FEDERAL RESERVE press release

For Use at 4:10 p.m.   February 5, 1982

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 December 21-22, 1981.

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 December 21-22, 1981

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP declined appreciably in the fourth quarter, after having increased at an annual rate of 1.4 percent in the third quarter, according to revised estimates of the Commerce Department. Average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to have risen less rapidly than over the first three quarters of the year.

In November the index of industrial production fell 2.1 percent, the largest of four consecutive monthly declines. The decline was broadly based, reflecting reductions in output for nearly all major product groupings, and was particularly sharp for durable consumer goods and durable goods materials. Capacity utilization in manufacturing fell 2 percentage points further to 74.9 percent, equal to its recent trough in July 1980.

Total nonfarm payroll employment declined by nearly 1/4 million in November, the same as in October. Employment decreases in both months were concentrated in manufacturing, and in November the trade sector registered its first decline since June 1980. The unemployment rate rose an additional 0.4 percentage point to 8.4 percent.

The nominal value of retail sales, which had declined 2.1 percent in October, rose 0.8 percent in November; the level in November remained well below the average for the third quarter. Unit sales of new automobiles, although up slightly in November, continued at a depressed rate.

Private housing starts in November, at an annual rate of about 870,000 units, changed little from the depressed level of October. Sales of new homes picked up in October, while sales of existing homes dropped further; total sales of new and existing homes were about one-third below the pace in 1980.

The producer price index for finished goods rose 0.5 percent in November, about the same as in October. Food prices declined in November while prices of energy-related items, particularly gasoline and natural gas, rose. During the first eleven months of 1981, the finished goods index increased at an annual rate of about 7-1/2 percent, well below the increase of nearly 12 percent over 1980. The consumer price index rose about 0.4 percent and 0.5 percent in October and November respectively; through November of this year the index increased at an annual rate of about 9-1/4 percent, compared with a rise of about 12-1/2 percent over 1980. The rise in the index of average hourly earnings was somewhat less rapid thus far in 1981 than during 1980.

In foreign exchange markets the trade-weighted value of the dollar had changed little on balance since mid-November, as a decline through the end of November was more than reversed in early December. Trading conditions in the final week of the intermeeting period were unsettled by the declaration of martial law in Poland. The U.S. trade deficit in October widened substantially from the unusually low rate in September. The average for the two months was about the same as that for July and August, but larger than that recorded in the first and second quarters of the year.

At its meeting on November 17, the Committee had noted the moderate shortfall in growth of M1-B in October from the 7 percent annual rate from September to December adopted at the preceding meeting and had decided that open market operations in the period until this meeting should be directed toward behavior of reserve aggregates consistent with growth of M1-B from October to December at an annual rate of about 7 percent (after allowance for shifts into NOW accounts) and with growth of M2 at an annual rate of around 11 percent. It was understood that somewhat more rapid growth of M1-B, consistent with the objective adopted at the preceding meeting, would be accepted. If it appeared to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting was likely to be associated with a federal funds rate persistently outside a range of 11 to 15 percent, the Chairman might call for a Committee consultation.

In the event, M1-B (adjusted for shifts into NOW accounts) expanded in November and early December at rates somewhat above the October-to-December path, as checkable deposits other than demand deposits rose markedly. Nevertheless, growth of M1-B from the third to the fourth quarter (partly estimated) was at an annual rate of only about 4-1/2 percent; and growth over the year from the fourth quarter of 1980 to the fourth quarter of 1981 was about 2 percent, well below the Committee's range of 3-1/2 to 6 percent. Growth of M2 accelerated in November to the highest rate so far in 1981, reflecting a surge in its nontransaction component in addition to the strength in M1-B. Growth over the year ending in the fourth quarter of 1981 was estimated at about 9-1/2 percent, somewhat above the Committee's range of 6 to 9 percent for the year.

