FEDERAL RESERVE press release

For Use at 4:10 p.m. August 15, 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 July 9, 1980. This record also includes policy actions taken during the period between the meeting on July 9, and the next regularly scheduled meeting held on August 12.

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 July 9, 1980

1. Domestic policy directive

The information reviewed at this meeting indicated that real output of goods and services had declined markedly in the second quarter after having expanded at an annual rate of 1.2 percent in the first quarter. Average prices, as measured by the fixed-weight price index for gross domestic business product, continued to rise at a rapid pace, but not so rapidly as in the first quarter.

The dollar value of total retail sales declined substantially in May for the fourth consecutive month; in real terms such sales had fallen 10 percent below their peak in January, the sharpest four-month drop on record. Unit sales of new automobiles slowed considerably further in May and remained weak in June.

The index of industrial production fell 2.1 percent in May, following a similar reduction in April. The decline was broadly based, reflecting reductions in output for all major product groupings. The rate of capacity utilization in manufacturing fell 2 percentage points further to 79 percent, 8 percentage points below its recent high in March 1979.

Nonfarm payroll employment declined in May and fell sharply further in June. Employment decreases were concentrated in manufacturing and construction in both months, and in June the service-producing sector registered its first decline since the previous recession. The unemployment rate, however, edged down from 7.8 to 7.7 percent in June, following large increases in the preceding two months.

The Department of Commerce survey of business spending plans taken in late April and May indicated that expenditures for plant and equipment would be about 10 percent higher in 1980 than in 1979. The survey also suggested, however, little real growth in such expenditures over the year after allowance for expected increases in prices.

Private housing starts fell considerably further in May to an annual rate of 920,000 units, one of the lowest monthly rates in the postwar period, while residential building permits edged up. There were some indications of improvement in new-home sales in May.

The rise in producer prices of finished goods and of materials moderated substantially in the second quarter following exceptionally rapid advances in other recent quarters. The rate of increase in consumer prices slowed appreciably in April and May from the accelerated pace in the first quarter. The recent moderation in both producer and consumer prices was due largely to a lessening of the rapid rise in prices of energy-related items. The index of average hourly earnings of private nonfarm production workers rose at an annual rate of about 9½ percent over the first half of 1980, compared with an increase of 8½ percent during 1979.

In foreign exchange markets the downward pressure on the dollar that had developed in early April abated in mid-June but reemerged in early July. The renewed pressure apparently reflected concern about the possibility of further declines in U.S. interest rates. The trade-weighted value of the dollar against major foreign currencies, which had fallen about 3-1/2 percent since the Committee's meeting on May 20 and about 11 percent since early April, was close to its level in early 1980.

The U.S. foreign trade deficit for April and May was well below the average for the first quarter, reflecting a reduction in both oil and non-oil imports. Nonagricultural exports increased slightly after exhibiting considerable strength in 1979 and in the first quarter of 1980.

At its meeting on May 20, the Committee had agreed that open market operations in the period until this meeting should be directed toward expansion of reserve aggregates consistent with growth of M-1A, M-1B, and M-2 at rates high enough to promote achievement of the Committee's objectives for growth over the year, provided that in the intermeeting period the weekly average federal funds rate remained within a range of 8-1/2 to 14 percent. Specifically, the Committee had agreed that operations should be directed toward encouraging growth of M-1A, M-1B, and M-2 over May and June at annual rates of 7 to 7-1/2 percent, 7-1/2 to 8 percent, and about 8 percent respectively. The Committee also had agreed that, in light of the earlier shortfall, moderately faster growth would be acceptable if that developed in response to a strengthening of the demand for money.

In pursuit of the Committee's objective of encouraging growth in the monetary aggregates, System open market operations were directed during the intermeeting period at fostering an ample availability of nonborrowed reserves, and conditions in the money market eased further. The federal funds rate declined from an average of about 10-7/8 percent in the statement week ending May 14 to around 9-3/8 percent in the statement week ending July 2. In recognition of the easier conditions in money markets, reductions in Federal Reserve discount rates from 13 percent to 11 percent in two equal steps were announced on May 28 and June 12.

