FEDERAL RESERVE press release

For Use at 4:10 p.m. October 24, 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 September 16, 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 September 16, 1980

Domestic policy directive

The information reviewed at this meeting suggested that the decline in real output of goods and services had moderated in the third quarter, following a contraction at an annual rate of 9.0 percent in the second quarter, and some recent data indicated that the decline might have ended, at least temporarily. Average prices, as measured by the fixed-weight price index for gross domestic business product, were continuing to rise at a rapid pace, which was, however, slightly below the annual rate of increase of about 10-1/2 percent indicated for the second quarter.

The dollar value of total retail sales rose considerably further in August, according to the advance report, after increasing sharply in June and July. Sales of new automobiles were at an annual rate of 8.6 million units, down from 9.0 million in July but appreciably above the second-quarter rate.

The index of industrial production rose an estimated 0.5 percent in August, following a cumulative decline of about 8.5 percent over the preceding six months. The August increase was fairly widespread among industry groupings, with notable gains in output of construction supplies and consumer home goods.

Nonfarm payroll employment expanded in August after several months of decline, and the unemployment rate edged down from 7.8 to 7.6 percent. Employment in manufacturing, which accounted for about half of the August increase, registered its first monthly gain since December 1979, and the length of the average workweek rose substantially.

The Department of Commerce survey of business spending plans taken in July and August indicated that current-dollar expenditures for plant and equipment would be about 8-3/4 percent higher in 1980 than in 1979. In view of the expenditures in the first half of 1980, the indicated increase for the year as a whole implied a marked decline in real outlays for the second half. New orders for nondefense capital goods and contracts for business construction strengthened in June and July but were still well below their levels early in the year.

Private housing starts edged up in July to an annual rate of about 1.3 million units, following a substantial rebound in June from the depressed levels of earlier months; building permits for new units rose markedly. Sales of new houses increased for the third successive month, bringing the number of unsold units to its lowest level in more than four years. Sales of existing homes, which had picked up in June after eight consecutive months of decline, rose substantially further in July.

Producer prices of finished goods rose rapidly in July and August, after increasing at a sharply reduced pace during the second quarter; the recent advances reflected mainly a surge in food prices. At the consumer level, increases in prices of food and many commodities accelerated in July, but a sharp decline in measured costs of homeownership held the overall consumer price index to its month-earlier level. 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 eight months of the year, somewhat faster than in 1979, but the rate of increase in July and August was more moderate than that earlier in the year.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had declined somewhat over the interval since the Committee's meeting on August 12. The U.S. foreign trade deficit was reduced further in July to a level significantly lower than the average for the second quarter. A sharp decline in petroleum imports accounted for most of the change as exports and non-oil imports were about unchanged.

At its meeting on August 12, the Committee had decided 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 from June to September at annual rates of about 6-1/2 percent, 9 percent, and 12 percent respectively, provided that in the intermeeting period the weekly average federal funds rate remained within a range of 8 to 14 percent. Early in the intermeeting interval, incoming data indicated that growth of M-1A and M-1B would probably exceed the Committee's third-quarter objectives, as well as earlier projections, by a wide margin, and growth of M-2 was also expected to be relatively rapid. Required reserves, and thus member bank demands for reserves, rose substantially in relation to the supply being made available through open market operations. As a consequence, member bank borrowings for reserve-adjustment purposes moved up sharply from a weekly average of about $110 million at the time of the August meeting to an average of about $825 million in the two latest statement weeks. The pressures on bank reserve positions were also associated with increases in the federal funds rate from the 8-1/2 to 9 percent area at the time of the August meeting to around 10-1/2 to 11 percent in recent days.

Growth of M-1A and M-1B accelerated in August to record annual rates of about 19-1/2 percent and 22 percent respectively from rates of about 7-3/4 percent and 11 percent in July. Expansion in M-2 remained rapid in August at an annual rate of about 14-1/4 percent but was down from growth rates averaging 18 percent in June and July. For the period from the fourth quarter of 1979 through August, growth of M-1A was in the lower half of the Committee's range for the year ending with the fourth quarter of 1980; growth of M-1B was in the upper half of its range, while growth of M-2 was somewhat above the upper limit of its range.

Total credit outstanding at U.S. commercial banks picked up in July and expanded substantially further in August, following a decline in the second quarter. Bank holdings of securities grew rapidly in both months, and total loans increased substantially in August, after changing little in July. Loans to businesses exhibited renewed strength in August, and real estate lending expanded moderately. A sharp decline in net issues of commercial paper by nonfinancial corporations partly offset the growth in business loans.

Market interest rates fluctuated widely but rose on balance over the intermeeting interval. Upward pressures on rates reflected market response to the exceptionally rapid growth in money and the associated impact on bank reserve positions, to further indications of improvement in real economic activity, to the disappointing performance of measures of inflation, and to concerns about prospective budgetary deficits. On balance, short-term rates increased about 1-1/2 to 2 percentage points over the inter-meeting period and long-term rates rose about 1/4 to 3/4 percentage point. Commercial banks raised their loan rate to prime business borrowers from 11 percent to 12-1/4 percent. In primary markets for home mortgages, rates on new commitments at savings and loan associations averaged a little over 13 percent compared with 12-1/4 percent at the time of the August meeting.

