FEDERAL RESERVE press release

For Use at 4:10 p.m. September 19, 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 August 12, 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 August 12, 1980

Domestic policy directive

The information reviewed at this meeting suggested that the decline in real output of goods and services began to moderate toward the end of the second quarter. For the quarter as a whole real GNP fell at an annual rate of 9.1 percent, according to preliminary estimates of the Commerce Department. The rise in average prices, as measured by the fixed-weight price index for gross domestic business product, moderated to an annual rate of about 9-1/2 percent in the second quarter from a rate of about 11-1/4 percent in the first quarter.

Following four months of substantial decreases, the dollar value of total retail sales rose considerably in both June and July. While increases in sales were fairly widespread, sharp gains in the automotive sector accounted for much of the two-month advance. Sales of new automobiles were at an annual rate of 9 million units in July, compared with a recent low of about 7-1/4 million in May.

Private housing starts rose substantially in June, to an annual rate of 1.2 million units from 910,000 units in May, and building permits for new units also increased markedly. The steep decline in sales of new homes during March and April was reversed in May and in June. Sales of existing homes also picked up in June, following a marked decrease over the preceding eight months.

The index of industrial production fell 2.4 percent in June, about the same as in both April and May. The decline was broadly based, reflecting reductions in output for all major product groupings. The rate of capacity utilization in manufacturing fell 2.3 percentage points further to 76.1 percent; the cumulative decline from its recent peak in March 1979 exceeded 10 percent.

Nonfarm payroll employment fell further in July but by considerably less than the average monthly decline in the second quarter. Employment decreases continued sizable in manufacturing, and the factory workweek remained at a reduced level. However, employment in the service-producing sector expanded significantly following only two months of decline. In contrast to the establishment data, employment as measured by the survey of households increased substantially in July after falling sharply earlier in the year. The civilian labor force also increased and the unemployment rate edged up from 7.7 to 7.8 percent.

The rise in both producer prices and consumer prices moderated in the second quarter following exceptionally rapid advances in the first quarter. The moderation reflected primarily 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 8-3/4 percent over the first seven months of the year, somewhat faster than in 1979.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had risen somewhat since late

July, after fluctuating in a narrow range earlier in the month, and was about 2 percent above its level at the time of the Committee's meeting on July 9. The U.S. foreign trade deficit was reduced further in June, bringing the average for the second quarter well below that for the first. A decline in both oil and non-oil imports accounted for the improvement as exports were about unchanged.

At its meeting on July 9, 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 over the three months from June to September at annual rates of about 7 percent, 8 percent, and 8 percent respectively, provided that in the intermeeting period the weekly average federal funds rate remained within a range of 8-1/2 to 14 percent. The Committee also had agreed that, in light of the shortfall in monetary growth over the first half of the year, moderately faster growth would be acceptable if that 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, the rate of growth in M-2 would be taken into account.

Early in the intermeeting period, the monetary aggregates appeared to be growing at rates slightly above those that had been specified for the period from June to September. In accordance with the Committee's objectives, System open market operations were directed toward providing the reserves consistent with that monetary growth. Later in the period, however, both M-1B and M-2 appeared to be growing considerably faster than their specified rates, and System operations were not directed toward accommodating this additional growth. As the demand for reserves expanded in association with the growth of deposits, excess reserves appeared to increase to exceptional levels, and conditions in the money market firmed. Member bank borrowing expanded temporarily, and the federal funds rate, after having fallen from an average of about 9-3/8 percent in the statement week ending July 2 to about 8-3/4 percent in the week ending July 23, rose to an average of slightly more than 9-1/2 percent in the week ending August 6.

Growth of M-1A and M-1B moderated in July to annual rates of about 7-1/2 and 10-3/4 percent respectively from rates of about 11-1/2 and 15 percent in June. In July, M-2 grew at an annual rate of 17 percent, only slightly below the exceptional rate recorded in the previous month; money market mutual funds, overnight repurchase agreements, and savings deposits continued to expand rapidly. As a result of the June-July resurgence, growth of M-1A over the period from the fourth quarter of 1979 to July was much closer to, but still somewhat below, the rate consistent with the lower limit of the Committee's range for the year ending in the fourth quarter of 1980; growth of M-1B was at about the lower limit of its range for the year, but growth of M-2 was at about the upper bound of its range.