Growth in M-1A and M-1B accelerated in June to annual rates of 13-3/4 percent and 16-3/4 percent respectively, following little change in May and sharp contraction in April. Growth in M-2 also accelerated in June to an annual rate of about 17-1/4 percent, up from a rate of 8-3/4 percent in May and a small decline in April; the faster growth in M-2 partly reflected rapid expansion in money market mutual funds. From the fourth quarter of 1979 to the second quarter of 1980, M-1A and M-1B grew at annual rates of about 1/2 and 1-3/4 percent respectively, considerably below the growth paths consistent with the Committee's ranges for the year ending in the fourth quarter of 1980; M-2 and M-3 grew at rates just above the lower bounds of their ranges.

Following rapid expansion in the first quarter, total credit outstanding at U.S. commercial banks contracted in June for the third consecutive month. The June decline reflected continuing weakness in loans, including business loans. However, short-term business borrowing was sustained by rapid growth in net issuance of commercial paper by nonfinancial corporations following a surge in such issuance to a record rate in May. Over the first half of 1980, total commercial bank credit grew at an annual rate of about 4-1/2 percent, somewhat below the lower bound of the Committee's range for the year.

Market interest rates declined considerably further in late May and the first half of June but since then most rates have retraced part of the decline. On balance, private short-term rates declined 100 to 125 basis points over the intermeeting period while most long-term rates fell 10 to 50 basis points; municipal bond yields, however, rose somewhat. Over the interval, commercial banks reduced their loan rate to prime business borrowers from 16-1/2 percent to 11-1/2 percent. In primary markets for home mortgages, average rates on new commitments at savings and loan associations declined to about 12-1/8 percent.

On May 22 the Board of Governors announced a partial phase-out of the special measures of credit restraint that had been put in place, or reinforced, on March 14. Subsequently, on July 3, the Board announced plans to complete the phase-out of the special credit restraint program. The Board noted that recent banking and other data clearly indicated that credit expansion was running at a moderate pace, and accordingly the special conditions necessitating the extraordinary credit restraint measures were no longer present.

According to staff estimates presented at this meeting, the decline in real GNP during the second quarter was larger than had been anticipated at the time of the meeting in May. The staff's projections suggested that real GNP would continue to decline in the remaining quarters of 1980, although at a progressively less rapid pace, and that the unemployment rate would increase substantially further. A modest recovery in real GNP appeared likely to begin around the turn of the year. The rise in prices, as measured by the fixed-weight index for gross domestic business product, was expected to remain rapid, but somewhat less rapid during 1981 than 1980.

Although members of the Committee differed somewhat in their appraisals of the depth of the overall decline and of the pace of the recovery, they generally agreed that the contraction in real GNP would continue well into the second half of 1980 and that a recovery in 1981 was likely to be modest compared with most earlier periods of recovery. All members believed that the rise in prices would remain rapid in 1981, although a few anticipated a somewhat more significant slowing than the staff projected; one or two members expected little if any improvement. However, it was suggested that uncertainty about the forecasts was especially great, partly because of the difficulty of evaluating the impact that persistent inflation might have on expectations and thus on various categories of expenditures.

At its meeting on February 4-5, 1980, the Committee had agreed that from the fourth quarter of 1979 to the fourth quarter of 1980 average rates of growth in the monetary aggregates within the following ranges appeared to be consistent with broad economic aims: M-1A, 3-1/2 to 6 percent; M-1B, 4 to 6-1/2 percent; M-2, 6 to 9 percent; and M-3, 6-1/2 to 9-1/2 percent. The associated range for the rate of growth in commercial bank credit was 6 to 9 percent. In establishing the ranges then, the Committee had agreed that monetary growth should slow further in 1980, following some deceleration in 1979, in line with the continuing objective of curbing inflation and providing the basis for restoration of economic stability and sustainable growth in output.

At this meeting, in accordance with the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act), the Committee reviewed the ranges for growth of the monetary and credit aggregates for the period from the fourth quarter of 1979 to the fourth quarter of 1980 that it had established at its meeting in February and gave preliminary consideration to objectives for monetary growth that might be appropriate for 1981.[1/] In doing so, the Committee continued to face unusual uncertainties concerning the forces affecting monetary growth. As noted earlier, expansion of both M-1A and M-1B from the fourth quarter of 1979 to the second quarter of 1980 fell considerably below the growth paths consistent with the Committee's ranges for the year. However, growth of M-2 and M-3 was considerably stronger: over the two quarters both of these aggregates grew at rates just above the lower bounds of their ranges. By midyear, growth of M-2 was near the midpoint of its range, and it appeared to be moving higher.

