FEDERAL RESERVE press release

For Use at 4:10 p.m. October 8, 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 August 24, 1982.

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 24, 1982

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP would advance only a little further in the current quarter, following an increase at an annual rate of about 1-1/4 percent in the second quarter. Average prices, as measured by the fixed-weight price index for gross domestic business product, were continuing to rise more slowly than in 1981.

The nominal value of retail sales rose 1 percent in July, according to the advance report, recovering only part of the 3-1/4 percent decline recorded in June. Sales of new domestic automobiles, which had dropped to an annual rate of 4.8 million units in June, rose a little in July and early August.

The index of industrial production was about unchanged in July, following a cumulative decline of more than 10 percent from the pre-recession level in July 1981. Production of business equipment continued to drop at its recent pace of 2 to 3 percent per month, while output of defense and space equipment continued to expand. Output of consumer goods picked up, reflecting mainly an increase in automobile assemblies, but automobile output in July was at a rate substantially above the sales pace of June and July, and production schedules for August were cut back.

Nonfarm payroll employment, after declining sharply in June, was essentially unchanged in July, as continued job losses in manufacturing were about offset by gains in trade and service industries. The unemployment rate rose 0.3 percentage point to 9.8 percent, as the civilian labor force expanded and total civilian employment was unchanged.

Private housing starts rose 34 percent in July, more than reversing the decline in June; but at an annual rate of 1.2 million units, starts remained low by historical standards. All of the July increase was in multifamily units; starts of such units more than doubled, in part because of an upsurge in those qualifying for rental subsidies under a federal government program terminating on September 30. That impending termination also apparently contributed to a substantial rise in July in newly issued permits for multifamily units; permits for single-family dwellings declined slightly and were at about the same pace as in the second quarter as a whole. Combined sales of new and existing homes in June continued about 25 percent below those of a year earlier.

The producer price index for finished goods and the consumer price index both rose 0.6 percent in July, following increases of 1.0 percent in June. At the producer level, prices of energy-related items increased sharply in both months and in July accounted for nearly all of the rise in the index; prices of foods and food materials fell substantially in July. At the consumer level, food prices edged down in July, while increases in energy prices and homeownership costs moderated from the rapid rates recorded in June. Over the first seven months of the year, the producer price index for finished goods and the consumer price index rose at annual rates of about 3 percent and 5-1/2 percent respectively, compared with increases of about 7 percent and 9 percent in 1981. The advance in the index of average hourly earnings also was considerably less rapid through July than during 1981.

In foreign exchange markets the trade-weighted value of the dollar against major currencies, while fluctuating over a wide range, had changed little on balance since late June despite a sharp decline in U.S. interest rates relative to foreign rates. The strength of the dollar in the face of narrowing interest rate differentials apparently reflected concerns of market participants about economic and financial difficulties abroad. The U.S. foreign trade deficit in the second quarter was somewhat below the first-quarter deficit, reflecting primarily a substantial drop in petroleum imports; the total of other imports rose somewhat and exports were about unchanged.

At its meeting on June 30 - July 1, the Committee had agreed to seek behavior of reserve aggregates associated with growth of M1 and M2 from June to September at annual rates of about 5 percent and about 9 percent respectively. It had also decided that somewhat more rapid growth would be acceptable depending on evidence that economic and financial uncertainties were leading to exceptional liquidity demands. Moreover, the Committee had noted that seasonal uncertainties, together with increased social security payments and the initial impact of the tax cut on cash balances, might lead to a temporary bulge in the monetary aggregates, particularly M1. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 10 to 15 percent.

M1 in fact declined slightly in July, following declines in May and June, as demand deposits continued to contract and growth in currency slowed further. Growth of M2, after moderating in June from a rapid pace in previous months, accelerated again in July. Small-denomination time deposits increased sharply during the month, and shares in money market mutual funds continued to expand at a relatively strong pace; in contrast, savings deposits at all depository institutions declined substantially after growing moderately during earlier months of the year.

