FEDERAL RESERVE press release

For Use at 4:30 p.m. October 7, 1983

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 23, 1983.

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 23, 1983

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP, which had grown at an annual rate of about 9-1/4 percent in the second quarter, was continuing to expand quite rapidly in the current quarter, propelled to a large extent by the relatively sharp swing in business inventories from liquidation to accumulation that appeared to be in process. Available indicators of final purchases remained generally favorable, though suggestive of a slowing from the unusually strong rate of expansion in the second quarter.

Personal consumption expenditures in the second quarter had risen at an exceptional annual rate of nearly 10 percent in real terms. Much of the increased spending occurred in April and May, as sales in all major categories advanced sharply. In June and July the nominal value of retail sales showed little further change, but surveys indicated a continuing high level of consumer confidence. Sales of new domestic automobiles moved up in June to a relatively strong annual rate of 7-1/4 million units and continued at that pace in July. In early August auto sales rose somewhat further despite reductions in the availability and value of financing concessions and other purchase incentives.

Total private housing starts edged down in July, as they had in June, to an annual rate of 1-3/4 million units. Permits, however, rose over the June-July period -- substantially for multifamily units and marginally on balance for single-family units. In the second quarter, combined sales of new and existing houses had risen to a rate more than 50 percent above the cyclical low in the third quarter of 1982, but there was evidence of some slowdown as the quarter progressed. Moreover, reports of an appreciable reduction in mortgage loan applications and an increase in cancellations of sales contracts suggested some weakening in home sales in July.

On the other hand, recent data continued on the average to indicate strengthening in business capital spending. The second quarter had marked a turnaround in that sector: new orders and shipments of nondefense capital goods were up 14 percent and 4-1/4 percent respectively from the previous quarter; and expenditures for equipment rose at an annual rate of 14 percent in real terms, the largest one-quarter advance in five years. This strengthening tendency appeared to be continuing. Production of business equipment remained strong in June and July, and shipments of nondefense capital goods rose in June to a level well above the average for the second quarter.

The index of industrial production rose 1.8 percent in July following large advances in the second quarter. As in other recent months, sizable gains in output occurred across a broad range of industries and were particularly large for consumer durable goods. By July the index had risen about 10-1/4 percent from its trough in November 1982, close to the average increase for comparable stages of economic recovery in the postwar period.

Nonfarm payroll employment, which had increased about 1 million in the second quarter, rose about 1/2 million further in July, and the civilian unemployment rate fell 0.5 percentage point to 9.5 percent. In manufacturing, employment advanced about 160,000, marking the fourth consecutive month of large gains, and the average workweek lengthened a bit further to 40.3 hours.

In July the producer price index for finished goods edged up 0.1 percent and the consumer price index rose 0.4 percent. Thus far in 1983, the producer price index has declined slightly, and the consumer price index and the index of average hourly earnings have risen at rates considerably below those in 1982.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies rose about 4-1/2 percent further in July and early August but subsequently depreciated about 3 percent. The fluctuation in the exchange rate was related in part to movements in U.S. interest rates over the period. The U.S. foreign trade deficit was smaller in June than in May, but the deficit was much larger in the second quarter than in the first, as imports rose while exports were essentially unchanged.

At its meeting on July 12-13, 1983, the Committee had decided that open market operations in the period until this meeting should be directed at increasing slightly further the existing degree of reserve restraint. That action was expected to be associated with growth of M2 and M3 at annual rates of about 8-1/2 and 8 percent respectively from June to September, consistent with the Committee's longer-run ranges of 7 to 10 percent for M2 for the period from February-March of 1983 to the fourth quarter of 1983 and 6-1/2 to 9-1/2 percent for M3 for the period from the fourth quarter of 1982 to the fourth quarter of 1983. The Committee had anticipated that a deceleration in growth of M1 to an annual rate of around 7 percent from June to September would be consistent with its third-quarter objectives for the broader aggregates and that expansion in total domestic nonfinancial debt would remain within its associated range of 8-1/2 to 11-1/2 percent for the year. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

Growth in M2 and M3 slowed substantially in July to annual rates of about 6-1/4 percent and 5 percent respectively. By July M2 was at a level near the midpoint of the Committee's range for 1983 and M3 was somewhat below the upper limit of its range. Growth in M1 decelerated to an annual rate of about 9 percent in July, less than half the average pace in the May-June period, but the level of M1 remained above the Committee's monitoring range for the second half of the year.

