for the broader aggregates. The associated range for total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1984. At this meeting the Committee began a review of the ranges for 1984 in the expectation that at its next meeting it would complete the review and establish ranges for the year within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act).[1/]

1/ The Committee also discussed the implications for open market operating procedures of the shift to contemporaneous reserve requirements effective February 2, 1984. The Committee's views were set forth in an announcement dated January 13, 1984, a copy of which is attached.

In the Committee's discussion of policy for the near term, most of the members agreed that the continued strength of the economic expansion and the spreading optimism, with the attendant risk that inflationary sentiment would intensify, argued against any easing of reserve conditions and in favor of maintaining at least the existing degree of reserve restraint. Such a policy would contemplate a slight move toward greater restraint if economic and monetary developments appeared to warrant such a course. According to an analysis presented at this meeting, the existing restraint on reserve conditions was likely to be associated with growth in M2 and M3 during the period from November to March at rates that were well within the ranges that the Committee had tentatively set previously for 1984. Such a policy was also likely to result in a considerable acceleration in the growth of M1 over the four-month period, given the anticipation that demands for transaction balances would be more in line with spending than they had been in recent months.

While nearly all the members could accept a policy of maintaining at least the existing degree of reserve restraint, some expressed a preference for some slight firming immediately in light of their assessment of the economic situation and concerns about the potential for a re-emergence of inflationary pressures. Other members preferred to make no change in the existing degree of restraint for now, pending a further evaluation of economic developments and monetary growth. In the view of some of these members, even a slight firming of reserve conditions at this time would incur the risk of a relatively pronounced reaction in financial markets, with damaging consequences for housing and other interest-sensitive sectors of the economy. Some members also emphasized that higher domestic interest rates could have a very undesirable impact on the value of the dollar in foreign exchange markets and on the international debt situation. A number of members were also influenced by the relatively sluggish growth of M1 over the course of recent months, although such growth appeared to be accelerating in December. Some urged that greater weight be placed on M1 in the formulation and implementation of policy; and in the view of one member, reserve conditions should be eased promptly if it became clear that growth in M1 was remaining sluggish.

At the conclusion of the discussion, most of the members indicated their acceptance of a short-run policy that called for maintaining at least the existing degree of restraint on reserve positions, subject to the possibility of a slight increase in such restraint depending on developments relating to the outlook for economic activity and price pressures and on evidence that monetary growth appeared to be exceeding the Committee's expectations. The members anticipated that such a policy would be associated with growth of both M2 and M3 at an annual rate of around 8 percent for the period from November 1983 to March 1984. The Committee believed that an acceleration in the growth of M1 to an annual rate of around 6 percent for the four-month period was likely to be consistent with its objectives for the broader aggregates and that expansion in total domestic nonfinancial debt over this period would be within the tentative range of 8 to 11 percent established for the year 1984. It was agreed 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.

It was also understood that the Committee would consult should the aggregates and the economy turn out to be significantly weaker than expected.

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

> The information reviewed at this meeting suggests that real GNP has grown at a relatively rapid pace in the current quarter, although the rate of expansion appears to have moderated since the spring and summer. In November, industrial production and nonfarm payroll employment increased appreciably further and the civilian unemployment rate declined 0.4 percentage point to 8.4 percent. Retail sales rose substantially in November following sizable gains in September and October. Housing starts increased in November to a level close to their third-quarter average. Recent data indicate continuing expansion in business capital spending. Producer prices were little changed on average in October and November, and consumer prices continued to increase in October at about the same pace as in other recent months. The index of average hourly earnings changed little in November after rising somewhat faster in September and October than in previous months; over the first eleven months of the year the index has risen more slowly than in 1982.
>
> The foreign exchange value of the dollar has risen considerably further since mid-November against a trade-weighted average of major foreign currencies. In October the U.S. foreign trade deficit was markedly higher than in the third quarter, reflecting a sharp rise in imports.
>
> After slowing substantially over the summer months, growth in M2 and M3 strengthened in October and November. M1 continued to grow at a sluggish pace in November but increased substantially in early December. Through November, M2 was at a level in the lower portion of the Committee's range for 1983, M3 was close to the upper limit of its range, and M1 was near the lower end of the Committee's monitoring range for the second half of the year. Most interest rates have risen somewhat since mid-November.
>
> The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to a sustainable pattern of international transactions. At its meeting

in July the Committee reconsidered the growth ranges for monetary and credit aggregates established earlier for 1983 in furtherance of these objectives and set tentative ranges for 1984. The Committee recognized that the relationships between such ranges and ultimate economic goals have become less predictable; that the impact of new deposit accounts on growth of monetary aggregates cannot be determined with a high degree of confidence; and that the availability of interest on large portions of transaction accounts may be reflected in some changes in the historical trends in velocity.

Against this background, the Committee at its July meeting reaffirmed the following growth ranges for the broader aggregates: for the period from February-March of 1983 to the fourth quarter of 1983, 7 to 10 percent at an annual rate for M2; 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. The Committee also agreed on tentative growth ranges for the period from the fourth quarter of 1983 to the fourth quarter of 1984 of 6-1/2 to 9-1/2 percent for M2 and 6 to 9 percent for M3. The Committee considered that growth of M1 in a range of 5 to 9 percent from the second quarter of 1983 to the fourth quarter of 1983, and in a range of 4 to 8 percent from the fourth quarter of 1983 to the fourth quarter of 1984, would be consistent with the ranges for the broader aggregates. The associated range for total domestic nonfinancial debt was reaffirmed at 8-1/2 to 11-1/2 percent for 1983 and tentatively set at 8 to 11 percent for 1984.