Total credit outstanding at U.S. commercial banks grew at an annual rate of about 6-1/2 percent in July, well below the pace in the first half of the year. Growth in business loans slowed in July, but generally strong business demands for short-term credit were reflected in an increase in loans booked at foreign branches of U.S. banks and in a sharp acceleration in issuance of commercial paper by nonfinancial businesses. Issuance of publicly offered bonds rose in July.

Nonborrowed reserves expanded relatively rapidly in July. However with the demand for reserves weak, in part reflecting the sluggishness of M1, adjustment borrowing by depository institutions (including seasonal borrowing) declined from an average of about $1.1 billion in June to about $330 million in the two statement weeks ending August 18.

Market interest rates had declined sharply over the period since the last Committee meeting. Short-term market rates fell 4 to 6 percentage points. The federal funds rate, for example, declined from around 14-1/2 percent at the end of June to about 10 percent in the statement week ending August 18 and to around 9 percent in the days immediately preceding this Committee meeting. Bond yields declined about 1-3/4 to 2 percentage points. A substantial part of the decline in long-term rates occurred in an unusually strong rally in debt markets around mid-August, when record price increases also occurred in the stock market. The strength of the downward movement in interest rates apparently reflected a shift in market sentiment about the outlook for interest rates against the background of strains in financial markets, relatively weak economic indicators, and legislative action on the federal budget. Over the intermeeting interval, the prime rate charged by commercial banks on short-term business loans was lowered from 16-1/2 percent to 13-1/2 percent. In conjunction with the decline in short-term market rates, the Federal Reserve discount rate was reduced in three steps from 12 percent to 10-1/2 percent over the period. In home mortgage markets, average rates on new commitments for fixed-rate conventional loans at savings and loan associations declined about 1/2 percentage point on balance.

The staff projections presented at this meeting suggested that real GNP would grow at a moderate pace over the year ahead but that the unemployment rate would remain near its recent high level. Inflation, as measured by the fixed-weight price index for gross domestic business product, was expected to pick up somewhat over the months ahead from the substantially reduced pace in the first half of 1982, but continued improvement in the underlying trend was anticipated.

In the Committee's discussion of the economic situation and outlook, several members commented that the timing of an economic recovery was subject to considerable uncertainty, but no member expressed disagreement with the general character of the staff projection. As at other recent meetings, some Committee members suggested that the principal risks of a deviation from the projection were on the down side. Reference was made to the growing expressions of concern in the business community and to financial strains being experienced by many business firms, financial institutions, and others. In this situation, spending might well remain weak in key sectors of the economy. Business capital spending was cited as especially vulnerable to remaining depressed, particularly in the event of renewed upward pressure on long-term interest rates. On the other hand, it was observed, continued success in the fight against inflation would over time ease pressures in long-term debt markets, improve business confidence, and strengthen business capital spending.

Some members commented that to date the midyear reduction in federal income taxes and the concurrent cost-of-living increase in social security payments appeared to have had little impact on consumer spending. The view was expressed, however, that the midyear tax actions were likely to exert a positive influence on a delayed basis. It was also noted that the recently reduced levels of interest rates, if they were sustained, would help to relieve financial pressures throughout the economy and thereby contribute to improvement in economic activity over the months ahead.

At its meeting on June 30 - July 1, the Committee had begun a review of the monetary growth objectives for the period from the fourth quarter of 1981 to the fourth quarter of 1982 that it had set in early February. Subsequently, at a meeting on July 15, the Committee had reaffirmed those objectives, which included ranges of 2-1/2 to 5-1/2 percent for M1, 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. At the same time the Committee agreed that growth in the monetary and credit aggregates around the top of the indicated ranges would be acceptable in the light of the relatively low base period for the M1 target and other factors, and that it would tolerate for some period of time growth somewhat above the target range should unusual precautionary demands for money and liquidity be evident in the light of current economic uncertainties. The Committee also indicated that it was tentatively planning to continue the current ranges for 1983 but that it would review that decision carefully in the light of developments over the remainder of 1982.