The weakness in the narrower measures of money that developed in the second quarter was unusual. It raised the question of whether the demand for money in relation to income and interest rates had shifted downward once again, perhaps as a response to the unusually high level of interest rates of the preceding quarter. It was also possible that part of the second-quarter decline in money balances was a temporary

1/ The Board's midyear report under the act was transmitted to the Congress on July 21, 1980.

phenomenon associated with the substantial repayments of short-term debt that followed the special measures of credit restraint announced on March 14. In the latter case, the public would probably make some effort to rebuild balances in the second half of the year, which would strengthen the demand for both M-1A and M-1B. In any event, in view of recent evidence of a preference for interest-bearing transactions accounts over demand deposits that was greater than anticipated, it appeared likely that M-1B would grow somewhat faster relative to M-1A than had been projected earlier in the year.

The stronger performance of the broader aggregates over the first half of the year in relation to their ranges for the year reflected rapid growth in instruments yielding market rates of interest, including shares in money market mutual funds. As short-term market interest rates declined sharply toward the end of the period, contraction in savings deposits at banks and other depository institutions slowed and then gave way to a rise. For part of the period, growth of M-3 was also promoted by issuance of large-denomination time deposits by commercial banks and thrift institutions, but the outstanding volume of such deposits began to contract in late spring as credit demands weakened.

For 1981, the prospective relationships among the various monetary aggregates were subject to even greater uncertainty because of, among other things, certain institutional changes expected to result from the Monetary Control Act of 1980. In particular, relationships among the aggregates will be affected by introduction of NOW accounts on a nationwide basis as of December 31, 1980, as authorized by that act.

During 1981, shifts of funds from demand deposits to NOW accounts are likely to be substantial, and will retard the growth of M-1A. At the same time, transfers from savings deposits and other interest-bearing assets to NOW accounts will enhance the growth of M-1B. To the extent that funds are shifted into NOW accounts from other deposit components of M-2 and M-3, growth of these aggregates will be unaffected. The behavior of these aggregates, however, will also be influenced by the further development of money market mutual funds, which are included in M-2. The possibility that the apparent downward shift in the demand for narrow money will persist into next year was an additional element of uncertainty.

In the Committee's discussion, all but one member favored retention of the ranges for 1980 that had been adopted at the meeting in February. The likely shift in relative growth of M-1A and M-1B was not considered large enough to justify "fine-tuning" the growth ranges at the expense of causing public confusion about the meaning of the adjustments. One member advocated a reduction in the ranges for both M-1A and M-1B.

In reaffirming the existing ranges for 1980, Committee members in general recognized that growth of the narrow aggregates over the year as a whole might reasonably fall below the midpoints of their ranges and possibly near the lower bounds. On the other hand, the recent behavior of the interest-bearing nontransactions components of M-2 and M-3, along with a possible pickup in demands for transactions balances, suggested that growth of the broader aggregates over the year as a whole might rise to about the midpoints of their ranges or, in the case of M-2, well into the upper part of the range. Committee members also recognized that the sharp contraction in commercial bank credit during the second quarter raised the possibility that growth over the year would fall short of its range, even if the anticipated resumption of expansion in bank credit occurred. It was noted, however, that a substantial portion of business credit needs was being met through other sources of funds, particularly the issuance of commercial paper and the flotation of corporate bonds.

Thus the Committee decided to retain the ranges for 1980 that it had established in February: for the period from the fourth quarter of 1979 to the fourth quarter of 1980, 3-1/2 to 6 percent for M-1A, 4 to 6-1/2 percent for M-1B, 6 to 9 percent for M-2, and 6-1/2 to 9-1/2 percent for M-3. The associated range for commercial bank credit remained 6 to 9 percent. As in the past, it was understood that the longer-run ranges, as well as the particular aggregates for which ranges were specified, would be reconsidered at any time that conditions might warrant, and that short-run factors might cause considerable variation in annual rates of growth from one month to the next and from one quarter to the next.

