FEDERAL RESERVE press release

For Use at 4:30 p.m. February 15, 1985

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 17-18, 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 December 17-18, 1984

1. Domestic policy directive

The information reviewed at this meeting indicated a mixed pattern of developments, with some sectors showing a pickup from the lull of earlier months. On balance, however, economic activity appeared to be expanding in the current quarter at a rate approximating the considerably reduced pace recorded in the third quarter. Broad measures of prices generally continued to increase at rates close to those in 1983.

After two months of decline, industrial production increased about 0.4 percent in November, largely reflecting a rebound in auto production from strike-reduced levels. Production of business equipment and construction supplies declined further, while output of materials turned up and production of defense and space equipment continued to advance strongly.

The rise in nonfarm payroll employment exceeded 300,000 in November for the second month in a row, compared with monthly increases averaging about 200,000 in the third quarter. There were large gains in the service and retail trade industries, but employment in manufacturing rose only slightly. The civilian unemployment rate fell 0.2 percentage point to 7.2 percent, following four months of virtually no change.

Retail sales, after changing little in October, rose an estimated 1.8 percent in November according to the advance report of the Census Bureau. The November gain was broadly based, but sales were especially strong at stores selling primarily discretionary items such as apparel and general merchandise. Sales of new domestic automobiles were at an annual rate of about 7-1/4 million units in both October and November, but rebounded to an annual rate of nearly 8-3/4 million units in the first ten days of December. Nevertheless, sales thus far in the fourth quarter were running at an annual rate about 1/2 million units below the third-quarter rate of nearly 8 million units.

Total private housing starts, at an annual rate of 1.5 million units in November, were about unchanged from the reduced October pace. However, newly issued building permits for residential construction rose nearly 11 percent in November. The declines in mortgage rates over recent months apparently helped to bolster home sales: in October, sales of new homes rose slightly further after a surge in September and sales of existing homes leveled off after declining for five consecutive months.

The rise in business fixed investment spending had slowed substantially in recent months, following exceptionally rapid growth earlier. Shipments and orders of equipment from domestic capital goods producers declined markedly in October. Nevertheless, recent surveys of business spending plans for 1985 indicated continued, though moderating, growth in expenditures in the quarters ahead.

The producer price index for finished goods rose 0.5 percent in November, after declining 0.2 percent in each of the preceding two months. The reversal reflected in part a 0.7 percent increase in food prices, which had declined on balance since July; prices for a variety of other consumer goods also picked up in November. Thus far in 1984 producer prices for finished goods had risen at an annual rate of less than 2 percent. Through October, the latest month for which data on consumer prices were available, the CPI had increased at an annual rate of about 4-1/4 percent. The index of average hourly earnings over the first 11 months of the year rose at an annual rate of about 3 percent, compared with an increase of 4 percent in 1983 as a whole.

The foreign exchange value of the dollar appreciated about 5 percent over the intermeeting interval; this rise reversed most of the previous decline from the peak in mid-October. The dollar moved up during the period despite a narrowing in the differential between U.S. and foreign interest rates. In October the U.S. foreign trade deficit was significantly reduced from the rate in the third quarter, mainly because of a sharp decline in non-oil imports.

At its meeting on November 7, 1984, the Committee had adopted a directive that called for a somewhat reduced degree of restraint on reserve positions. The members expected that such an approach to policy implementation would be consistent with growth of M2 and M3 at annual rates of about 7-1/2 and 9 percent respectively, as established at the early October meeting for the period from September to December. Given the appreciable decline in M1 in October, its growth over the three-month period was expected to be at an annual rate of around 3 percent, rather than the 6 percent rate anticipated at the October meeting; however, the members indicated that more rapid growth in M1 than currently anticipated would be acceptable for the quarter. Lesser restraint on reserve positions would be sought if growth in the monetary aggregates was significantly below expectations, evaluated in the context of the strength of the business expansion and inflationary pressures, conditions in domestic and international financial markets, and the rate of growth in domestic nonfinancial debt. Conversely, greater restraint might be acceptable in the event of substantially more rapid growth than expected in the monetary aggregates and evidence that economic activity and inflationary pressures were strengthening significantly. The intermeeting range for the federal funds rate was set at 7 to 11 percent.

In November M1 increased at an annual rate of about 8-1/2 percent, offsetting the decline in October. Since early summer M1 had grown little on balance, and from the fourth quarter of 1983 through November its growth was in the lower half of the Committee's range for 1984. Growth in M2 and M3 was especially rapid in November, at annual rates of about 15 and 16 percent respectively, bringing M2 to the midpoint of its longer-run range and M3 a bit further above the upper limit of its range. Expansion in total domestic nonfinancial debt was estimated to have picked up to an annual rate of about 14 percent in November, reflecting very large government borrowing and continued strong growth in private credit. Thus far in 1984, expansion in domestic nonfinancial debt was running appreciably above the Committee's monitoring range for the year.

