FEDERAL RESERVE press release

For Use at 4:30 p.m. October 5, 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 August 21, 1984.

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 August 21, 1984

1. Domestic policy directive

The information reviewed at this meeting suggested that the expansion in economic activity was continuing at a relatively strong pace, though moderating from the annual rate of about 7-1/2 percent recorded for the second quarter. Thus far in 1984, average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to have risen more slowly than in 1983.

Industrial production rose 0.9 percent in July, the same as the increase in the preceding month which had been revised upward. Production of durable consumer goods increased sharply, while output of nondurable goods rose little on balance. Output of business equipment remained sizable though somewhat below the advanced pace of other recent months. The rate of capacity utilization in manufacturing reached 82.6 percent in July, its highest level since early 1980.

Labor market reports for July gave mixed signals. Nonfarm payroll employment rose 300,000 further, just a little less than the average gain over the first six months of the year. However, the civilian unemployment rate, which had plunged to 7.1 percent in June, returned to its May level of 7.5 percent, as the survey of households showed a sharp drop in employment after two months of especially large increases. For the three-month period ending in July, both measures of employment reported a sizable increase of nearly 1 million jobs.

Retail sales fell 0.9 percent in July, after rising considerably in both the first and the second quarters of the year. Sales declines were reported at nearly all major types of stores but were especially pronounced at general merchandise, apparel, and furniture and appliance stores where growth had been especially strong earlier. Sales of new domestic automobiles were a little above the annual rate of about 8-1/4 million units recorded for the first half of the year; but they dropped back to a rate of about 7-1/2 million units in the first 10 days of August, in part because some popular models were in short supply.

Housing starts fell in July to a rate appreciably below the average in the second quarter. Starts of single-family units, declining for the third month in a row, were nearly 14 percent below the second-quarter average; multifamily starts, though edging down in July, remained above the average in the preceding quarter. Newly issued building permits declined almost 12 percent in July, with issuance down by comparable margins for both single-family and multifamily construction.

In contrast to the slowing in the consumer and housing sectors, business fixed investment continued to expand quite rapidly, and commitments for future spending remained high. Shipments of nondefense capital goods rose further in June and were up nearly 6 percent for the second quarter as a whole. New orders for such goods increased about 5 percent in the quarter and the backlog of outstanding orders continued to rise.

Incoming information on prices and wages indicated a continuation of recent favorable trends. The producer price index for finished goods increased 0.3 percent in July, after three months of virtually no change. Data on consumer prices in July were not yet available, but in June the consumer price index had risen 0.2 percent for the second consecutive month. Over the first seven months of 1984, producer prices increased at an annual rate of about 3 percent, and over the first half of the year, consumer prices and the index of average hourly earnings rose at annual rates of about 4 percent and 3-1/2 percent respectively.

In the period following the July FOMC meeting, the foreign exchange value of the dollar against a trade-weighted average of major foreign currencies rose about 2 percent further to a new high in early August; subsequently the dollar's value fluctuated in a range a little below the peak. Over most of the intermeeting interval exchange markets were quite volatile, apparently reflecting changing perceptions among market participants about the outlook for interest rates, inflation, and economic activity in the United States. The merchandise trade deficit in June was somewhat above the May level, and for the second quarter as a whole the deficit was little changed from the high first-quarter rate.

At its meeting on July 16-17, 1984, the Committee had decided that open market operations in the period until this meeting should be directed initially toward maintaining existing pressures on reserve positions. That action was expected to be consistent with growth in M1, M2, and M3 at annual rates of around 5-1/2, 7-1/2, and 9 percent respectively during the period from June to September. The Committee also agreed that somewhat greater restraint would be acceptable in the event of more substantial growth of the monetary aggregates, while somewhat lesser restraint might be acceptable if growth of the monetary aggregates slowed significantly. Any such adjustment would be considered only in the context of appraisals of the continuing strength of the business expansion, inflationary pressures, financial market conditions, and the rate of credit growth. The intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee, was set at 8 to 12 percent.