Growth in nonborrowed reserves picked up in November and thus far in December from the October rate, but on balance remained well below the pace of last summer. Borrowings from Federal Reserve Banks for purposes of adjusting reserve positions remained relatively low on the average in the five weeks of the intermeeting period; they were little changed from those in the week ending November 18 and were well below levels in the immediately preceding weeks. The federal funds rate declined from about 13-1/4 percent in the days just before the November meeting to around 12 percent in early December and then moved up into a range of 12 to 12-1/2 percent. On December 3 the Board of Governors announced a reduction in Federal Reserve discount rates from 13 to 12 percent to bring them into better alignment with the short-term rates that had recently been prevailing in the market.

Short-term market interest rates declined about 3/4 to 1 percentage point further in the latter part of November, and bond yields moved down about 1/4 to 1/2 percentage point. Subsequently, most market rates rose to levels close to or somewhat higher than those prevailing at the time of the mid-November FOMC meeting, apparently in response to strength in the monetary aggregates and reports of administration estimates of substantially enlarged budget deficits. However, the prime rate charged by commercial banks on short-term business loans was reduced about 1 percentage point further to 15-3/4 percent over the intermeeting period, and the average rate for primary conventional mortgages also declined about 1 percentage point.

Expansion in total credit outstanding at U.S. commercial banks slowed to an annual rate of about 3-1/4 percent in November. The slowing reflected primarily a sharp reduction in bank holdings of Treasury securities and a further moderation in the growth of business loans. Short-term borrowing by businesses through issuance of commercial paper rose substantially, however, as the spread between commercial bank prime rates and market interest rates widened. In response to the decline in long-term interest rates, moreover, the volume of public offerings of corporate bonds rose in November to a record level; the pace of offerings slowed in early December but was still relatively large.

The staff projections presented at this meeting suggested that real GNP would continue to decline in the first quarter of 1982, although at a pace considerably slower than that estimated for the fourth quarter of 1981, and that activity would begin to recover in the second quarter. The unemployment rate was expected to rise somewhat further to a peak in the second quarter of the new year. The rise in the fixed-weight price index for gross domestic business product was projected to slow further in the quarters ahead.

In the Committee's discussion of the economic situation and outlook, the consensus was that real GNP was declining appreciably in the current quarter. It was suggested that the overall reduction in output was likely to be at least as deep as the average decline in recessions since the Second World War, but it was also observed that uncertainty concerning the likely severity of a recession typically was great at this early stage. Business capital spending was one sector that seemed vulnerable to a weaker performance than generally being projected. The mood in the business community, particularly the industrial sector, was described as gloomy, because of the sluggish economic growth in recent years, the currently low rates of capacity utilization, and the widespread expectation of huge federal budget deficits and high real interest rates.

It was also observed, however, that the risk of significant further contraction in the housing and auto sectors appeared small. Those sectors were likely to benefit from the declines in interest rates that had already occurred. Moreover, the income tax reductions already legislated were generally expected to contribute to an upturn in economic activity by the middle of 1982.

With respect to the outlook for continued progress in reducing inflationary pressures, the view was expressed that the climate appeared to be more favorable for moderation in negotiation of new labor contracts and in pricing decisions than it had been for many years. In some industries and regions, measures to preserve jobs were coming to be viewed as more important than improvements in wages and benefits. Competition from imports, moreover, was exerting a restraining influence on wages and prices.

At its meeting in July 1981, the Committee had reaffirmed the monetary growth ranges for the period from the fourth quarter of 1980 to the fourth quarter of 1981 that it had set at its meeting in early February. These ranges were 3 to 5-1/2 percent for M1-A and 3-1/2 to 6 percent for M1-B, abstracting from the impact of NOW accounts on a nationwide basis; 6 to 9 percent for M2; and 6-1/2 to 9-1/2 percent for M3. The associated range for bank credit was 6 to 9 percent. The Committee had recognized that a shortfall in M1-B growth in the first half of the year partly reflected a shift in public preferences toward other highly liquid assets and that growth in the broader aggregates had been running somewhat above the upper end of the ranges. In light of its desire to maintain moderate growth in money over the balance of the year, the Committee expected that growth in M1-B for the year would be near the lower end of its range. At the same time, growth in the broader monetary aggregates might be at the higher end of their ranges. For the period from the fourth quarter of 1981 to the fourth quarter of 1982, the Committee had tentatively agreed that growth of M1, M2, and M3 within ranges of 2-1/2 to 5-1/2 percent, 6 to 9 percent, and 6-1/2 to 9-1/2 percent respectively would be appropriate. At this meeting, the Committee began a review of the ranges for 1982 in the expectation that at the meeting scheduled for early February it would complete the review and establish ranges for the year within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act).

