

FEDERAL RESERVE press release



For Use at 4:10 p.m.

November 21, 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 October 21, 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 October 21, 1980

1. Domestic policy directive

The information reviewed at this meeting suggested that economic activity had expanded in the third quarter. According to preliminary estimates of the Commerce Department, real GNP increased at an annual rate of 1 percent in the quarter, following a contraction at an annual rate of about 9-1/2 percent in the second quarter. Average prices, as measured by the fixed-weight price index for gross domestic business product, continued to rise at the annual rate of about 10-1/2 percent recorded in the second quarter.

The dollar value of total retail sales rose in September for the fourth consecutive month. Sales at food stores and gas service stations rose sharply, while combined sales at general merchandise, apparel, and furniture and appliance stores were about unchanged, following large increases in July and August. Sales of new automobiles changed little in September, but for the third quarter as a whole they were up substantially from the depressed rate in the second quarter.

Private housing starts rose considerably further in September, to an annual rate of more than 1.5 million units. Most of the increase was in multifamily units and apparently reflected a bulge in starts associated with federal subsidies at the end of the fiscal year. In August, sales of new houses declined somewhat, after rising markedly

over the previous three months, but the stock of unsold units fell further to its lowest level in more than four years. Sales of existing homes, which had accelerated in July, rose somewhat further in August.

The index of industrial production rose an estimated 1 percent in September; the index had increased 0.6 percent in August after declining somewhat more than 8 percent over the previous six months. The increase in September, like that in August, was broadly based and included notable gains in output of materials, construction supplies, and consumer home goods. The rate of capacity utilization in manufacturing increased nearly 1 percentage point during August and September, following a cumulative decline of more than 12 percentage points from the peak in March 1979.

Nonfarm payroll employment expanded in September for the second consecutive month, and the unemployment rate edged down from 7.6 to 7.5 percent. Employment gains were especially strong in trade and service industries. Employment in manufacturing rose further, and the length of the average workweek edged up to a level one-half hour above its July trough.

Producer prices of finished goods declined slightly in September, but they rose substantially on the average during the third quarter as a whole. At the consumer level, increases in food prices accelerated sharply in August, but prices of energy items continued to rise at a greatly reduced pace and homeownership costs declined somewhat further; excluding those categories, consumer prices increased at about the 8 percent pace that had prevailed since April. The rise in the index of average hourly earnings of private nonfarm production workers moderated in the third quarter, but

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the increase over the first nine months of the year was at an annual rate of 8-1/2 percent, about the same as in 1979.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had risen somewhat on balance over the interval since the Committee's meeting in mid-September. The U.S. foreign trade deficit in August remained at a level well below the monthly average in the second quarter. The volume and value of oil imports fell sharply in the July-August period, while the value of other imports was about unchanged and the value of exports increased.

At its meeting on September 16, 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 over the period from August to December at annual rates of about 4 percent, 6-1/2 percent, and 8-1/2 percent respectively, provided that in the period until the next regular meeting the weekly average federal funds rate remained within a range of 8 to 14 percent. Early in the intermeeting period, incoming data indicated that the monetary aggregates, particularly M-1A and M-1B, were growing faster than the rates consistent with the Committee's objectives for the August-to-December period. Required reserves and member bank demands for reserves expanded substantially in relation to the supply of reserves being made available through open market operations. Consequently, member bank borrowings for reserve-adjustment purposes increased sharply, to an average of \$1.4 billion in the four statement weeks ending on October 15 from an average of about \$835 million in the preceding

four weeks. These developments were associated with additional upward pressures on the federal funds rate and other short-term interest rates. Those pressures were intensified by an increase in Federal Reserve discount rates from 10 to 11 percent announced on September 25. In the days preceding this meeting, the funds rate was in the area of 12-1/2 to 13 percent, compared with 10-1/2 to 11 percent in the days just before the Committee's meeting on September 16.

In September, M-1A and M-1B grew at annual rates of 12-1/4 and 15-1/4 percent respectively, down markedly from the record rates set in August but still far above the rates consistent with the Committee's objectives for the period from August to December. Expansion in M-2 moderated further in September, to an annual rate of about 8-1/4 percent, reflecting in part a further slowing in the growth of nontransaction accounts included in that measure of money. However, M-3 grew more rapidly than M-2 for the first time since the spring, as both banks and thrift institutions stepped up their issuance of large-denomination certificates of deposit and other managed liabilities. For the period from the fourth quarter of 1979 through September, growth of M-1A was just above the midpoint of the Committee's range for the year ending in the fourth quarter of 1980; M-1B and M-2 grew at rates somewhat above the upper limits of their respective ranges, and growth of M-3 was near the upper limit of its range.