M1 contracted at an annual rate of 1-1/2 percent in July, after increasing at an average annual rate of about 12 percent in May and June. Data for early August, however, suggested some rebound in M1 growth. Growth in M2 was at an annual rate of about 5 percent in July, a relatively slow pace that was due in part to the sluggishness in M1, while expansion in M3 was relatively well maintained at an annual rate of a little below 9 percent. Despite the decline in M1 and comparatively slow growth in M2 in July, these aggregates remained well within the Committee's objectives for the year. From the fourth quarter of 1983 through July, M1 grew at a rate a bit above the midpoint of the Committee's range of 4 to 8 percent for 1984; M2 increased at a rate a little below the midpoint of its longer-run range of 6 to 9 percent. Over the same period, M3 expanded at a rate somewhat above the upper limit of its range of 6 to 9 percent.

Expansion of total domestic nonfinancial debt was estimated to have remained at an annual rate of around 13 percent in July, keeping growth thus far in 1984 at a pace above the Committee's monitoring range of 8 to 11 percent for the year. A pickup in growth of federal debt offset some slowing in expansion of private debt, as merger-related borrowing lessened. Total credit at U.S. commercial banks expanded at an estimated annual rate of 9-1/4 percent in July, after rising only slightly in June. The acceleration primarily reflected a shift from liquidation to accumulation in holdings of U.S. Treasury securities; growth in business and consumer loans showed little change from the pace in June.

Total reserves decreased in July at an annual rate of about 2 percent, after expanding rapidly over the two preceding months. The contraction reflected a marked deceleration in growth of required reserves, associated with weakness in transaction accounts as demand deposits fell following a sharp increase in June, and a reduction in excess reserves from the relatively high June level. In the two complete reserve maintenance periods since the July FOMC meeting, adjustment plus seasonal borrowing continued to average in the neighborhood of $1 billion.

Despite little change in the average level of borrowing from the discount window, the federal funds rate tended to drift higher over the intermeeting period; recently funds traded in a range of 11-1/2 to 11-3/4 percent, up from about 11-1/4 percent at the time of the Committee meeting in July, as banks seemed to be somewhat reluctant to borrow from the discount window and they bid more aggressively for funds in the market. Some other very short-term rates rose slightly over the intermeeting period but most short- and long-term rates declined, with yields on bonds falling about 5/8 to 3/4 percentage point. Stock price indexes advanced 9 to 10 percent over the interval on record trading volume, as the market reacted positively to interpretations of the future course of monetary policy in connection with the Federal Reserve's midyear report to the Congress, and to incoming data on economic activity, prices, and money supply growth.

The staff projections presented at this meeting continued to suggest that expansion in real GNP would moderate over the balance of the year and in 1985, a pattern of growth often characteristic of maturing business expansions and rising utilization of productive resources. The unemployment rate was projected to decline somewhat further over the period and, though current information on cost and price pressures remained quite favorable, the rate of price increase was expected to pick up a little from its recent pace.

In their discussion of the economic situation and outlook, Committee members generally agreed that the expansion in economic activity was continuing at a relatively strong pace, although they expected the rate of growth to slow appreciably over the next several quarters. They recognized, however, that the outlook for economic activity and for prices and wages remained subject to substantial uncertainties. These were especially pronounced because of the distortions created by unprecedented deficits in the federal budget and the balance of payments, the strength of the dollar, and the sensitive state of domestic and international financial markets.

A number of members pointed to indications--such as in housing, retail sales, and steel production--that the rate of expansion might be moderating appreciably and some members commented on the emergence of more cautious attitudes among businessmen in many parts of the country. Members also referred to the cyclical tendency for expansions to lose momentum over time and to the risks inherent in the various imbalances and financial strains that were affecting the economy. Some members, however, continued to view the risks as mainly in the direction of more rapid expansion than was generally expected, given the economy's current momentum, the strength of business investment, and a highly stimulative fiscal policy. With regard to the nearer-term outlook, it was noted that a prolonged strike in the automobile industry could have a considerable impact, at least temporarily, in retarding the overall expansion.

The members expressed somewhat diverging views on the outlook for inflation. Some placed considerable stress on the prospect that price and wage pressures might increase as the economy's productive resources became more fully employed. An inflationary threat was also seen in the possibility of a sizable decline in the foreign exchange value of the dollar. Likewise, a number of members expressed concern that an excessive wage settlement in the automobile industry, if it were to occur, would tend to have an inflationary impact on other wage negotiations, with widespread consequences for wage-cost pressures in the economy.