With respect to objectives for monetary growth in 1981, most Committee members expressed strong reservations about attempting to be numerically precise at this time, owing to the unusual uncertainties about the relationships among the monetary aggregates and about their relationship to economic activity; they felt that a more general statement, consistent with the letter and intent of the law as they understood it, would be more meaningful and less confusing. The members generally wished to reaffirm the Committee's long-standing objective of moving gradually toward rates of monetary expansion consistent with general price stability. Some members emphasized a possible inconsistency between reduced monetary growth and satisfactory recovery in activity should strong price pressures persist, as assumed in the administration's forecast. A few were unwilling to assume, pending further appraisal of price and other developments in coming months, that progress could be made in 1981 toward the longer-term goal of reduced monetary growth. However, most members believed that the Committee should indicate firmly its intent to make more progress in 1981 toward its objective of reduction in monetary growth over time. One view was that the reduction in monetary growth should be stated only with respect to the narrowly defined monetary aggregates, even if it were not feasible to do so in specific quantitative terms. Another was that the objective should be stated only in terms of a small reduction in the ranges for the broader aggregates, in light of the distorted behavior of M-1A and M-1B anticipated because of the prospective growth of NOW accounts on a nationwide basis.

At the conclusion of the discussion, there was rather general agreement among members of the Committee that it would be appropriate to plan for some further progress in 1981 toward reduction in the targeted ranges, but that it would be premature at this time to set forth precise ranges for each monetary aggregate for next year, especially given the uncertainty generated by the institutional changes affecting the relationships among the aggregates. Moreover, the appropriate monetary growth in

1981 relative to 1980 would depend to some extent on actual growth this year--that is, on exactly where in the present ranges the various aggregates fall at yearend.

The Committee adopted the following ranges for rates of growth in monetary aggregates for the period from the fourth quarter of 1979 to the fourth quarter of 1980: M-1A, 3-1/2 to 6 percent; M-1B, 4 to 6-1/2 percent; M-2, 6 to 9 percent; and M-3, 6-1/2 to 9-1/2 percent. The associated range for bank credit is 6 to 9 percent.

Votes for this action: Messrs. Volcker, Gramley, Morris, Partee, Rice, Roos, Schultz, Solomon, Mrs. Teeters, Messrs. Winn and Balles. Vote against this action: Mr. Wallich. (Mr. Balles voted as alternate for Mr. Guffey.)

Mr. Wallich dissented from this action because he believed that the ranges for growth of M-1A and M-1B over the year ending in the fourth quarter of 1980 should be reduced by 1/2 percentage point. In his opinion, efforts to bring these aggregates up into the ranges adopted in February implied excessively rapid monetary growth over the months ahead.

In the Committee's discussion of policy for the short run, the members agreed that operations in the period before the next meeting should be directed toward expansion of monetary aggregates over the third quarter at rates that would promote achievement of its monetary objectives for the year. In doing so, the members recognized that a number of months might be required in the process and that, in any case, growth of the narrower aggregates over the year as a whole might well fall near the lower bounds of their ranges.

Specifically, 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 of M-1A, M-1B, and M-2 over the third quarter of 1980 at annual rates of about 7 percent, 8 percent, and 8 percent respectively, provided that in the period before the next regular meeting the weekly average federal funds rate remained within a range of 8-1/2 to 14 percent. The Committee also agreed that in light of the shortfall in monetary growth over the first half of the year, moderately faster growth would be acceptable if it developed in response to a strengthening in the public's demand for money balances as narrowly defined. In assessing the behavior of M-1A and M-1B, it was also understood that the rate of growth in M-2 would be taken into account. 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 promptly to 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 indicates a marked contraction in real GNP in the second quarter. In May total retail sales declined substantially for the fourth consecutive month, and housing starts, industrial production, and nonfarm payroll employment continued to decline. Employment fell sharply further in June; however, the unemployment rate edged down from 7.8 to 7.7 percent, following large increases in April and May. The overall rise in prices of goods and services has moderated in recent months, in large part owing to a lessening of the rapid rise in energy items. Over the first six months of the year, the rise in the index of average hourly earnings was moderately faster than the pace recorded in 1979.