Total borrowing by domestic nonfinancial sectors was estimated to have slowed somewhat in July from its average in the second quarter, largely because of reduced borrowing by the federal government, with growth in nonfinancial debt remaining within its longer-run range for 1983. Expansion of bank credit was at an annual rate of around 10 percent in July, about the same as in the second quarter. Its composition, however, changed substantially. Total loans expanded at a rate more than double the pace in the second quarter, while acquisitions of U.S. Treasury securities slowed appreciably. Outstanding business loans, which had declined slightly in the second quarter, grew at an annual rate of about 12 percent in July, and consumer loans expanded at an annual rate of more than 20 percent, nearly twice the pace recorded in the second quarter. The pickup in lending to businesses by banks in part reflected reduced issuance of bonds by corporations in reaction to increases in long-term market interest rates.

Growth in total reserves decelerated to an annual rate of about 6 percent in July, but nonborrowed reserves (including extended credit at the discount window) changed little as adjustment plus seasonal borrowing rose from about $680 million in June to around $875 million in July. Such borrowing increased further in the first half of August to about $1 billion.

With a little greater restraint on reserve availability relative to demands, the federal funds rate and other short-term interest rates rose about 20 to 40 basis points on balance over the intermeeting period. Atypically, long-term rates rose by more than short-term rates, increasing about 80 basis points. Market participants apparently reacted to indications of further strength in the economy, to concern about possible increases in inflationary pressure later during the economic recovery, and to the heavy borrowing by the U.S. Treasury, particularly in connection with the mid-August financing, as well as to the slightly firmer degree of restraint on bank reserve positions. After reaching an intermeeting peak in the second week of August, most interest rates retraced the greater part of their earlier increases, apparently reflecting responses to slower-than-expected growth in the money supply and incoming data--including the leveling off of retail sales in June and July--that suggested a more moderate pace of economic expansion. Most commercial banks raised the prime rate charged on short-term business loans by 1/2 percentage point to 11 percent in the early part of August. Average rates on new commitments for fixed-rate conventional home mortgage loans at savings and loan associations were up about 60 basis points over the period; the ceiling rate on FHA- and VA-underwritten mortgage loans, which had been raised 1 percentage point as of August 1, was reduced 1/2 percentage point to 13 percent, effective on the day of this meeting.

The staff projections presented at this meeting indicated that the economic recovery would continue in the latter part of 1983 and in 1984, though at a more moderate pace than in the second and third quarters of this year. Consumer spending, while continuing to grow, was expected to become a less expansive factor. Gains stemming from expenditures on housing and increased business inventories were also expected to provide less stimulus over the projection period. On the other hand, the staff expected business fixed investment to provide some additional impetus to overall economic growth. The staff continued to project a gradual decline in the unemployment rate over the balance of the year and a further decline in 1984. Upward pressures on prices and wages were expected to remain relatively moderate over the projection horizon, although the impact on food prices of adverse weather conditions might be expected to raise prices, overall, a little more than had been previously projected.

During the Committee's discussion of the economic situation and outlook, the members noted the tentative indications of some slowing in the pace of the recovery, but they agreed that continuing economic expansion was a likely prospect for the period through 1984. Views differed to some extent regarding the prospective strength of the ongoing recovery, although all the members expected the rate of growth to moderate considerably from its recent pace. Several agreed that growth at about the moderate pace projected by the staff was a reasonable expectation for the next several quarters. But some believed that the expansion could be on the faster side, whereas others thought that slower growth was more probable.

Factors that would tend to strengthen the expansion included, it was noted, the substantial momentum of the recovery and the favorable prospects in such circumstances that a substantial pickup in business fixed investment might develop as businesses became more optimistic about the outlook. Orders for business equipment had been running higher over the course of recent months, and many businesses were reporting expanding sales and rising profits.