In implementing monetary policy, the Committee agreed that substantial weight would continue to be placed on the behavior of the broader monetary aggregates. The behavior of M1 and total domestic nonfinancial debt will be monitored, with the degree of weight placed on M1 over time dependent on evidence that velocity characteristics are resuming more predictable patterns. 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 maintain at least the existing degree of reserve restraint. The action is expected to be associated with growth of M2 and M3 at annual rates of around 8 percent from November to March. The Committee anticipates that M1 growth at an annual rate of around 6 percent from November to March will be consistent with its objectives for the broader aggregates, and that expansion in total domestic nonfinancial debt would continue at around its recent pace. Depending on evidence about the continuing strength of economic recovery and other factors bearing on the business and inflation outlook, somewhat greater restraint would be acceptable should the aggregates expand more rapidly. 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, Gramley, Guffey, Keehn, Morris, Partee, Rice, Roberts, Mrs. Teeters and Mr. Wallich. Vote against this action: Mr. Martin.

Mr. Martin dissented from this action because of his concern that any tightening of reserve conditions and the associated increase in interest rates would present a threat to the sustainability of the economic expansion: needed business investment would be more expensive, international debt servicing more burdensome, and interest-sensitive housing more vulnerable.

2. Authorization for Domestic Open Market Operations

At its previous meeting the Committee had voted to increase from $4 billion to $5 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, for the intermeeting period ending with the close of business on December 20, 1983. At this meeting the Committee voted to retain the $5 billion limit for the upcoming intermeeting interval beginning on December 21, 1983.

Votes for this action: Messrs. Volcker, Solomon, Gramley, Guffey, Keehn, Martin, Morris, Partee, Rice, Roberts, 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 the weeks ahead in order to absorb reserves that had been provided recently to meet seasonal needs for currency in circulation.

For immediate release January 13, 1984

The Federal Reserve today issued the attached statement which discusses the relationship of contemporaneous reserve requirements to open market operating procedures.

-0-

Attachment

Beginning Thursday, February 2, the new contemporaneous reserve requirement (CRR) system will become effective. In that connection, questions have been raised about the implications of this change for the Federal Reserve's open market operating procedures. This issue has been considered by the Federal Open Market Committee. Taking account of technical transitional uncertainties as well as policy judgments about the role of M1 and other monetary aggregates under current circumstances, the Committee agreed to make no substantial change in current operating procedures at this time.

Background

The new CRR system differs from the present lagged reserve requirement structure in two principal ways. First, required reserves against transactions deposits will have to be held on an essentially contemporaneous basis, instead of being lagged by two weeks. Second, the reserve holding period has been lengthened from one week to two weeks (with the relevant period for deposits also lengthened to roughly the same two weeks--the 2-week deposit period running from Tuesday to the second Monday, and the reserve period running from Thursday to the second Wednesday).

This structural change in the reserve accounting system has tightened the linkage between reserves and the current behavior of transactions deposits--demand deposits and interest-bearing accounts with full checking privileges (NOW and similar accounts). These deposits, along with currency, held by the public, comprise M1, the measure of money most nearly related to the transactions needs of the economy. But because of NOW and similar accounts, which have grown substantially in volume over the past few years, M1 is also affected by saving propensities and patterns. The Committee has been placing less weight than formerly on M1 because of the institutional changes that have altered its composition, affected its behavior, and increased uncertainties about its relationship to the economy.

Other, broader aggregates--M2 and M3--encompass M1 plus other highly liquid assets and forms of saving, such as money market funds accounts and time and savings deposits held at banks and thrift institutions. Some of these other assets also, in one degree or another, serve transactions purposes, though they are not, by law, subject to transactions reserve requirements. In general, the bulk of the assets in the broad aggregates are not subject to reserve requirements, although nonpersonal time deposits bear a relatively small lagged requirement.

Open market operations and CRR

Adaptations in open market operating procedures to CRR must take account of certain technical and transitional issues as well as the policy issue about the weight to be given M1 and other monetary aggregates in operations. The more technical and transitional issues involve how the depository system as a whole adjusts to the new reserve requirement system--which may influence demands for excess reserves, attitudes toward the discount window, and the speed of asset and liability adjustments generally. It can be expected that some time will elapse before banks and other depository institutions have fully adjusted their reserve management, as well as portfolio and liability management, to the new system. Money managers have to become accustomed to operating without certain knowledge of their required reserves for a full reserve averaging period during most of that period. In addition, usual start-up problems with new data systems will probably add to uncertainties at least for a while. Such data problems would also affect the timing and reliability of figures available to the Federal Reserve.

These technical issues aside, the new reserve requirement structure would potentially permit somewhat closer short-term control of M1 in particular. With CRR, if open market operations were geared primarily to M1, an "automatic" tightening or easing of reserve positions that worked to bring M1 under control would tend to occur somewhat more promptly than with lagged reserve accounting.

Whether operating procedures should be adapted for this purpose does not depend on the technical characteristics of the reserve requirement system in place but rather on broader policy judgments about the relative weight to be given to M1 as a target and the desirability of seeking close short-run control of that aggregate. To the extent less weight continues to be placed on M1, and relatively more on broader aggregates less closely related to reserves, "automatic" changes in reserve pressures in response to short-run movements in M1 alone may not be appropriate.

In light of these various considerations, the Committee agreed that no substantial change would be made in open market operating procedures at this time. These operating procedures will be reviewed after a transitional period in the context of the role played by the monetary aggregates, particularly M1, in policy implementation and the potential implicit in CRR for achieving closer short-run control of M1.

###