Expansion in total credit outstanding at U.S. commercial banks was relatively rapid in September, although somewhat below the August pace. Bank acquisitions of securities moderated in September from the brisk pace

in the previous two months; but growth in total loans, including business loans, accelerated, following a substantial increase in August. Net issuance of commercial paper by nonfinancial corporations declined further in September.

Short-term market interest rates rose $5/8$ to $1-1/2$ percentage points further over the intermeeting period, while long-term rates changed little on balance. Over the interval, commercial banks increased their loan rate to prime business borrowers from $12-1/4$ to 14 percent. In primary markets for home mortgages, average rates on new commitments for conventional loans at savings and loan associations rose to about $13-3/4$ percent from a little over 13 percent at the time of the September meeting.

The staff projections presented at this meeting suggested that the rise in real GNP in the third quarter marked the beginning of a recovery, but a sluggish one that was likely to be associated with some further increase in the rate of unemployment over the next few quarters. The projections continued to suggest that the rise in the fixed-weight price index for gross domestic business product would be somewhat less rapid in 1981 than in 1980.

During the Committee's discussion of the economic situation, the members agreed that recovery in economic activity had begun, and several suggested that growth in real GNP could well be greater in the current quarter than that incorporated in the staff projections and greater than that in the third quarter. However, prospects for 1981 were viewed with much more uncertainty, and considerable skepticism was expressed about the degree of confidence with which consumer and business behavior could be forecast in the current environment.

Major sources of uncertainty as well as of concern with regard to the business outlook were the continued rapid pace of inflation and the substantial rebound of interest rates so soon after the turnaround in economic activity. In these circumstances, the outlook for consumer spending was very clouded. It was suggested, for example, that continued expansion in consumption expenditures and a further decline in the already low personal saving rate might tend to sustain the recovery in activity for a time, as consumers attempted to maintain their standards of living or even to anticipate additional increases in prices. Alternatively, consumer spending might be constrained by the low saving rate, by increases in prices of foods and other necessities, and by rising interest rates. Similarly, concern was expressed that the rise in interest rates, aggravated by the prospect of sizable budget deficits, would have significantly adverse consequences for residential construction and business investment; but it was also suggested that in the current inflationary environment the higher levels of interest rates might have considerably less inhibiting effects than they would have had in the past.

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 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. 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 noted that growth of the narrower monetary aggregates in September had substantially exceeded the rates consistent with the growth objectives for the period from August to December adopted at the meeting on September 16. Those objectives in turn had been consistent with growth for M-1A just below the midpoint of the Committee's range for the year from the fourth quarter of 1979 to the fourth quarter of 1980 and with growth for M-1B just below the upper bound of its range. The members had recognized that, owing to shifts in the public's preferences for deposits of various types, growth of M-2 over the year might slightly exceed its range.

According to a staff analysis, expansion in the public's demands for money might be expected to slow substantially in the final three months of the year even with some further pickup in growth of nominal GNP, because of the substantial accumulation of cash balances in the third quarter and the large increase in short-term interest rates since midyear. The analysis also emphasized that the differential between

growth of M-1A and M-1B would remain appreciably greater than had been anticipated when the ranges for growth of the aggregates during 1980 were first adopted in February.

In the Committee's discussion of policy for the period immediately ahead, all of the members favored pursuit of a sharp reduction in monetary expansion over the final three months of the year from the rapid pace of recent months. The uncertainty concerning projections of much slower growth in the monetary aggregates was emphasized, and it was generally recognized that further evidence that growth was proceeding faster than targeted in the short run would require greater pressure on bank reserve positions. The members differed somewhat in their views with respect to the precise growth rate targets that should be adopted for the period ahead. A number of members favored growth objectives for the final three months of the year that would arithmetically compensate for the overshoot in September and thus would be consistent with the growth rates for the period from August to December that had been adopted at the Committee's meeting in September. Most members, on the other hand, favored adoption of objectives that would contemplate slightly higher growth over the final three months of the year, given the developments in the aggregates since the last meeting, although they were willing to accept lower rates of growth should such rates emerge as a result of pressures already placed on bank reserves.

Those who favored the objectives precisely consistent with the growth rates adopted at the preceding meeting believed that such a stated objective was appropriate in the interest of reducing inflationary expectations and strengthening confidence. It was considered in this context that,

while the differences discussed were small, the lower objective could better assure the maintenance of growth of M-1B, as well as that of M-1A, within its range for the year, which could be psychologically important. The point was made, moreover, that very slow monetary growth in the course of the fourth quarter could be tolerated in view of the rapid growth in the third quarter, and also that such a development would contribute toward gradual year-to-year reduction in monetary growth.

