FEDERAL RESERVE press release

For Use at 4:30 p.m. May 25, 1984

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 March 26-27, 1984.

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 March 26-27, 1984

1. Domestic policy directive

The information reviewed at this meeting indicated that growth in real GNP had accelerated markedly in the first quarter from the 5 percent annual rate of expansion in the fourth quarter of 1983. The latest data suggested that demands for goods and services might remain relatively strong in the months ahead, though real growth was expected to slow from the first-quarter pace. The rise in average prices, as measured by the fixed-weight index for gross domestic business product, appeared to have increased somewhat, but wage increases generally remained moderate.

The index of industrial production rose 1-1/4 percent in both January and February, after average monthly increases of about 1/2 percent in the fourth quarter. Gains in output were widespread across major product and material categories, with especially large increases in construction supplies, consumer goods, and durable goods materials. Despite relatively lean inventories at automobile dealers, auto production was little changed in January and February from the 8 million unit rate recorded in December, as some plants producing the more popular large-size cars were encountering capacity constraints. The rate of capacity utilization in manufacturing rose one percentage point further in February to 81.0 percent--the highest level since May 1981 and only slightly below the 81.8 percent average for the 1967-82 period.

In January and February gains in nonfarm payroll employment averaged 325,000, substantially above the average monthly increases of about 250,000 in the fourth quarter. Manufacturing employment continued to rise by more than 100,000 in each month, and the factory workweek, which had jumped 0.5 hour in January to 41.0 hours, held steady in February at its highest level since 1967. The civilian unemployment rate declined 0.2 percentage point each month to 7.8 percent in February.

Consumer spending has contributed substantially to recent gains in economic activity. Retail sales grew at an exceptional pace in January and changed little in February. The automobile market was particularly strong, with sales of domestic models in January and February, at an annual rate of 8-1/2 million units, up over 1 million units from the average pace during the fourth quarter. Sales during the first 20 days of March continued relatively strong, at a pace of about 8 million units.

Private housing starts surged in January and February, reaching an annual rate of nearly 2.2 million units, the highest level in almost six years and well above the rate of 1.7 million units recorded in the fourth quarter and in 1983 as a whole. Building permits for residential construction also rose in both January and February, and homes sales remained high.

In the business sector, capital outlays have continued to grow, though at rates below the unusually rapid expansion in the last half of 1983. Shipments of nondefense capital goods weakened in the first two months of the year but remained at high levels. Other recent information, including a rising trend in new orders and survey reports of upward revisions in business spending plans, generally suggests continuing strength in business fixed investment.

The producer price index for finished goods and the consumer price index both increased about 1/2 percent per month in January and February. The rise in prices was faster than in the fourth quarter of 1984, with increases concentrated in the food sector. The index of average hourly earnings rose only slightly over the first two months of the year, although total compensation costs apparently increased more rapidly, in part because of higher payroll taxes for social security.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies declined about 7 percent from the end of January through the first week of March. Concerns about inflation prospects in the United States, given large budget deficits and a strengthening private economy, were cited by market participants as factors weakening the dollar. More recently, part of that decline was retraced, apparently aided by rises in U.S. interest rates relative to foreign rates. The merchandise trade deficit rose sharply in January, mainly because of larger non-oil imports.

At its meeting on January 30-31, 1984, the Federal Open Market Committee had agreed that in the short run policy should be directed at maintaining the existing degree of restraint on reserve positions. The members anticipated that such a policy would be associated with growth of both M2 and M3 at an annual rate of around 8 percent for the period from December to March and growth of M1 at an annual rate of about 7 percent over the three-month period. The rate of expansion in total domestic nonfinancial debt was thought likely to be within the Committee's monitoring range of 8 to 11 percent for the year 1984. It was also agreed that the need for lesser or greater restraint on reserves would be evaluated against the background of developments relating to the strength of the business expansion and of inflationary pressures. The intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee, was retained at 6 to 10 percent.

Data available through mid-March indicated that since December M1 and M3 had been expanding somewhat more rapidly than anticipated at the January meeting. Tentative estimates suggested that in the first quarter as a whole M1 and M3 grew at annual rates of about 7-1/4 percent and 8-1/2 percent from the fourth quarter, well up in their longer-run ranges of 4 to 8 percent and 6 to 9 percent respectively established by the Committee for 1984. Growth in M2 appeared to have been less rapid than previously expected and was estimated to be at a rate in the lower part of the 6 to 9 percent range for 1984.

The debt of domestic nonfinancial sectors apparently increased in January and February at a pace substantially above the Committee's monitoring range for the year. Total credit at U.S. commercial banks continued to expand rapidly, at an annual rate of about 11 percent in January and 15 percent in February. Loan demand continued to be brisk in all major categories of loans--business, consumer, and real estate. Even after adjusting for the loan growth in February that was associated with merger-related financing, business borrowing at banks and in the commercial paper market remained substantial.