Total credit outstanding at U.S. commercial banks apparently expanded in July after three months of decline. The July rise reflected a sharp increase in bank holdings of securities and a cessation of declines in loan portfolios; business loans increased marginally and real estate loans rose moderately while consumer loans were estimated to have fallen further. Net issues of commercial paper by nonfinancial corporations moderated substantially in July from an exceptionally strong pace in other recent months.

Market interest rates rose considerably further over the intermeeting period. Markets were called upon to absorb large amounts of Treasury and corporate securities, and market participants reacted to prospects for tax reductions and enlarged government deficits, to more rapid monetary growth, and to indications of some improvement in the economic outlook. Over the interval, short-term rates increased about 50 basis points and long-term rates about 75 basis points. In primary markets for home mortgages average rates on new commitments at savings and loan associations rose slightly, to 12-1/4 percent. Over this period, however, commercial banks reduced their loan rate to prime business borrowers from 11-1/2 to 11 percent. On July 25 the Board of Governors announced a reduction in Federal Reserve Bank discount rates from 11 to 10 percent to bring the discount rate into closer alignment with the level of short-term market interest rates and bank lending rates.

The staff projections prepared for this meeting, like those of early July, suggested that real GNP would decline at a progressively less rapid pace in the third and fourth quarters of the year, and the contraction was now anticipated to be less pronounced than had appeared likely a month earlier. A modest recovery in real GNP was expected to begin around the turn of the year. Nevertheless, the rise in the unemployment rate over the months ahead was still projected to be substantial. The projections of price changes were essentially the same as a month ago: the rise in the fixed-weight index for gross domestic business product was anticipated to remain rapid, although somewhat less rapid during 1981 than 1980.

Members of the Committee agreed in general that further declines in economic activity would be more moderate than had appeared probable a month earlier and that a modest recovery was likely to begin before or around the turn of the year. However, a few members emphasized that the evidence supporting such a judgment was quite limited and that the recession still could prove to be more severe and more protracted than projected. With respect to inflation, a number of members felt that prospects had deteriorated and that little if any reduction in the rate of increase in prices was to be expected.

At its meeting in July, the Committee reaffirmed the ranges for monetary growth in 1980 that it had established in February. Thus, the Committee 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. For the period from the fourth quarter of 1980 to the fourth quarter of 1981, the Committee 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. It was understood that the longer-run ranges would be reconsidered as conditions might warrant.

In contemplating policy for the period immediately ahead, the Committee took note of a staff analysis suggesting that over the two months of August and September growth of M-1B was likely to moderate in relation to growth of M-1A, as the recent rise in market interest rates contributed to a slowing of growth in ATS balances from the extraordinarily rapid rates of recent months. (Such balances tend to include varying amounts of ordinary passbook savings.) It was also anticipated that growth of M-2 would slow relative to that of M-1B, as expansion of money market mutual funds moderated further in response to a reduction in the attractiveness of their yields relative to yields on competing investments. Nevertheless, the apparent shifts in the public's preferences for different types of assets suggested that if M-1A grew from June to September at or even somewhat less than the annual rate of 7 percent that had been specified at the meeting in early July, growth of M-1B and, still more so, growth of M-2 would exceed the annual rate of 8 percent that had been specified for both aggregates.

The staff analysis also suggested that extrapolation of growth in M-1A at an annual rate of 7 percent in the final three months of the year would result in growth from the fourth quarter of 1979 to the fourth quarter of 1980 at a rate slightly above the lower bound of the Committee's range for that period. If the relationships of the third quarter persisted, growth of M-1B over the year would be near the midpoint of its range; growth of M-2 would be at about the upper bound and that of M-3 near the midpoint of their ranges.