Members who were relatively optimistic about the outlook for inflation stressed, among other factors, the prospects for continued good gains in productivity. They commented in particular about the renascent and apparently strong determination of businessmen to hold down their costs and to improve the efficiency of their operations. Moreover, the large investments in capital during recent quarters would, it was argued, help to enhance productivity over time. One member also observed that, while a sizable decline in the foreign exchange value of the dollar would tend to increase upward price pressures, such a result might well be more limited or delayed longer than usual in light of the relatively sluggish pace of economic activity abroad and consequent efforts by foreign competitors to retain recently enhanced U.S. market shares through aggressive pricing.

At its meeting in July, the Committee had reviewed and reaffirmed the basic policy objectives that it had established in January for growth of the monetary and credit aggregates in 1984 and had set tentative objectives for growth in 1985. For 1984 the policy objectives included growth of 4 to 8 percent for M1 and 6 to 9 percent for both M2 and M3 for the period from the fourth quarter of 1983 to the fourth quarter of 1984. The associated range for growth in total domestic nonfinancial debt was also reaffirmed at 8 to 11 percent for the year 1984. Given developments in the first half of the year, the Committee anticipated that M3 and particularly nonfinancial debt might increase at rates somewhat above the upper limits of their 1984 ranges. The tentative ranges established for 1985 included reductions of 1 and 1/2 percentage point from the upper limits of the 1984 ranges for M1 and M2, respectively, and no changes in the range for M3 and the associated range for total domestic nonfinancial debt.

In the Committee's discussion of policy implementation for the weeks immediately ahead, a majority of the members expressed a preference for continuing to maintain about the current degree of restraint on reserve positions. A number of members, while finding the current approach to policy implementation acceptable, nonetheless were prepared to look toward some slight easing of reserve conditions, either currently or soon should monetary growth fail to pick up from recent trends. They believed that such an approach would likely be consistent with attainment of the third-quarter objectives for monetary growth that had been set at the July meeting, given the shortfall in the aggregates since the meeting, and would also be consistent with signs of some weakening in the rate of economic growth relative to expectations. Moreover, in the view of at least some of these members, some lessening in the degree of reserve restraint would appropriately tend to offset the unusual pressures that had developed in the federal funds market during June and July. Those pressures were not associated with any change in the degree of reserve restraint, but they appeared to reflect the emergence of more conservative reserve management attitudes on the part of banks. Other members commented, however, that any active effort to ease reserve conditions would be undesirable at present, and could well be misinterpreted, unless clearly related to emerging weakness in monetary growth in the context of appreciably slower-than-expected expansion in economic activity.

One Committee member indicated a preference for somewhat tighter reserve conditions so as to help assure moderate rates of monetary expansion. In this view, the near-term pressure on interest rates that might result from such an approach to policy implementation could well preclude the need for greater, and more disruptive, rate increases later. On the other hand, other members commented that further restraint would be undesirable except in the context of rapid monetary growth against a background of greater strength in economic activity. It was viewed that current reserve conditions had become restrictive enough, as pressures on financial institutions and borrowers had cumulated over a number of months, so that the risk of an unduly rapid spurt of money and credit growth was relatively low.

In discussing how operations might be adjusted during the intermeeting period if monetary growth should prove to be significantly faster or slower than targeted for the current quarter, most members felt that the implementation of open market operations should be sensitive to the potential desirability of somewhat lesser restraint over the weeks ahead, as well as to the possible need for some greater restraint should monetary growth resume at an excessive rate against a background of greater economic ebullience than seemed to be taking place currently. As compared with conditions at the time of the previous meeting, the monetary aggregates had weakened--with M1, for example, closer to the middle of its longer-run range--and there were more indications of a moderation in the expansion of economic activity. It was understood that any intermeeting adjustment in reserve pressures would not be made automatically in response to the behavior of the monetary aggregates, but would be undertaken only in the context of appraisals of the strength of economic activity and inflationary pressures, and evaluations of conditions in domestic and international financial and banking markets and the rate of credit growth.

At the conclusion of the discussion, all but one member indicated their acceptance of a directive specifying no change at this time in the degree of pressure on reserve positions, but calling for a response to any significant deviation in the aggregates from expectations against the background of economic and financial developments. The members anticipated that this approach to policy implementation would be consistent with growth of the various aggregates at rates for the quarter close to those specified at the previous meeting. Specifically, M1 was expected to grow at an annual rate of around 5 percent or slightly less for the period from June to September, a little less than expected at the previous meeting reflecting the contraction in M1 in July. The annual rates of growth for M2 and M3 in the third quarter would continue to be 7-1/2 and 9 percent respectively. The intermeeting range for the federal funds rate was left unchanged at 8 to 12 percent. It was also recognized that, within the context of this overall approach, operations might need to be modified if unusual financial strains appeared to be developing.