In looking ahead to 1982, it had been decided earlier to abandon as of the beginning of the year the compilation of M1-A and the shift-adjusted M1-B (that is, M1-B adjusted to exclude that portion of flows into NOW accounts in 1981 estimated to have come from other interest-bearing assets rather than from demand deposits). That decision was based on a judgment that, after a full year of availability of NOW accounts on a national basis, the magnitude of additional shifts might no longer be significant, and that in any event, it would not be possible to make reliable estimates of the sources of funds flowing into such accounts. The remaining aggregate for M1 in 1982 will be the one formerly labeled M1-B, which includes the total amount of NOW accounts.

In the near-term pursuit of the fundamental objective of fostering the financial conditions that would help to reduce inflation and promote recovery in economic activity on a sustainable basis, the Committee continued to face considerable uncertainty about the interpretation of the behavior of the monetary aggregates. Growth of other checkable deposits (OCD) had picked up sharply in November and early December. (Such deposits include NOW accounts and ATS accounts at banks and thrift institutions and credit union share draft accounts.) Moreover, the surge in OCD was accompanied by a renewal of flows into savings deposits at commercial banks and continuation of substantial flows into money market mutual funds, which raised growth of M2 in November to the highest rate so far in 1981. Given the volatility of the behavior of the monetary aggregates in the short run, it seemed that the recent spurt might have resulted partly from an expansion of highly liquid precautionary balances at a time of considerable uncertainty about near-term economic and financial conditions, as well as a response to the lower level of market interest rates in earlier weeks.

The Committee decided to specify monetary growth rates for the four-month period from November 1981 to March 1982, because data for December were necessarily incomplete at the time of the meeting. It was generally recognized that a marked slowing in monetary growth in the early months of 1982 from the rapid pace in November and early December was desirable. Some members stressed the desirability of specifying growth rates for both M1 and M2 for the four-month period that would be within the ranges that had been tentatively adopted for 1982, partly with a view to avoiding any possible misunderstanding of the Committee's objectives in the period before completion of the review of its growth ranges for 1982. Other members stressed the importance of avoiding an abrupt deceleration of monetary growth in the first quarter of 1982, particularly if accompanied by upward interest rate pressures, because such developments might well hamper recovery in economic activity. A number of members were willing to accept relatively rapid growth in the period ahead, to the extent that it reflected a continuation of the recent behavior of other checkable deposits and thus might reflect expansion in its sizable savings component.

At the conclusion of the discussion, the Committee decided to seek behavior of reserve aggregates associated with growth of M1 and M2 from November 1981 to March 1982 at annual rates of around 4 to 5 percent and around 9 to 10 percent respectively. In setting the objective for

M1, the Committee took account of the relatively rapid growth that had already taken place through the first part of December. It also recognized that interpretation of actual money growth might need to take account of the significance of fluctuations in NOW accounts, which recently had been growing relatively rapidly. The intermeeting range for the federal funds rate that provides a mechanism for initiating consultation of the Committee was set at 10 to 14 percent.