In the Committee's discussion of policy, several members stressed the unusual uncertainties about both the relative rates of growth in the monetary aggregates in this period and the relationships between growth of the aggregates and the course of economic activity. In the light of the special factors accounting for the larger differentials than had been anticipated earlier, many members were satisfied to retain for the period from June to September the 7 percent annual rate for growth of M-1A that had been specified a month earlier and to accept the higher rates of growth in M-1B and M-2 that now appeared to be associated with that rate for M-1A. In general, they felt that any appreciable lowering of the June-September rate for M-1A would require a reduced provision of nonborrowed reserves, provoking a rise in member bank borrowings and further increases in interest rates in the near term, although the Committee's longer-run targets did not at this time clearly suggest the need for reduced growth of the monetary aggregates. In that view, prospects for economic activity did not appear to support leaning toward lower growth in the aggregates at this time. The observation was made that inflation was still a major problem but that monetary policy evidently was already exerting some restraint. It was also noted that if in the period ahead monetary growth appeared to be significantly stronger than anticipated, the Committee's operating procedures were likely to result in increases in member bank borrowings and thus in the federal funds rate and other short-term rates; in those circumstances, increases in interest rates would be seen more clearly as a consequence of the need to avoid excessive monetary growth.

A few members preferred to reduce somewhat the specified rate for growth of M-1A over the period from June to September and to specify a rate for growth of M-1B that was closer to or the same as the rate that had been specified a month earlier. It was suggested that it would be appropriate at this time to take steps to provide greater assurance that growth of the aggregates would be moderate over the remainder of the year, in view of the rapid growth recently and the resulting progress in overcoming the April-May shortfall. The indications of some improvement in the outlook for economic activity recently, combined with the perceived deterioration in prospects for inflation, seemed consistent with a slightly lower rate of reserve provision. The opinion was also expressed that, at least for the present, M-1B was the most reliable of the monetary aggregates as a guide to policy.

It was generally expected that with any of the approaches to the aggregates under discussion, the federal funds rate on a weekly average basis would remain well within the range of 8-1/2 to 14 percent that had been specified at the meeting in early July, although in the statement week ending July 23 it had fallen as low as 8-3/4 percent. There were proposals to make a slight reduction in the lower limit, in the upper limit, or in both limits, as well as to retain the range of 8-1/2 to 14 percent.

At the conclusion of the discussion, the Committee agreed to specify a slightly lower rate of growth for M-1A over the third quarter and higher rates for M-1B and M-2 than the rates specified a month earlier.

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 period from June to September at annual rates of about 6-1/2 percent, 9 percent, and 12 percent respectively, provided that in the period before the next regular meeting the weekly average federal funds rate remained within a range of 8 to 14 percent. Member bank borrowings were not expected to increase appreciably from the recent, near-frictional levels unless the monetary aggregates grew more rapidly than the specified rates. 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 suggests that the decline in economic activity, which was marked in the second quarter as a whole, has been moderating. While industrial production and nonfarm payroll employment continued to decline sharply in June, total retail sales advanced after four months of substantial decreases, and housing starts rose from a depressed level. In July retail sales advanced further; nonfarm payroll employment declined, but not so sharply as during the second quarter, and the unemployment rate edged up from 7.7 to 7.8 percent. The overall rise in prices of goods and services moderated in the second quarter, in large part owing to a lessening of the rapid rise in energy items. Over the first seven months of the year, the rise in the index of average hourly earnings was somewhat faster than the pace recorded in 1979.

The weighted average value of the dollar in exchange markets has risen somewhat since late July, after having fluctuated in a narrow range earlier in the month. A reduced U.S. foreign trade deficit in June brought the average for the second quarter well below the average for the first quarter.

Monetary expansion remained rapid in July, although not so rapid as in June. The recent resurgence brought growth of M-1A closer to and that of M-1B about to the lower bounds of the Committee's ranges for the year from the fourth quarter of 1979 to the fourth quarter of 1980. However, the rate of growth for M-2 was near the upper bound of its range. Market interest rates have risen considerably further in recent weeks.

Taking account of past and prospective economic developments, the Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation, encourage economic recovery, and contribute to a sustainable pattern of international transactions. At its meeting in July, the Committee agreed 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 was 6 to 9 percent. For the period from the fourth quarter of 1980 to the fourth quarter of 1981, the Committee looked toward a reduction in the ranges for growth of M-1A, M-1B, and M-2 on the order of ½ percentage point from the ranges adopted for 1980, abstracting from institutional influences affecting the behavior of the aggregates. These ranges will be reconsidered as conditions warrant.

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 6½ percent, 9 percent, and 12 percent respectively, provided that in the period before the next regular meeting the weekly average federal funds rate remains within a range of 8 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.)