On the other hand, members who were less sanguine about the long-run strength of the recovery cautioned that housing and other interest-sensitive sectors of the economy might weaken appreciably over coming months, given the current relatively high level of real interest rates. Reports of a slowdown in new mortgage applications, increased cancellations of existing sales contracts, and high vacancy rates in rental units were cited as indications that the recovery in the housing sector might wane. A few members also expressed the view that automobile sales might slow somewhat more than generally expected as the pent-up demand for automobiles began to be satisfied. Another member suggested more generally that growth in consumer spending would probably be more moderate than anticipated as consumers attempted to save a higher, and more normal, proportion of their incomes than had been the case in recent quarters.

Members continued to express concern about the prospects for large federal deficits. Although a stimulative fiscal policy had contributed to the rebound in economic activity, continued large deficits as the recovery proceeded would tend to intensify credit market pressures and divert financial and real resources from needed private investment in plant and equipment and housing. The view was expressed that actions to reduce future deficits, if of sufficient magnitude, could work to ease pressures on interest rates in a period of rising private credit demands. Actual interest rates would of course be influenced by a broad range of developments, including the degree of strength in private credit demands, the outlook for inflation, and the volume of capital inflows from abroad.

A number of members commented that strong competition in many markets, including foreign competition, along with successful efforts by many businesses to cut costs, was having a restraining effect on prices and wages. Concern was expressed, however, that upward pressures on prices and wages could develop as levels of capacity utilization and employment continued to rise. Members also noted the possibility that the domestic price level would be adversely affected by higher import prices if the value of the dollar were to decline substantially on foreign exchange markets and by rising food prices that would result from the interaction of adverse weather conditions and governmental policies to reduce farm supplies.

Turning to policy for the near term, the Committee considered whether any further adjustment in the degree of restraint on bank reserve conditions would be desirable under current economic and financial circumstances, given the behavior of the monetary and credit aggregates. The members noted that growth in the broader aggregates, on which the Committee had been placing primary emphasis, had slowed substantially. Both M2 and M3 appeared to be expanding at rates that were somewhat below their June-to-September target paths and their recent levels were within the longer-run ranges that the Committee had established for the year. A staff analysis suggested that the slowdown in the growth of M2 and M3 might have resulted in part from special factors, including an unusually large buildup in July in the average level of Treasury balances, which probably led to reduced bank reliance on managed liabilities to finance credit expansion. An unwinding of these developments in the weeks ahead could be associated with some acceleration in the growth of M2 and M3 over the balance of the third quarter. Growth in M1 had moderated somewhat further in July, but it remained above the short-run, June-to-September path that the Committee had expected would be consistent with its third-quarter objectives for the broader aggregates and also above its longer-run monitoring range. Incoming data suggested, however, that M1 growth would probably continue to decelerate in August.

At the conclusion of the discussion the members agreed that no change needed to be made at this time in the degree of pressure on bank reserves. Accordingly, a consensus was expressed in favor of maintaining about the existing degree of reserve restraint for the period immediately ahead. The members anticipated that such a policy course would be associated with growth of both M2 and M3 at annual rates of around 8 percent for the period from June to September. The members also agreed that the need for greater or lesser restraint on reserve conditions should be evaluated against the background of available evidence about trends in economic activity and prices and conditions in domestic and international financial markets, including foreign exchange markets. Depending upon such developments, lesser restraint would be acceptable in the event of a significant shortfall in the growth of the aggregates over the period ahead, while somewhat greater restraint would be acceptable in the context of more rapid growth in the aggregates. The Committee continued to anticipate that its third-quarter objectives for the broader aggregates would be consistent with a deceleration in M1 growth to an annual rate of around 7 percent from June to September, and that expansion in total nonfinancial debt would remain within the range of 8-1/2 to 11-1/2 percent established for the year. It was agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee, would remain at 6 to 10 percent.

