FEDERAL RESERVE press release

For Use at 4:10 p.m. February 8, 1980

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 January 8-9, 1980.

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 January 8-9, 1980

Domestic policy directive

The information reviewed at this meeting suggested that, contrary to the estimates presented at the time of the November 20 meeting, real output of goods and services expanded somewhat further in the fourth quarter of 1979 after its rebound in the third quarter. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to have risen at a pace close to the annual rate of about 10 percent experienced during the first three quarters of the year.

Total retail sales strengthened in November and recovered the sizable decline of October, although sales of new automobiles remained at a reduced level. In December, auto sales improved considerably.

The index of industrial production fell 0.5 percent in November, and on balance the level of production was little changed from that in December 1978. Nonfarm payroll employment rose considerably in October and November, following three months of slower expansion, and the rate of unemployment edged down in November from 6.0 to 5.8 percent.

Private housing starts declined somewhat in October and fell sharply further in November to an annual rate of 1.5 million units. Building permits for new units declined substantially in both October and November, and combined sales of new and existing single-family homes appeared to be lower in both months.

The latest survey of business plans taken by the Department of Commerce in late October and November suggested that spending for plant and equipment would be 14.7 percent greater in 1979 than in 1978. The survey also indicated that investment outlays would increase at an annual rate of 12.8 percent over the first half of 1980.

Producer prices of finished goods and consumer prices continued to rise rapidly in November, reflecting in part the continuing diffusion of earlier increases in energy costs. Advances in prices of food contributed importantly to the November rise in producer prices, while further sharp increases in the costs of homeownership were a major factor in sustaining the upward pressure on consumer prices.

The index of average hourly earnings of private nonfarm production workers rose at an annual rate of 9-1/2 percent in November and at a rate of about 8 percent over the first 11 months of 1979, close to the rate of increase in 1978. Labor cost pressures in the nonfarm business sector intensified during 1979, as large increases in total hourly compensation were associated with a decline in productivity.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had depreciated about 3 percent since mid-November, reflecting in large part developments relating to Iran and Afghanistan and a firming of monetary conditions in a number of foreign countries. The U.S. trade deficit in October and November averaged slightly below the rate for the third quarter. In November a decline in the value of oil imports contributed to the improvement, as a sharp drop in the physical volume of oil more than offset a further rise in its price.

At its meeting on November 20, 1979, the Committee had reaffirmed the broad objectives for monetary growth adopted at its meeting on October 6 and had decided that over the remainder of 1979 the Manager for Domestic Operations should continue to restrain expansion of bank reserves in pursuit of the Committee's objective of decelerating growth of M-1, M-2, and M-3 over the fourth quarter to rates that would hold expansion of these monetary aggregates from the fourth quarter of 1978 to the fourth quarter of 1979 within the Committee's ranges for that period; it was understood at the meeting that persistence of recent relationships might result in growth of M-2 at about the upper limit of its range. Specifically, the Committee instructed the Manager to restrain the expansion of bank reserves to a pace thought to be consistent with growth at average annual rates of about 5 percent for M-1 and 8-1/2 percent for M-2 in November and December, provided that in the period before the next regular meeting the weekly average federal funds rate remained generally within a range of 11-1/2 to 15-1/2 percent.

Over the first four weeks after the November meeting, both total and nonborrowed reserves grew at about the rates projected at the time of the meeting. Member bank borrowings averaged about $1-3/4 billion, compared with an average of slightly less than $2 billion in the preceding three weeks, and the federal funds rate continued to average around 13-1/2 percent. Toward the end of the four-week period, however, the demand for reserves appeared to be easing relative to the path consistent with desired monetary growth. In the three weeks remaining before this meeting, member bank borrowings declined to a daily average of about $1.1 billion. Despite the decline in borrowings, the federal funds rate edged up to an average of about 14 percent in late December and early January, at least in part because of exceptionally large demands for excess reserves around the year-end holidays.

Expansion in the major monetary aggregates remained at a reduced pace in November and December, after having slowed markedly in October. Over the two-month period, M-1, M-2, and M-3 grew at annual rates of about 3-1/4 percent, 6 percent, and 5-3/4 percent respectively.[1/] Over the three months from September to December, M-1 grew at a rate of about 3 percent and M-2 and M-3 at rates of about 7 percent and 6-1/4 percent respectively.

The reduced growth in the monetary aggregates over the fourth quarter was associated with a slowing of expansion in interest-bearing deposits as the quarter progressed. At commercial banks, net flows into money market certificates and large-denomination time deposits accounted for all of the growth in interest-bearing deposits during the quarter. Among nonbank thrift institutions, mutual saving banks and credit unions experienced particularly weak net inflows.