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 declined appreciably in the fourth quarter and that prices on the average rose less rapidly than over the first three quarters of the year. In November industrial production fell more than in preceding months; nonfarm payroll employment, especially in manufacturing, declined sharply further; and the unemployment rate rose an additional 0.4 percentage points to 8.4 percent. The nominal value of retail sales increased, but the level was still well below the average for the third quarter. Housing starts remained at a depressed level. The rise in the index of average hourly earnings has been somewhat less rapid this year than during 1980.
>
> The weighted average value of the dollar against major foreign currencies has changed little on balance since mid-November. The U.S. foreign trade deficit in October widened substantially from the unusually low rate in September, and the average for the two months was about the same as that for July and August.
>
> M1-B (adjusted for estimated shifts into NOW accounts) expanded substantially in November and early December, but its level in November was still well below the lower end of the Committee's range for growth over the year from the fourth quarter of 1980 to the fourth quarter of 1981. Growth of M2 accelerated sharply in November, raising its level above the upper end of its range for the year. Short-term market interest rates and bond yields continued to decline

in the latter part of November, but since then they have risen to levels generally higher than those of mid-November; over the period since mid-November, mortgage interest rates have declined further. On December 3 the Board of Governors announced a reduction in Federal Reserve basic discount rates from 13 to 12 percent.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation, promote a resumption of growth in output on a sustainable basis, and contribute to a sustainable pattern of international transactions. At its meeting in early July, the Committee agreed that its objectives would be furthered by reaffirming the monetary growth ranges for the period from the fourth quarter of 1980 to the fourth quarter of 1981 that it had set at the February meeting. These ranges included growth of 3-1/2 to 6 percent for M1-B, abstracting from the impact of flows into NOW accounts on a nationwide basis, and growth of 6 to 9 percent and 6-1/2 to 9-1/2 percent for M2 and M3 respectively. The Committee recognized that the shortfall in M1-B growth in the first half of the year partly reflected a shift in public preferences toward other highly liquid assets and that growth in the broader aggregates had been running at about or somewhat above the upper end of their ranges. In light of its desire to maintain moderate growth in money over the balance of the year, the Committee expected that growth in M1-B for the year would be near the lower end of its range. At the same time, growth in the broader aggregates might be high in their ranges. The associated range for bank credit was 6 to 9 percent. The Committee also tentatively agreed that for the period from the fourth quarter of 1981 to the fourth quarter of 1982 growth of M1, M2, and M3 within ranges of 2-1/2 to 5-1/2 percent, 6 to 9 percent, and 6-1/2 to 9-1/2 percent respectively would be appropriate.

In the short run, the Committee seeks behavior of reserve aggregates consistent with growth of M1 and M2 from November 1981 to March at annual rates of around 4 to 5 percent and 9 to 10 percent respectively. The target for M1 no longer reflects the "shift-adjustment" for conversion of outstanding interest-bearing assets into new NOW accounts, formerly estimated in the "shift-adjusted" M1-B series. In setting the M1 target the Committee took account of the relatively rapid growth that had already taken place through the first part of December; it also recognized that interpretation of actual money growth may need to take account of the significance of fluctuations in NOW accounts, which have recently been growing relatively rapidly. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 10 to 14 percent.

Votes for this action: Messrs. Volcker, Boehne, Corrigan, Gramley, Keehn, Partee, Rice, Schultz, Mrs. Teeters, and Mr. Wallich. Votes against this action: Messrs. Solomon and Boykin.

Mr. Solomon dissented from this action because he felt it was particularly important at the beginning of an annual target period that the Committee not formulate its directive in terms that conveyed an unrealistic sense of precision. In his view, the directive language referring to the November-to-March growth rates in M1 and M2 did seem to convey such a sense.

Mr. Boykin dissented from this action because he favored specification of somewhat lower rates for growth in the monetary aggregates from November to March. For M2 in particular, he stressed the desirability of specifying a rate no higher than the range of 6 to 9 percent that had earlier been tentatively adopted for growth over 1982, with a view to avoiding a possible interpretation that the Committee had implicitly raised its objective before completion of the current review of the growth ranges for 1982.

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 February 2, 1982.

Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Keehn, Partee, Rice, Schultz, Mrs. Teeters, and Mr. Wallich. Votes against this action: None.

This action was taken on recommendation of the Manager for Domestic Operations. The Manager had advised that substantial net sales of securities were likely to be required during January in order to absorb reserves that had been provided over recent weeks to meet seasonal needs for currency in circulation.