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

> The information reviewed at this meeting suggests continued rapid growth in real GNP in the current quarter. Industrial production increased sharply in July following large gains in the second quarter. Nonfarm payroll employment also rose substantially further in July and the civilian unemployment rate declined 1/2 percentage point to 9.5 percent. After rising sharply in the spring, retail sales have leveled off recently. Housing starts edged down over the past two months but permits continued to rise. Recent data on new orders and shipments on average continued to indicate strength in the demand for business equipment. In July, information on producer and consumer prices and the index of average hourly earnings was consistent with earlier indications of a considerable moderation in the rate of inflation.
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> Growth in the broader monetary aggregates slowed substantially in July, bringing M2 to a level near the midpoint of the Committee's range for 1983 and M3 to a level somewhat below the upper limit of its range. Growth in M1 decelerated considerably from its May-June pace, but its level remained above the Committee's monitoring range for the year. Interest rates rose appreciably through much of the intermeeting period but recently market rates have retraced most of their rise.
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> In part reflecting the course of U.S. interest rates, the weighted average value of the dollar against major foreign currencies rose substantially further in July and early August, but the rise was followed by a subsequent decline that reversed most of the earlier increase. The U.S. foreign trade deficit was smaller in June than in May, but the deficit in the second quarter was much larger than in the first as imports rose while exports were essentially unchanged.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to a sustainable pattern of international transactions. At its meeting in July the Committee reconsidered the growth ranges for monetary and credit aggregates established earlier for 1983 in furtherance of these objectives and set tentative ranges for 1984. The Committee recognized that the relationships between such ranges and ultimate economic goals have become less predictable; that the impact of new deposit accounts on growth of the monetary aggregates cannot be determined with a high degree of confidence; and that the availability of interest on large portions of transaction accounts may be reflected in some changes in the historical trends in velocity.

Against this background, the Committee at its July meeting reaffirmed the following growth ranges for the broader aggregates: for the period from February-March of 1983 to the fourth quarter of 1983, 7 to 10 percent at an annual rate for M2; and for the period from the fourth quarter of 1982 to the fourth quarter of 1983, 6-1/2 to 9-1/2 percent for M3. The Committee also agreed on tentative growth ranges for the period from the fourth quarter of 1983 to the fourth quarter of 1984 of 6-1/2 to 9-1/2 percent for M2 and 6 to 9 percent for M3. The Committee considered that growth in M1 in a range of 5 to 9 percent from the second quarter of 1983 to the fourth quarter of 1983, and in a range of 4 to 8 percent from the fourth quarter of 1983 to the fourth quarter of 1984 would be consistent with the ranges for the broader aggregates. The associated range for total domestic nonfinancial debt was reaffirmed at 8-1/2 to 11-1/2 percent for 1983 and tentatively set at 8 to 11 percent for 1984.

In implementing monetary policy, the Committee agreed that substantial weight would continue to be placed on the behavior of the broader monetary aggregates. The behavior of M1 and total domestic nonfinancial debt will be monitored, with the degree of weight placed on M1 over time dependent on evidence that velocity characteristics are resuming more predictable patterns. The Committee understood that policy implementation would involve continuing appraisal of the relationships between the various measures of money and credit and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

> The Committee seeks in the short run to maintain the existing degree of reserve restraint. The action is expected to be associated with growth of M2 and M3 at annual rates of around 8 percent from June to September, consistent with the targets established for these aggregates for the year. Depending on evidence about the strength of economic recovery and other factors bearing on the business and inflation outlook, lesser restraint would be acceptable in the context of a significant shortfall in growth of the aggregates from current expectations, while somewhat greater restraint would be acceptable should the aggregates expand more rapidly. The Committee anticipates that a deceleration in M1 growth to an annual rate of around 7 percent from June to September will be consistent with its third-quarter objectives for the broader aggregates, and that expansion in total domestic nonfinancial debt would remain within the range established for the year. 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 6 to 10 percent.

> Votes for this action: Messrs. Volcker, Solomon, Gramley, Guffey, Keehn, Martin, Morris, Partee, Rice, Roberts, Mrs. Teeters, and Mr. Wallich. Votes against this action: None.

2. Authorization for Foreign Currency Operations

In August 1982 the Committee had authorized the temporary establishment of a special swap arrangement of $325 million with the Bank of Mexico, in addition to the regular swap arrangement of $700 million, effective for the period from August 28, 1982, through August 23, 1983. At this meeting the Committee was apprised that the Bank of Mexico was making the final repayment of dollars drawn under the special swap facility and that the facility would expire today as scheduled. It was also noted that drawings made on the

$700 million regular swap arrangement had been repaid earlier and that as of this date there would be no outstanding drawings on the Federal Reserve System by the Bank of Mexico.