The staff projections presented at this meeting suggested that the decline in real GNP would be much less pronounced in the third quarter than had appeared likely a month earlier; a modest recovery in real GNP was expected to begin by year-end and to continue in 1981. The unemployment rate was projected to increase somewhat more gradually over the months ahead than had been anticipated earlier. While the projections suggested slightly larger price increases, the staff continued to expect that the rise in the fixed-weight index for gross domestic business product would be somewhat less rapid in 1981 than in 1980.

The Committee's discussion of the economic outlook indicated a broadly shared judgment that a recovery in economic activity was under way, and some members believed that the economy was likely to be somewhat stronger in the fourth quarter than the staff was projecting. Other members were less sanguine about the near-term outlook, and some expressed the view that a renewed downturn could not be ruled out. With regard to the outlook for 1981, the members were in broad agreement with the staff projection of a modest recovery. Concern was expressed that, despite the competitive pressures in many industries and relatively high levels of unemployment, a substantial rise in wages and prices remained in prospect for the year ahead. Under such circumstances several members noted a potential dilemma between the need for sustained recovery and the need for significant progress toward bringing inflation under control.

At its meeting in July, the Committee had 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 warranted.

In contemplating policy for the period immediately ahead, the Committee took note of a staff analysis indicating that growth of M-1A and M-1B was running well above, and growth of M-2 moderately above, the objectives established by the Committee for the June-to-September period. Given the recent behavior of money, achievement of the Committee's monetary growth objectives for the year would require a marked slowing in growth over the balance of the year and the staff projection suggested that such a slowing was likely in September.

In the Committee's discussion of policy, all of the members favored operations over the period ahead directed toward the deceleration in monetary growth needed to promote achievement of the Committee's objectives for the year. The members recognized that achievement of the growth objectives for M-1A and M-1B might be associated with expansion in M-2 at a rate slightly in excess of the Committee's 1980 range for that broader measure of money, given the shifts that had occurred in the public's preferences for deposits of various types. The members also recognized that, in light of the rapid expansion in NOW and ATS accounts, growth in M-1B for the year was likely to be higher relative to growth in M-1A than was implied by the ranges set for each of these monetary aggregates at the start of the year.

While there was general agreement that monetary expansion should be reduced substantially from the recent pace, differing views emerged concerning the specific growth objectives that should be established for the August-to-December period. Some members favored growth-rate objectives on the low side of the ranges that were considered at this meeting in order to provide greater assurance that the Committee would achieve its objectives for the year as a whole. Members supporting this view emphasized the need for a policy posture that would minimize any risk of exacerbating inflationary forces in the economy or worsening inflationary expectations. Other members believed that, in light of present economic and financial market conditions, growth in the August-to-December period might reasonably be a bit higher, consistent with growth for the year in the upper part of the range established for M-1B and around the midpoint of the range set for M-1A; this approach was also viewed as consistent with broad, longer-run policy objectives. In this connection it was observed that interest rates had already risen appreciably from their recent lows, that these increases might well begin to reduce money and credit demands over the months ahead, that economic recovery was in its very early stages, and that some sectors such as housing were especially sensitive to emerging credit conditions.

Still other members proposed a middle course--a policy approach that was adopted. It was generally recognized that differences in approach were relatively minor: all of the members favored a policy that would greatly reduce growth in the aggregates over the balance of the year. In the discussion, it was observed that the reserve path to achieve restraint in money growth would probably not involve an immediate change in money market conditions, assuming that money growth did slow sharply in September. Differences for the most part turned on the degree of pressure on bank reserve positions that could emerge should money demand begin to exceed the money supply path.

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 of M-1A, M-1B, and M-2 over the August-to-December period at annual rates of about 4 percent, 6-1/2 percent, and 8-1/2 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. 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 has moderated in the third quarter following a sharp contraction in the second quarter. Industrial production and nonfarm payroll employment expanded in August after several months of decline; the unemployment rate edged down from 7.8 to 7.6 percent; and total retail sales advanced considerably further. In July housing starts rose slightly, following a substantial rebound in June, and were well above the depressed levels of the preceding three months. Producer prices of finished goods rose rapidly in July and August, after increasing at a sharply reduced pace in the second quarter; the recent advance reflected mainly a surge in food prices. Over the first eight 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 declined somewhat over the past five weeks. The U.S. trade deficit in July was significantly lower than the monthly average in the second quarter, reflecting a sharp decline in petroleum imports.
>
> M-1A and M-1B grew at record rates in August, while growth in M-2 moderated from an exceptionally rapid pace in June and July. For the year through August growth of M-1A was in the lower half and growth of M-1B in the upper half of their respective ranges set by the Committee for the year from the fourth quarter of 1979 to the fourth

quarter of 1980, while growth in M-2 was somewhat above the upper limit of its range. Market interest rates have fluctuated widely since mid-August and on balance short-term rates have risen considerably while long-term rates have increased moderately.

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 August to December period at annual rates of about 4 percent, 6½ percent, and 8½ 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, Schultz, Solomon, and Mrs. Teeters. Votes against this action: Messrs. Guffey, Roos, Wallich and Winn.

Messrs. Guffey, Roos, Wallich and Winn dissented because they believed that, given the excessive monetary expansion in recent months and the outlook for inflation, the directive adopted at this meeting incurred too much of a risk that the Committee's objectives for monetary growth in 1980 would be exceeded. To enhance the prospects for restraining monetary growth to rates consistent with the longer-run ranges, they favored specifying lower rates of growth for M-1A, M-1B, and M-2 over the August-to-December period than those that were adopted.