Other members, while also seeking sharply reduced growth rates of the aggregates in the months ahead, attached less significance to targets precisely consistent with the August-to-December objectives adopted a month earlier, in light of the inherent volatility of the data in the short run. Committee actions affected the money supply only with some lag, and given actions already in place and the uncertainties in the economic outlook, the possibility could not be excluded that very ambitious short-run objectives with respect to restraint could generate undesirable instability in both interest rates and the money supply over a somewhat longer period and thus be counter to the Committee's more fundamental goals. These members agreed, however, that further indications of excessive monetary growth would need to be reflected in further pressures on bank reserve positions.

During the Committee's discussion, most members agreed that the differences concerning the numerical targets for growth over the last three months of the year should be reconciled by small adjustments among the competing views, with the general understanding that some shortfall from the specified rates of monetary growth would be accepted. It was pointed out that, in light of the recent excessive rate of monetary expansion,

growth of M-1B could marginally exceed the upper bound of its range for 1980 if increases over the months ahead equalled or exceeded the numerical specifications. In that connection, it was also emphasized that an inconsistency had become apparent during the course of the year between the longer-run ranges for M-1A and M-1B as a result of faster than expected growth of ATS and NOW accounts, which had been at the expense partly of demand deposits and partly of savings deposits or other sources of funds not included in M-1. In light of those developments during the past year, the range for growth of M-1B in 1980 presumably should have been somewhat higher than that actually adopted, while the range for M-1A should have been somewhat lower, to achieve the intended economic result. It was understood that the agreed approach would be associated with significant further pressures on bank reserve positions if growth of the monetary aggregates and the associated demands for reserves proved to be greater than anticipated. In light of the recent rise in the federal funds rate and the objective of sharply reducing monetary growth, sentiment was expressed for raising the intermeeting range for the funds rate from the range of 8 to 14 percent specified at the September meeting.

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 September-to-December period at annual rates of about 2-1/2 percent, 5 percent, and 7-1/4 percent respectively, or somewhat less, provided that in the period before the next regular meeting the weekly average federal funds rate remained within a range of

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9 to 15 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 real GNP increased somewhat in the third quarter following the sharp contraction in the second quarter, while prices on the average continued to rise rapidly. The recovery in retail sales and housing starts that began in June continued during the third quarter. Industrial production and nonfarm payroll employment expanded in September for the second consecutive month, and the unemployment rate edged down from 7.6 to 7.5 percent. The rise in the index of average hourly earnings moderated in the third quarter, but the rise over the first nine months of the year was about as rapid as in 1979.

The weighted average value of the dollar in exchange markets on balance has risen somewhat over the past month. The U.S. trade deficit in August remained well below the monthly average in the second quarter.

M-1A and M-1B continued to grow rapidly in September, although not so rapidly as in August, while growth in M-2 moderated further. From the fourth quarter of 1979 to September, growth of M-1A was slightly above the midpoint of the range set by the Committee for growth over the year ending in the fourth quarter of 1980, while growth of M-1B and M-2 was somewhat above the upper limits of their ranges. Expansion in commercial bank credit was relatively rapid in both August and

September. On balance short-term market interest rates have risen considerably further since mid-September while long-term rates have changed little; average rates on new home mortgage commitments have continued upward. An increase in Federal Reserve discount rates from 10 to 11 percent was announced on September 25.

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 $3\frac{1}{2}$ to 6 percent, 4 to $6\frac{1}{2}$ percent, 6 to 9 percent, and $6\frac{1}{2}$ to $9\frac{1}{2}$ 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 $\frac{1}{2}$ 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 behavior of reserve aggregates consistent with growth of M-1A, M-1B, and M-2 over the September-to-December period at annual rates of about $2\frac{1}{2}$ percent, 5 percent, and $7\frac{1}{2}$ percent respectively, or somewhat less, provided that in the period before the next regular meeting the weekly average federal funds rate remains within a range of 9 to 15 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, Guffey, Partee, Rice,
Schultz, Solomon, and Mrs. Teeters.
Votes against this action: Messrs.
Morris, Roos, Wallich, and Winn.

Messrs. Morris, Roos, Wallich and Winn dissented from this action because, given the excessive monetary expansion in recent months, they favored specification of lower monetary growth rates for the period from September to December than those adopted at this meeting. In their view, such a policy stance was appropriate in order to enhance the prospects for restraining growth of the monetary aggregates within the Committee's ranges for the period from the fourth quarter of 1979 to the fourth quarter of 1980 and thereby contribute to restraining inflation.

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 November 18, 1980.

Votes for this action: Messrs.
Volcker, Gramley, Guffey, Morris,
Partee, Rice, Roos, Schultz, Solomon,
Mrs. Teeters, Messrs. Wallich, and
Winn. Votes against this action:
None.