At this meeting the Committee reviewed the short-run objectives that it had established at the previous meeting calling for expansion at annual rates of about 5 percent for M1 and about 9 percent for M2 over the three months from June to September. Data available through mid-August indicated that growth in M1 was running below the Committee's objective, while partial data suggested that growth in M2 had moved above the objective for the three-month period. In relation to the Committee's objectives for the year as a whole, the latest staff estimates indicated that the expansion of M1 was within its longer-run range, while that of M2 was somewhat above its 1982 range.

During the Committee's discussion, most of the members agreed that the short-run growth objectives adopted at the previous meeting remained appropriate under current economic and financial conditions and should be retained. The view was expressed that the substantial recent decline in interest rates, which in part reflected growing public awareness of the progress that had been made in curbing inflation, provided welcome relief in easing financial strains throughout the economy. A number of members expressed concern, however, about the volatility of interest rates and some commented that further sharp movements in either direction over the near term might have damaging consequences. Some members emphasized that a pronounced increase from current levels would aggravate financial strains and inhibit recovery in interest-sensitive sectors of the economy. Some members also suggested that a large further decline might foster a resurgence of inflationary expectations and could prove to be unsustainable and therefore unsettling to financial markets. Several members expressed the view that the Committee should review its policy if reserve provision to meet monetary growth objectives was fostering a substantial change in pressures on bank reserve positions and in credit markets.

Reference was made to the relative strength in M2 over the course of recent weeks that appeared to be related in part to unusual demands for liquid investments, such as money market funds, at comparatively attractive yields. The members agreed that under prevailing circumstances, M2 growth somewhat above its short-run target would be acceptable over the period immediately ahead.

At the conclusion of the discussion the Committee agreed to reaffirm the objectives for monetary growth established at the June 30 - July 1 meeting for the June to September period. The Committee decided that somewhat more rapid growth in the monetary aggregates would be acceptable depending upon evidence that economic and financial uncertainties were fostering unusual liquidity demands for monetary assets and were contributing to substantial volatility in interest rates. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 7 to 11 percent.

The following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests only a little further advance in real GNP in the current quarter, following a relatively small increase in the second quarter, while prices on the average are continuing to rise more slowly than in 1981. In July the nominal value of retail sales rose somewhat from a sharply reduced June level; housing starts increased substantially, though from a relatively low rate; and industrial production and nonfarm payroll employment were essentially unchanged. The unemployment rate rose 0.3 percentage point to 9.8 percent. Over the first seven months of the year the advance in the index of average hourly earnings was considerably less rapid than during 1981.

The weighted average value of the dollar against major foreign currencies, while fluctuating over a wide range, has changed little on balance since late June despite a sharp decline in U.S. interest rates relative to foreign rates. Demand for dollars appeared to reflect concern about economic and financial difficulties abroad. The U.S. foreign trade deficit in the second quarter was somewhat below the first-quarter deficit, with petroleum imports down substantially.

M1 declined slightly in June and July, while growth of M2 moderated somewhat from its average pace earlier in the year. Business demands for credit, especially short-term credit, remained generally strong. Market interest rates have declined sharply since around midyear, reflecting a shift in market sentiment about the outlook for interest rates against the background of strains in financial markets, relatively weak economic indicators, and legislative action on the federal budget. The Federal Reserve discount rate was reduced in three steps from 12 percent to 10-1/2 percent during the period.

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 February, the Committee had agreed that its objectives would be furthered by growth of M1, M2, and M3 from the fourth quarter of 1981 to the fourth quarter of 1982 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. The associated range for bank credit was 6 to 9 percent. The Committee began a review of these ranges at its meeting on June 30 - July 1, and at a meeting on July 15, it reaffirmed the targets for the year set in February. At the same time the Committee agreed that growth in the monetary and credit aggregates around the top of the indicated ranges would be acceptable in the light of the relatively low base period for the M1 target and other factors, and that it would tolerate for some period of time growth somewhat above the target range should unusual precautionary demands for money and liquidity be evident in the light of current economic uncertainties. The Committee also indicated that it was tentatively planning to continue the current ranges for 1983 but that it would review that decision carefully in the light of developments over the remainder of 1982.