The downward pressure on the dollar in exchange markets that emerged in early April abated in mid-June, and then was resumed in early July. The average U.S. foreign trade deficit for April and May was well below the average for the first quarter, reflecting reduced oil and non-oil imports.

Monetary expansion was rapid in June, following weakness earlier in the spring. Over the first half of the year growth of M-1A and M-1B fell short of the rates consistent with the Committee's ranges for the year from the fourth quarter of 1979 to the fourth quarter of 1980; the rate of growth for M-2 was just above the lower bound of its range. Outstanding bank loans to business declined substantially during the second quarter following a large increase in the first quarter. Market interest rates declined considerably further in late May and the first half of June, but since then most rates have retraced part of the decline. Reductions in Federal Reserve discount rates from 13 to 11 percent in equal steps were announced on May 28 and June 12.

Taking account of past and prospective economic developments, 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. The Committee agrees that these objectives would be furthered by growth of M-1A, M-1B, M-2, and M-3 from the fourth quarter of 1979 to the fourth quarter of 1980 within ranges of 3½ to 6 percent, 4 to 6½ percent, 6 to 9 percent, and 6½ to 9½ percent respectively. The associated range for bank credit is 6 to 9 percent.

In the short run, the Committee seeks expansion of reserve aggregates consistent with growth of M-1A, M-1B, and M-2 over the third quarter of 1980 at annual rates of about 7 percent, 8 percent, and 8 percent respectively, provided that in the period before the next regular meeting the weekly average federal funds rate remains within a range of 8½ to 14 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, Gramley, Morris, Partee, Rice, Roos, Schultz, Solomon, Mrs. Teeters, Messrs. Wallich, Winn, and Balles. Votes against this action: None. (Mr. Balles voted as alternate for Mr. Guffey.)

Subsequent to the meeting, Chairman Volcker advised the Committee that its attempt to cut through the institutional uncertainty affecting the behavior of and relationships among the various monetary aggregates and to describe the broad substance of its intent with respect to monetary growth ranges for 1981 apparently had led to some misunderstanding at the monetary oversight hearings before the Senate and House banking committees on July 22-23. In an attempt to clear up that misunderstanding, the Chairman recommended that the Committee indicate its general intent of looking toward a reduction in ranges of growth for M-1A, M-1B, and M-2 for 1981 on the order of 1/2 percentage point, abstracting from the institutional influences affecting the behavior of the aggregates. The Committee voted to approve the Chairman's recommendation. It was understood that all of the ranges would be reassessed in February 1981, or before, in accordance with usual procedures.

On July 29, 1980, the Committee agreed that for the period from the fourth quarter of 1980 to the fourth quarter of 1981, it looked toward a reduction in the ranges for growth of M-1A, M-1B, and M-2 on the order of 1/2 percentage point from the ranges adopted for 1980, abstracting from institutional influences affecting the behavior of the aggregates.

Votes for this action: Messrs. Volcker, Gramley, Guffey, Partee, Rice, Roos, Schultz, Solomon, Wallich, Winn, and Eastburn. Vote against this action: Mrs. Teeters. (Mr. Eastburn voted as alternate for Mr. Morris.)

Mrs. Teeters dissented from this action because she believed that it was undesirable to specify precise numerical ranges for monetary growth in 1981 so far in advance while economic activity was still contracting. In her opinion, monetary goals for 1981 specified at this time could prove to be inconsistent with other, as yet undetermined, economic policies and with the objective of reducing inflation while encouraging a sustainable recovery in economic activity. She was especially concerned about a possible inconsistency in view of the unusually great uncertainties generated by the introduction of NOW accounts nationally and by shifts in the relationship among money, interest rates, and nominal GNP.

2. Authorization for domestic open market operations.

At this meeting the Committee voted to increase from $3 billion to $4 billion the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective immediately, for the period ending with the close of business on August 12, 1980.

> Votes for this action: Messrs. Volcker, Gramley, Morris, Partee, Rice, Roos, Schultz, Solomon, Mrs. Teeters, Messrs. Wallich, Winn, and Balles. Votes against this action: None. (Mr. Balles voted as alternate for Mr. Guffey.)

This action was taken in light of projections indicating a need for substantial reserve-absorbing operations over the coming intermeeting interval to counter the effects of significant reductions in required reserves associated with the phase-out of the special credit restraint program.