Open market operations over the intermeeting interval were directed at achieving some reduction in pressures on bank reserves against the background of lagging growth in the narrow money supply, generally sluggish expansion in the economy, subdued inflation, and continued strength of the dollar in foreign exchange markets. The average level of borrowing by depository institutions at the discount window moved down on balance over the period, and in November nonborrowed and total reserves increased at annual rates of about 17-1/2 and 11-1/4 percent respectively. The decline in borrowing, along with a reduction in the discount rate from 9 to 8-1/2 percent on November 21, was associated with a drop in the federal funds rate from the 9-1/2 to 10 percent area at the time of the November FOMC meeting to around 8-3/4 percent recently, with trading on the days immediately preceding this meeting somewhat below that level. Other short-term interest rates also moved down, declining about 50 to 90 basis points; intermediate-term rates fell about 45 to 65 basis points, while most long-term rates declined only modestly. At savings and loan associations, however, the average rate on new commitments for fixed-rate conventional home mortgage loans -- which typically move in lagged response to changes in market yields -- declined 65 basis points over the period. Most commercial banks reduced their "prime" rate in several steps by 75 basis points to 11-1/4 percent, and a few banks were lowering their rates further at the time of this meeting.

The staff projections presented at this meeting suggested that growth in real GNP in the short run would be somewhat slower than previously anticipated as some final demands were expected to be satisfied by reductions of inventories rather than through current production. For the year 1985, however, the staff continued to expect a moderate rate of expansion in economic activity. The unemployment rate was projected to edge down over the period and the rate of price increase to remain close to that experienced in 1984.

In the Committee's discussion of the economic situation and outlook, the members differed to some extent on the prospects for economic activity in 1985, but they generally agreed that underlying economic conditions favored further moderate growth during the year, especially in the context of a stimulative fiscal policy and the decline in interest rates that had occurred. While various measures of economic activity continued to indicate a mixed pattern of developments, some recent information suggested a less sluggish overall performance than earlier. With reference to the staff projection, a few members felt that the risks of a deviation were in the direction of somewhat faster growth. Some others saw those risks as about evenly balanced, while several believed there were more risks of a shortfall. Many members were concerned that the projected rate of expansion was in any event inadequate in light of the availability of labor and capacity and other factors.

The members continued to give considerable emphasis to the many risks that could lead to an unexpected outcome, especially in view of potential complications associated with massive and sustained federal deficits and very large imbalances in the nation's foreign trade. Other areas of uncertainty related to various financial strains or other problems in several sectors of the economy, including energy-related industries and especially agriculture which was experiencing serious difficulties in many parts of the country. It was also noted that the recent tax proposals of the U.S. Treasury might tend to alter business spending plans in uncertain ways as the likelihood of implementation of various elements of the proposals was assessed.

The members recognized that the performance of the economy in the months immediately ahead would depend in important measure on consumer expenditures. The rising incomes of consumers, their large holdings of liquid assets, and an apparently high degree of consumer confidence pointed to continuing growth in consumer spending. In the view of at least some members, however, such spending might remain relatively sluggish during the year ahead. They noted in this regard that consumer expenditures often tended to falter during the third year of an expansion and that the substantial rise that had already occurred in consumer debt might inhibit further increases in debt-financed expenditures. Moreover, a substantial portion of consumer demand might in any event continue to be met from imports, with adverse consequences for domestic production.

Members noted that growth in business fixed investment had moderated considerably in recent months from an exceptionally rapid pace earlier. While continuing growth could be expected in 1985, it would probably contribute much less than earlier to overall gains in economic activity, but uncertainties connected with the recent tax proposals might affect the extent of the slowdown. On the other hand, reduced mortgage rates would make housing a less constraining influence on economic activity than it had been in recent quarters, and the view was expressed that some revival in housing construction was a reasonable prospect for 1985. It was noted, though, that uncertainties about future tax legislation could exert some restraining effect on housing, notably with regard to certain financing activities and particular types of housing such as second homes.

As they had at previous meetings, the members gave a good deal of attention to the effects of the continuing strength of the dollar in foreign exchange markets. The related surge in imports was having a very negative impact on production in many domestic industries, while expansion in exports was being curbed by the appreciated value of the dollar as well as by relatively slow economic growth abroad. Some members commented that they saw little or no prospect for significant improvement in the trade balance in 1985. If the foreign exchange value of the dollar were to decline moderately, foreign suppliers were viewed as likely to absorb some of the exchange loss through their profits, at least in the short run, in order to protect their market shares in the United States, in the process moderating any inflationary impact of the dollar's decline. It was noted that a rapid decline of the dollar might have undesirable effects on confidence or on the stability of markets if it led to a worsening of inflationary expectations.