The implementation in early February of contemporaneous reserve-requirement accounting, and also the legislated phasedown to lower reserve requirements for member banks under the Monetary Control Act at the same time, apparently prompted a cautious approach to reserve management by depository institutions, entailing for a time, as anticipated, an unusually high level of excess reserves. In large part because of the high volume of excess reserves, but also reflecting the strength in required reserves accompanying growth in transaction deposits, total and nonborrowed reserves expanded rapidly in February. They appeared to be changing little in March, however, as excess reserves declined. Borrowing at the discount window averaged about $600 million over the first three reserve maintenance periods following the previous meeting, but moved up to an average of somewhat over $1 billion in the current maintenance period which began in mid-March.

Market interest rates moved considerably higher over the intermeeting period, generally rising about 3/4 to 1 percentage point in both short- and long-term markets. The increases appeared to be induced by the strength of economic activity and private credit demands, disappointment over the absence of significant progress to curb the federal deficit, concern that prices might rise more rapidly, and expectations that monetary policy would not accommodate rapid growth in money and credit. Federal funds traded in a range of 9-1/2 to 9-3/4 percent during most of the intermeeting interval; most recently, however, the funds rate tended to fluctuate around 10 percent and was occasionally somewhat higher. Against the background of generally rising market rates and brisk business loan demand, commercial banks raised their "prime loan" rate from 11 to 11-1/2 percent in mid-March. Average rates on new commitments for fixed-rate conventional home mortgage loans rose nearly 1/4 percentage point on balance over the intermeeting period.

The staff projections presented at this meeting suggested that growth in real GNP would moderate considerably over the course of the year but that the rate of price increase might pick up somewhat from its recent pace. It was expected that inventory investment and auto demand would level off and that housing activity would decline from the advanced pace of the first quarter. The impetus for continued economic expansion was expected to come from business fixed investment, from government purchases and, with rising world economic activity, from export demand.

In the Committee's discussion of the economic situation and outlook, members expressed concern that the current pace of the economic expansion, if maintained for long, would lead to growing imbalances, to price and wage pressures in some sectors of the economy and to continuation--against the background of persisting large federal deficits--of exceptionally heavy credit demands. Consequently, the sustainability of the expansion would be jeopardized. The view that the present rate of economic growth could be expected to moderate was widely shared, but several members suggested that it might remain significantly faster than generally anticipated, at least over the months immediately ahead. It was noted, for instance, that business investment and inventory rebuilding might well provide greater stimulus to economic activity than many expected. Moreover, members indicated particular concern that fiscal policy was likely to remain unduly stimulative in the context of an economy with rapidly rising levels of resource utilization, including a few industries that were beginning to experience pressures on existing capacity.

At the same time, several members observed that, in the light of various imbalances and distortions, both domestic and international, the economy might be vulnerable to large and sudden increases in interest rates and pressures on financial markets. The emergence of strong business credit demands on top of a continuing large rate of increase in consumer and mortgage credit and massive Treasury financings accentuated these risks. Housing and the thrift industry that serviced it were likely to be seriously affected by any further marked rise in interest rates, especially in an environment in which variable rate and other new financing instruments were exposing a growing number of borrowers to unaccustomed financial risks. Reference was also made to the vulnerability of commercial construction, notably that involving office structures, given the considerable volume of new building in several sections of the country that were experiencing high vacancy rates. In agriculture, a sizable number of farmers were experiencing serious debt problems that were being worsened by pressures on earnings and lower land prices. On the international side, higher U.S. interest rates would clearly exacerbate the debt servicing problems of several less developed countries. The very large foreign trade deficit was also seen as a threat to the continuing health of the economy.

The members expressed a good deal of concern about the possibility of an intensification of price and wage pressures. While price increases had accelerated only slightly in recent months and wage advances had remained relatively restrained, a number of members commented that inflationary expectations appeared to be worsening. Capacity utilization rates were already high in some sectors of the economy and, more generally, were approaching levels that had been associated with rising rates of inflation in previous periods of economic expansion. In this situation, an environment conducive to more aggressive pricing could develop despite the increase in profit margins of many companies during the expansion period. The trend in wage settlements would be a key element in that respect, with potentially trend-setting wage negotiations scheduled for later in the year. The ready availability of imports was a material factor restraining prices for a wide range of goods, but a sharp decline in the foreign exchange value of the dollar could aggravate inflationary pressures. In evaluating the price outlook it was also noted that, in contrast to the experience in some earlier years, oil prices were not contributing to inflation, and one member observed that faster growth in the labor force, should it materialize following the slow growth in 1983, combined with a rate of unemployment that was still relatively high by historic standards, would also tend to curb inflationary pressures.