1/ M-1 comprises private demand deposits and currency in circulation. M-2 comprises M-1 and commercial bank time and savings deposits other than large-denomination certificates of deposit. M-3 is M-2 plus deposits at nonbank thrift institutions (savings and loan associations, mutual savings banks, and credit unions).

Growth in total loans and investments at commercial banks slowed sharply in the fourth quarter. Slower expansion was especially pronounced in business loans. Growth in real estate loans remained close to the pace in the first three quarters of the year.

Since the November meeting of the Committee, interest rates had fluctuated over a relatively wide range, although they had been somewhat less volatile than in the previous intermeeting period. On balance, most interest rates had declined. Most banks had reduced their loan rate to prime business borrowers from 15-3/4 to 15-1/4 percent, and a few banks had cut the rate to 15 percent. Mortgage rates had edged higher in the primary market, and available information suggested continued weakness in mortgage commitments and lending activity at nonbank thrift institutions.

Staff projections suggested that growth of nominal gross national product would slow considerably in the current quarter and then pick up gradually over the remainder of 1980. The projections suggested, however, that a contraction in real GNP would develop in the current quarter and would continue later in the year, although at a diminishing pace in the second half, and that the rate of unemployment would increase substantially. The rise in average prices was projected to accelerate slightly during the early part of 1980, mainly because of increases in energy costs, but to subside later.

In the Committee's consideration of the economic outlook, several members stressed the elements of uncertainty in the current situation. The observation was made that the relationships of the past appeared to provide less guidance than usual in appraising the current situation and outlook. In the latter part of 1979, for example, overall activity had been unexpectedly strong and the widely anticipated recession had not developed, although automobile production and housing starts had declined. In the judgment of a number of members, a downturn now seemed to be getting under way, but there was also recognition that it could be delayed for another quarter or two.

Consumption expenditures in particular were stronger in late 1979 than had been anticipated, and the saving rate fell to an exceptionally low level. To the extent that the reduced saving rate was attributable to buying in anticipation of rapid increases in prices, strength in consumer buying could persist for a time. On the other hand, to the extent that the reduced rate reflected pressure on consumer budgets arising from past inflation and from the onset of the heating season with sharply higher prices for energy, the strength in consumer buying could give way rather promptly to substantial weakness.

The outlook for domestic economic activity continued to be clouded by political developments abroad. The problem of the U.S. hostages held in Iran was unresolved, and in recent days international tensions had been heightened by the Soviet Union's invasion of Afghanistan. Increased defense spending could have an impact on economic activity, although current information suggested that increases would be of limited proportions.

Inflation remained a major concern. In part because of earlier increases in oil prices and in mortgage interest rates, the consumer price indexes to be published in the next few months probably would continue to show exceptionally large advances.

At its meeting on July 11, 1979, the Committee had reaffirmed the following ranges for monetary growth from the fourth quarter of 1978 to the fourth quarter of 1979 that it had established in February: M-1, 1-1/2 to 4-1/2 percent; M-2, 5 to 8 percent; and M-3, 6 to 9 percent. Having established the range for M-1 in February on the assumption that expansion of automatic transfer service (ATS) and negotiable order of withdrawal (NOW) accounts would dampen growth by about 3 percentage points over the year, the Committee also agreed that actual growth of M-1 might vary in relation to its range to the extent of any deviation from that estimate. Later in the year, expansion of such accounts appeared to be reducing measured growth of M-1 over the year by about 1-1/2 percentage points, and after allowance for the deviation from the earlier assumption, the equivalent range was 3 to 6 percent. Over the year ending in the fourth quarter of 1979, M-1 grew about 5-1/2 percent, M-2 about 8-1/4 percent, and M-3 about 8 percent.[1/]

At the July meeting the Committee also anticipated that growth of the monetary and credit aggregates over the year ending in the fourth quarter of 1980 might be within the ranges established for 1979. At this meeting the Committee began a review of the ranges for 1980. It

1/ These growth rates are based on revised data for the monetary aggregates, reflecting new benchmarks for deposits at nonmember banks that were published on January 10, 1980. On the basis of unrevised figures, the growth rates were slightly lower for M-1 and M-2--about 5 percent and 8 percent respectively.

was understood that at its meeting scheduled for early February the Committee would complete its review and would establish ranges for 1980 within the framework of the Full Employment and Balanced Growth (Humphrey-Hawkins) Act of 1978.

In the discussion of policy for the near term, the members in general considered rates of monetary growth for the three months from December to March within the framework of some reduction in ranges for growth over the whole of 1980 from those for 1979 in pursuit of the Committee's objective of reducing the rate of inflation. The Committee also took note of a staff analysis indicating that the demand for money could be relatively weak in the first quarter of 1980, if growth of nominal GNP did in fact slow sharply, and could strengthen as the year progressed.