The members continued to regard the outlook for inflation as relatively favorable in the sense that a moderate expansion in economic activity was not seen as likely to be associated with renewed upward pressures on wages and prices or, absent a sharp decline in the dollar, strong new price pressures from other sources. Members noted that prices of sensitive commodities were still declining and that there appeared to have been a downward shift in inflationary expectations in recent months, with favorable implications for future progress in containing wage and price increases. Indeed, a number of members commented that somewhat faster economic growth than was generally expected at this time might also be compatible with little or no additional inflationary pressures in 1985. At the same time, it was emphasized that the rate of inflation was still too high and needed to be reduced over time. One member also expressed the view that improvements in productivity were likely to contribute to diminishing inflationary pressures over the longer run. On the negative side, a sizable decline in the value of the dollar would in time exert upward pressure on domestic prices, although given the lags that were involved, any such impact might be relatively limited during 1985. Reference was also made to uncertainties about productivity improvements and to a desire to raise profit margins in many industries, even though competitive factors, both domestic and international, might well continue to hold prices down for a time.

At its meeting in July the Committee had agreed on policy objectives that called for tentative growth ranges for the period from the fourth quarter of 1984 to the fourth quarter of 1985 of 4 to 7 percent for M1, 6 to 8-1/2 percent for M2, and 6 to 9 percent for M3. The associated range for total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1985. At this meeting the Committee reviewed background factors bearing on the ranges for 1985 -- including how experience in 1984 may affect the establishment and implementation of those ranges -- in the expectation that at its next meeting it would reassess and set specific ranges for the year within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act).

During the Committee's discussion of policy implementation for the intermeeting period ahead, most of the members expressed a preference for directing open market operations toward some further easing of reserve conditions to encourage satisfactory growth in M1 and to improve the prospects for economic expansion in 1985. The views of these members differed to some extent on the degree of easing that should be sought. A few members, though, wanted essentially to maintain, pending new developments, the lesser degree of reserve restraint that had been achieved recently.

In the discussion of the pressures to be sought on reserve positions, some members stressed the risks of inadequate economic expansion in 1985 and commented that even a relatively rapid pace of economic growth next year would not be likely to incur much risk of stimulating a significant intensification of inflationary pressures. Some observed that despite sizable declines in nominal interest rates, real interest rates were still quite high, partly because of a downward shift in inflationary expectations, and were exerting considerable restraint on economic activity. A number of members also commented that domestic considerations in favor of lesser restraint were reinforced by the need to take account of the strength of the dollar in foreign exchange markets and the severe debt-servicing problems of several developing countries. Other members, particularly those who preferred little or no easing of reserve conditions, noted the possibility that the expansion might turn out to be more vigorous than was generally expected. The impact of reduced interest rates had not yet been fully reflected in the economy and more time was needed to gauge that impact as the Committee endeavored to steer an appropriate policy course that would encourage expansion in economic activity while avoiding an intensification of inflation.

The members concurred that growth in M1 might accelerate over the months ahead, partly in lagged response to sizable declines in short-term interest rates during recent months, but several were of the view that some additional easing of reserve conditions was probably needed to help assure adequate growth in M1. It was noted that there was as yet no clear evidence that the recent easing of reserve conditions and accompanying decline in short-term interest rates would foster a sustained rebound in M1 growth. On the other hand, growth in the broader aggregates appeared to be exceeding the Committee's expectations for the fourth quarter by a substantial margin and it was suggested that the performance of M1 needed to be evaluated in light of that development. With respect to the outlook for the broader aggregates, the members generally anticipated appreciable slowing from the unusually rapid growth experienced in recent weeks, largely because they expected inflows of funds to money market deposit accounts and money market mutual funds to slow substantially as the interest rates paid on such accounts were adjusted down to bring them into better alignment with short-term market rates.