In the Committee's discussion of policy for the period ahead, there was a relatively narrow range of preferences with regard to monetary growth objectives for the second quarter. All of the members wanted to maintain growth within the Committee's longer-run ranges; while, as earlier, growth in the broader aggregates in the upper part of their ranges was considered acceptable, there was a desire to see M1 closer to the middle of its range over a period of time. A number of members suggested that the degree of reserve pressure might be attuned a bit more rapidly than over the past year to deviations in monetary aggregates from objectives, but no member advocated that the degree of reserve restraint be adjusted automatically and related solely to the performance of the monetary aggregates. Some members emphasized their concern that growth in the aggregates was more likely to exceed than to fall short of the second-quarter objectives if the expansion in economic activity remained exceptionally strong. The Committee, it was argued, should in that event be prepared to lean cautiously, in the present environment, against excessive monetary growth as it emerged. The point was also emphasized by some members that significant shortfalls in monetary growth might desirably lead to some easing of interest rate pressures. There was general acceptance of an approach that would take into account such factors as the apparent strength of economic activity and of inflationary pressures in any adjustment of the degree of reserve restraint. A number of members also called attention to the rate of credit growth, which had accelerated considerably in early 1984 and which appeared to be an important factor in recent interest rate increases.

With regard to preferences for the Committee's operational approach, there were some differences of view about whether the recent degree of reserve restraint should be maintained or altered in the period ahead, and under what conditions. Many felt that maintenance of something like the degree of restraint that had developed in recent days offered a reasonable prospect for achieving the monetary growth and financial market conditions that would foster a sustainable pace of economic expansion, help to contain inflation, and minimize the potential damage to interest-sensitive sectors of the economy. However, several of these members foresaw economic and monetary developments that might call for some further restraint during the intermeeting period, and they wanted to be prepared to move promptly in that event. Some members did not want to rule out the possibility of lesser restraint, but most regarded such a development as less likely.

Other members of the Committee, viewing demand pressures on the economy as stronger and posing a more immediate threat of rising price pressures and growing imbalances, felt that some intensification in the degree of reserve restraint was called for at this time. This would, it was maintained, reduce the risk that much more vigorous restraint would be needed later, with sharply adverse consequences for sectors of the economy that were vulnerable to rising interest rates. These members were, nonetheless, concerned about moving too aggressively in the direction of greater restraint, given the sensitive state of domestic and international credit markets and uncertainties about the underlying strength of demand pressures.

In light of recent market developments, the members agreed that the intermeeting range for the federal funds rate should be raised from the 6 to 10 percent that had been specified since mid-November 1982. It was understood that the federal funds range is essentially a mechanism for initiating Committee consultations when its limits look as if they might be persistently exceeded. In that context, however, members indicated differing views, within a narrow range, as to the appropriate "consultation point." Some members preferred a smaller increase in that limit to provide for earlier consultation of the Committee should significant further pressures develop in financial markets; others favored a bit more leeway in the degree of pressure that would be acceptable before a consultation would be triggered. In general, it was understood that the federal funds rate was likely to fluctuate in response not only to conditions in the reserve market, partly in the context of the newly introduced two-week reserve period, but also to changing market expectations about the course of credit and money demands and monetary policy. In the discussion of the degree of reserve restraint that would be consistent with the Committee's money and credit objectives, it was noted that reserve paths might have to be considered in light of changes in the discount rate that might subsequently be made by the Board of Governors, depending on such surrounding circumstances as the intensity of bank demands for borrowing, overall money and credit demands, and whether the market had already adjusted to any new discount rate.

At the conclusion of its discussion the Committee decided to seek to maintain pressures on reserve positions that were deemed to be consistent with growth of M1, M2, and M3 from March to June at annual rates of around 6-1/2, 8, and 8-1/2 percent, respectively; initially those pressures should be close to those that had emerged in recent days. The members agreed that greater restraint on reserve conditions would be acceptable in the context of more substantial growth in the monetary aggregates, while somewhat lesser restraint might be acceptable if monetary growth were significantly slower. In either event, the need for greater or lesser restraint would also be appraised against the background of developments relating to the continuing strength of the business expansion and of inflationary pressures and the rate of expansion in total credit. It was agreed that the intermeeting range for the federal funds rate would be raised to 7-1/2 to 11-1/2 percent.

At the conclusion of the meeting the following domestic policy directive was issued to the Federal Reserve Bank of New York:

> The information reviewed at this meeting indicates that growth in real GNP has accelerated markedly in the current quarter and suggests that demand for goods and services may remain relatively strong in the months ahead. In January and February, industrial production rose at a considerably faster pace than in the fourth quarter, and gains in nonfarm payroll employment were

large over the two-month period. The civilian unemployment rate declined 0.2 percentage point each month to 7.8 percent in February. Retail sales grew at an exceptional pace in January and changed little in February. Housing starts rose substantially in both months to the highest rate in several years. Information on outlays and spending plans generally suggests continuing strength in business fixed investment. Prices rose somewhat faster in early 1984 than in the fourth quarter, with increases concentrated in the food sector. The index of average hourly earnings rose only slightly over the first two months of the year, although total compensation costs appear to have increased more rapidly.