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

> The information reviewed at this meeting suggests that the expansion in economic activity is continuing at a strong pace, but there are indications of a moderation in the rate of growth. In July, industrial production and nonfarm payroll employment rose further, but retail sales fell after rising considerably in earlier months and housing starts declined to a rate appreciably below the average in the second quarter. The civilian unemployment rate increased 0.4 percentage point to 7.5 percent. Information on outlays and spending plans

continues to suggest strength in business fixed investment. Since the beginning of the year, average prices and the index of average hourly earnings have risen more slowly than in 1983.

In July, M1 declined after two months of rapid growth, though data for early August suggested some rebound, while M2 expanded at a relatively slow pace. M3 growth, however, remained comparatively sizable. From the fourth quarter of 1983 through July, M1 grew at a rate a bit above the midpoint of the Committee's range for 1984; M2 increased at a rate a little below the midpoint of its longer-run range, while M3 expanded at a rate above the upper limit of its range. Growth in total domestic nonfinancial debt appears to be continuing at a pace above the Committee's monitoring range for the year, reflecting very large government borrowing along with strong private credit growth. Most interest rates have fallen considerably since the July meeting of the Committee, with the largest declines generally in intermediate and long-term bond markets.

The foreign exchange value of the dollar against a trade-weighted average of major foreign currencies rose further to a new high in early August and since then has fluctuated in a range just below the peak. The merchandise trade deficit in June was somewhat above the May level, and for the second quarter as a whole the deficit was little changed from the high first-quarter rate.

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 an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at the July meeting to reaffirm the ranges for monetary growth that it had established in January: 4 to 8 percent for M1 and 6 to 9 percent for both M2 and M3 for the period from the fourth quarter of 1983 to the fourth quarter of 1984. The associated range for total domestic nonfinancial debt was also reaffirmed at 8 to 11 percent for the year 1984. It was anticipated that M3 and nonfinancial debt might increase at rates somewhat above the upper limits of their 1984 ranges, given developments in the first half of the year, but the Committee felt that higher target ranges would provide inappropriate benchmarks for evaluating longer-term trends in M3 and credit growth. For 1985 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1984 to the fourth quarter of 1985, of 4 to 7 percent for M1, 6 to 8-1/2 percent for M2, and 6 to 9 percent for M3. The associated range for nonfinancial debt was set at 8 to 11 percent.

The Committee understood that policy implementation would require continuing appraisal of the relationships not only among the various measures of money and credit but also between those aggregates and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

In the implementation of policy in the short run, the Committee seeks to maintain existing pressures on reserve positions. This action is expected to be consistent with growth in M1 at an annual rate of around 5 percent or slightly less, and in M2 and M3 at annual rates of around 7-1/2 and 9 percent respectively during the period from June to September. Somewhat greater reserve restraint would be acceptable in the event of more substantial growth of the monetary aggregates, while somewhat lesser restraint would be acceptable in the event of significantly slower growth. In either case, such a change would be considered only in the context of appraisals of the continuing strength of the business expansion, inflationary pressures, financial market conditions, and the rate of credit growth. 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 8 to 12 percent.

Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, and Ms. Seger. Vote against this action: Mr. Wallich.

Mr. Wallich dissented from this action because he preferred a directive calling for a somewhat greater degree of reserve restraint and marginally lower monetary growth in the third quarter. In his view such a directive was more likely to help avert more serious inflation and financial pressures later.

2. Authorization for domestic open market operations

At this meeting, the Committee approved a temporary increase from $4 billion to $6 billion in 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. The increase was effective for the intermeeting period ending with the close of business on October 2, 1984.

Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, Ms. Seger, 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 projected increases in required reserves and currency might require net purchases of securities over the intermeeting interval in amounts close to the usual $4 billion leeway. A likely rise in Treasury balances at Federal Reserve Banks would add to the need for System purchases of securities. Accordingly, the Manager requested the temporary increase in the limit to provide the necessary leeway for handling that contingency.