> In the short run, the Committee continues to seek behavior of reserve aggregates consistent with growth of M1 and M2 from June to September at annual rates of about 5 percent and about 9 percent respectively. Somewhat more rapid growth would be acceptable depending on evidence that economic and financial uncertainties are leading to exceptional liquidity demands and changes in financial asset holdings. 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 7 to 11 percent.

> Votes for this action: Messrs. Volcker, Solomon, Balles, Black, Ford, Mrs. Horn, Messrs. Martin, Partee, Rice, and Mrs. Teeters. Vote against this action: Mr. Wallich. Absent and not voting: Mr. Gramley.

Mr. Wallich dissented from this action because he favored an approach to operations early in the period that would lessen the chances of short-term interest rates remaining below the prevailing discount rate or falling further below it. He was concerned that such interest rate behavior would tend to accelerate monetary expansion and that the necessary restraint of reserve growth to curb such expansion might lead to a sizable rebound in short-term rates with adverse implications for business and consumer confidence.

2. Authorization for foreign currency operations

At this meeting Committee members were apprised of the status of ongoing discussions with the Government of Mexico regarding short-term financing arrangements to support Mexico's efforts to strengthen its economic and financial position. At its meeting on June 30 - July 1, the Committee had agreed, in response to a request by officials of the Bank of Mexico, that it would stand ready to provide to the Bank of Mexico up to the full $700 million available under the Federal Reserve System's existing swap arrangement with that Bank. Subsequently, on August 4, 1982, the Bank of Mexico, which had drawn on its swap line on an overnight basis on a few occasions in recent months, drew $700 million for a period of three months.

At the time of this meeting, negotiations were under way among Mexico, the U.S. Treasury, major central banks, and other lenders to provide multilateral financial support to Mexico. The purpose of the support was to effect an orderly transition to an economic stabilization program that the Government of Mexico had announced was being developed. The Committee authorized Federal Reserve participation in the proposed multilateral financing package through the temporary establishment of a special swap arrangement of $325 million with the Bank of Mexico in addition to the regular arrangement of $700 million. Accordingly, paragraph 2 of the Committee's authorization for foreign currency operations was amended, effective August 28, 1982, for the period through August 23, 1983, to read as follows:

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign Bank	Amount of arrangement (millions of dollars equivalent)
Austrian National Bank	250
National Bank of Belgium	1,000
Bank of Canada	2,000
National Bank of Denmark	250
Bank of England	3,000
Bank of France	2,000
German Federal Bank	6,000
Bank of Italy	3,000
Bank of Japan	5,000
Bank of Mexico:	
Regular	700
Special	325
Netherlands Bank	500
Bank of Norway	250
Bank of Sweden	300
Swiss National Bank	4,000
Bank for International Settlements:	
Dollars against Swiss francs	600
Dollars against authorized European currencies other than Swiss francs	1,250

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

Votes for this action: Messrs. Volcker, Solomon, Balles, Black, Ford, Mrs. Horn, Messrs. Martin, Partee, Rice, Mrs. Teeters, and Mr. Wallich. Votes against this action: None. Absent and not voting: Mr. Gramley.

On August 30, 1982, the U.S. Treasury and the Federal Reserve announced that they were participating with central banks of other Group of Ten countries, Spain, and Switzerland, under the aegis of the Bank for International Settlements, in making available to the Bank of Mexico short-term financing totaling $1.85 billion. The Treasury would provide $600 million through the Exchange Stabilization Fund, in conjunction with the $325 million that the Federal Reserve was making available through its additional swap arrangement. The multilateral financing program provided that drawings by Mexico would be made in line with progress toward agreement between the Mexican Government and the International Monetary Fund (IMF) on an economic adjustment program that will permit Mexico to qualify for drawings under the IMF's Extended Fund Facility.