The foreign exchange value of the dollar against a trade-weighted average of major foreign currencies declined considerably from the end of January through the first week of March, but part of that decline was retraced more recently. The merchandise trade deficit rose sharply in January, mainly because of larger non-oil imports.

Data available through mid-March indicate that M1 and M3 have expanded somewhat more rapidly than anticipated at the previous meeting; since the fourth quarter of 1983, M1 and M3 are tentatively estimated to have grown at rates close to the upper limits of the Committee's ranges for 1984. Growth in M2 appears to have been less rapid than previously expected and was estimated to be at a rate in the lower part of its longer-run range. In January and February, growth of total domestic nonfinancial debt apparently rose at a pace substantially above the Committee's monitoring range for the year, and bank credit continued to expand at a relatively rapid rate. Interest rates have risen considerably since late January.

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 an improved pattern of international transactions. The Committee established growth ranges for the broader aggregates of 6 to 9 percent for both M2 and M3 for the period from the fourth quarter of 1983 to the fourth quarter of 1984. The Committee also considered that a range of 4 to 8 percent for M1 would be appropriate for the same period, taking account of the possibility that, in the light of the changed composition of M1, its relationship to GNP over time may be shifting. Pending further experience, growth in that aggregate will need to be interpreted in the light of the growth in the other monetary aggregates, which for the time being would continue to receive substantial weight. The associated range for total domestic nonfinancial debt was set at 8 to 11 percent for the year 1984.

The Committee understood that policy implementation would require continuing appraisal of the relationships not only among the various measures of money and credit but also between those aggregates and nominal GNP, including evaluation of conditions in domestic credit and foreign exchange markets.

In the short run the Committee seeks to maintain pressures on bank reserve positions judged to be consistent with growth in M1, M2, and M3 at annual rates of around 6-1/2, 8, and 8-1/2 percent, respectively, during the period from March to June. Greater reserve restraint would be acceptable in the event of more substantial growth of the monetary aggregates, while somewhat lesser restraint might be acceptable if growth of the monetary aggregates slowed significantly; in either case, such a change would be considered in the context of appraisals of the continuing strength of the business expansion, inflationary pressures, and the rate of credit growth.

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 7-1/2 to 11-1/2 percent.

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

Messrs. Gramley and Wallich dissented from this action because they preferred a directive calling for a somewhat greater degree of reserve restraint and slightly lower objectives for monetary growth in the second quarter. In their view the strength of the economic expansion warranted more restraint now in order to help avert more serious inflation and financial pressures later.

Mr. Martin disented because he was concerned that implementation of the Committee's policy was likely to lead to more restraint than would be desirable in light of the vulnerability of key sectors of the economy to rising interest rates. Thrift institutions, housing, agriculture, and also problems associated with less developed country debt were examples that he cited. In his view, slightly higher objectives for monetary growth needed to be established for the second quarter.

2. Review of continuing authorizations

The Committee followed its customary practice of reviewing all of its continuing authorizations and directives at this first regular meeting of the Federal Open Market Committee following the election of new members from the Federal Reserve Banks to serve for the year beginning March 1, 1984. The Committee reaffirmed the authorization for domestic open market operations, the authorization for foreign currency operations, the foreign currency directive, and the procedural instructions with respect to foreign currency operations in the forms in which they were currently outstanding. The Committee also reaffirmed its agreement with the Treasury to warehouse foreign currencies on the terms adopted on March 18, 1980, with the understanding that the agreement would continue to be subject to annual review.

Votes for these actions: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, Mrs. Teeters, and Mr. Wallich. Votes against these actions: None.

3. <u>Authorization for domestic open market operations</u>

At this meeting, the Committee approved a temporary increase from $4 billion to $6 billion in 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. The increase was effective for the intermeeting period ending with the close of business on May 22, 1984. Subsequently, on April 18, 1984, the Committee voted to increase the limit for the intermeeting period by an additional $1 billion to $7 billion.

> Votes for these actions: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, Mrs. Teeters, and Mr. Wallich. Votes against these actions: None.

These actions were taken on the recommendation of the Manager for Domestic Operations. The Manager had advised that substantial net purchases of securities were likely to be required over the intermeeting interval in order to accommodate large reserve needs resulting from an expected bulge in Treasury balances at Federal Reserve Banks. By April 18, the leeway for further purchases had been reduced to about $100 million, as the increase in Treasury balances proved to be somewhat larger than had been anticipated earlier. The Manager requested the additional $1 billion increase in the limit to provide for flexibility in the normal course of open market operations.