A number of members favored pursuit of somewhat slower monetary growth in the early months of the year than they might accept for the whole year, and some indicated a willingness to tolerate relatively slow monetary growth if significant declines in interest rates developed in the weeks immediately ahead. These views were consistent with the possibility that the demand for money would be relatively weak early in the year and that pressures for monetary growth were likely to increase later in the year if growth of nominal GNP picked up. Moreover, concern was expressed that any substantial declines in interest rates might be interpreted as a significant easing of monetary policy and thus could have adverse consequences for inflationary expectations and for the foreign exchange value of the dollar. Other members of the Committee, however, expressed skepticism about the feasibility of fine tuning policy in an effort to provide for rather small, intra-year variations in the rate of monetary growth.

Differences in views concerning the particular rates of monetary growth to be specified for the period from December to March were not great. Preferences were expressed for growth indexed by expansion in M-1 at an annual rate of 4 percent, a rate of 5 percent, and something between the two.

With respect to the acceptable range of fluctuation for the federal funds rate, almost all members preferred to retain the range of 11-1/2 to 15-1/2 percent originally adopted at the meeting on October 6, 1979, and continued at the meeting on November 20. One member suggested raising the range slightly, to 12 to 16 percent.

At the conclusion of the discussion, the Committee agreed that open market operations in the period until the next meeting should be directed toward expansion of reserve aggregates consistent with growth over the first quarter of 1980 at an annual rate between 4 and 5 percent for M-1 and on the order of 7 percent for M-2, provided that the weekly average federal funds rate remained within a range of 11-1/2 to 15-1/2 percent. If it appeared during the period before the next regular meeting that the constraint on the federal funds rate was inconsistent with the objective for the expansion of reserves, the Manager for Domestic Operations was to promptly notify the Chairman who would then decide whether the situation called for supplementary instructions from the Committee.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that real output of goods and services expanded somewhat further in the final quarter of 1979 and that prices on the average continued to rise rapidly. In November retail sales strengthened and nonfarm payroll employment rose considerably further, but industrial production declined somewhat and private housing starts fell. The unemployment rate edged down from 6.0 to 5.8 percent. Producer prices of finished goods and consumer prices continued to rise rapidly, in part because of the spreading effects of earlier increases in energy costs. Over recent months the rise in the index of average hourly earnings has remained close to the rapid pace during 1978.

The trade-weighted value of the dollar against major foreign currencies has depreciated about 3 percent since mid-November, reflecting in large part the Middle East situation as well as a firming of monetary conditions in a number of foreign countries. The U.S. foreign trade deficit in October and November on the average was slightly below the rate for the third quarter.

Growth of the major monetary aggregates, which had slowed in October, remained at reduced rates in the final months of 1979. From the fourth quarter of 1978 to the fourth quarter of 1979 M-1 grew 5-1/2 percent, M-2 about 8-1/4 percent, and M-3 about 8 percent. Most market interest rates have declined somewhat on balance since the Committee's meeting in late November.

Taking account of past and prospective developments in employment, unemployment, production, investment, real income, productivity, international trade and payments, and prices, the Federal Open Market Committee seeks to foster monetary and financial conditions that will resist inflationary pressures while encouraging moderate economic expansion and contributing to a sustainable pattern of international transactions. At its meeting on July 11, 1979, the Committee agreed that these objectives would be furthered by growth of M-1, M-2, and M-3 from the fourth quarter of 1978 to the fourth quarter of 1979 within ranges of 1-1/2 to 4-1/2 percent, 5 to 8 percent, and 6 to 9 percent respectively. It appeared that expansion of ATS and NOW accounts would dampen growth of

M-1 by about 1-1/2 percentage points over the year, half as much as assumed early in the year; thus after allowance for the deviation from the earlier estimate, the equivalent range for M-1 was 3 to 6 percent. The associated range for bank credit was 7-1/2 to 10-1/2 percent. The Committee anticipated that for the period from the fourth quarter of 1979 to the fourth quarter of 1980, growth may be within the same ranges, depending upon emerging economic conditions and appropriate adjustments that may be required by legislation or judicial developments affecting interest-bearing transactions accounts. Ranges for 1980 will be reconsidered at the meeting of the Committee scheduled for early February.

In the short run, the Committee seeks expansion of reserve aggregates consistent with growth over the first quarter of 1980 at an annual rate between 4 and 5 percent for M-1 and on the order of 7 percent for M-2, provided that in the period before the next regular meeting the weekly average federal funds rate remains within a range of 11-1/2 to 15-1/2 percent.

If it appears during the period before the next meeting that the constraint on the federal funds rate is inconsistent with the objective for the expansion of reserves, the Manager for Domestic Operations is promptly to notify the Chairman who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Volcker, Balles, Black, Coldwell, Kimbrel, Mayo, Partee, Rice, Schultz, Mrs. Teeters, Messrs. Wallich, and Timlen. Votes against this action: None. (Mr. Timlen voted as an alternate member.)