Along with other short-term rates, the federal funds rate had declined considerably in recent weeks and might fall a little more if pressures on reserve positions were eased somewhat further. Under the circumstances, most of the members were in favor of a technical downward adjustment in the current intermeeting range of 7 to 11 percent. It was suggested during this discussion that a rise in the federal funds rate to around the upper limit of the existing range would imply reserve conditions that were inconsistent with the Committee's objectives for monetary growth. On the other hand, some members cautioned that a decline in the rate that was too precipitous or sizable might signal more of an easing to markets than was needed to achieve the Committee's objectives.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored or could accept a directive that called for some further reduction in the degree of restraint on reserve positions. The members expected that such an approach to policy implementation would be consistent with growth of M1 at an annual rate of around 7 percent during the four-month period from November to March and with expansion of both M2 and M3 at an annual rate of about 9 percent during the same period. Because of the currently estimated shortfall in M1 growth in the fourth quarter compared with the members' expectations at the beginning of the quarter, the Committee decided that somewhat more rapid growth of M1 would be acceptable for the period ahead, particularly if the faster growth occurred in the context of sluggish expansion in economic activity and continued strength of the dollar in foreign exchange markets. The Committee also indicated that greater restraint on reserve positions might be acceptable in the event of substantially more rapid growth in the monetary aggregates than was currently expected and indications that economic activity and inflationary pressures were strengthening significantly. It was agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee when its boundaries are persistently exceeded, should be reduced by one percentage point to 6 to 10 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 a mixed pattern of developments but on balance suggests that economic activity is continuing to expand in the current quarter at a rate approximating the considerably reduced pace recorded in the third quarter. Nonfarm payroll employment rose substantially further outside of manufacturing in November, and the civilian unemployment rate fell from 7.4 to 7.2 percent. After two months of decline industrial production increased somewhat in November, largely reflecting a rebound in auto production from strike-reduced levels. Retail sales registered a large gain in November after changing little in October. Information on outlays suggests substantially slower expansion in business fixed investment, following exceptionally rapid growth earlier. Since the beginning of the year, broad measures of prices generally have continued to rise at rates close to, or somewhat above, those recorded in 1983, and the index of average hourly earnings has risen somewhat more slowly.
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> Growth of the monetary aggregates strengthened markedly in November. The November expansion in M1 offset the decline in October, and this aggregate has grown little on balance since early summer; from the fourth quarter of 1983 through November, M1 grew at a

rate in the lower half of the Committee's range for 1984. Growth in the broader aggregates was especially rapid in November, bringing M2 to the midpoint of its longer-run range and M3 a bit further above the upper limit of its range. Expansion in total domestic nonfinancial debt is continuing above the Committee's monitoring range for the year, reflecting very large government borrowing and strong private credit growth. Interest rates have fallen further since the November meeting of the Committee, with the largest declines concentrated in short-term markets. On November 21, the Federal Reserve approved a reduction in the discount rate from 9 to 8-1/2 percent.

Since early November the foreign exchange value of the dollar against a trade-weighted average of major foreign currencies has appreciated substantially, reversing most of the previous decline from its mid-October peak. The merchandise trade deficit in October was significantly reduced from the rate in the third quarter, mainly reflecting a sharp decline in non-oil imports.

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. In furtherance of these objectives the Committee agreed at the July meeting to reaffirm the ranges for monetary growth that it had established in January: 4 to 8 percent for M1 and 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 associated range for total domestic nonfinancial debt was also reaffirmed at 8 to 11 percent for the year 1984. It was anticipated that M3 and nonfinancial debt might increase at rates somewhat above the upper limits of their 1984 ranges, given developments in the first half of the year, but the Committee felt that higher target ranges would provide inappropriate benchmarks for evaluating longer-term trends in M3 and credit growth. For 1985 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1984 to the fourth quarter of 1985, of 4 to 7 percent for M1, 6 to 8-1/2 percent for M2, and 6 to 9 percent for M3. The associated range for nonfinancial debt was set at 8 to 11 percent.

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 evaluations of conditions in domestic credit and foreign exchange markets.

In the implementation of policy in the short run, the Committee seeks to reduce pressures on reserve positions consistent with growth of M1, M2, and M3 at annual rates of around 7, 9, and 9 percent, respectively, during the period from November to March. Somewhat more rapid growth of M1 would be acceptable in light of the currently estimated shortfall in growth for the fourth quarter relative to the Committee's expectations at the beginning of the period, particularly in the context of sluggish growth in economic activity and continued strength of the dollar in exchange markets. Greater restraint on reserve positions might be acceptable in the event of substantially more rapid monetary growth and indications of significant strengthening of economic activity and inflationary pressures. 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, Boehne, Boykin, Corrigan, Mrs. Horn, Messrs. Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: Messrs. Solomon and Gramley.

Mr. Solomon dissented from this action because, although he thought some further easing would be appropriate over the coming period, he believed such action should be relatively gradual. In particular, he was concerned that the provision of reserves sought by the Committee risked an excessive decline in short-term rates and an overreaction in the financial markets. He therefore preferred a more cautious probing towards easier reserve conditions.

Mr. Gramley dissented because he could not accept a directive that called for further easing of reserve conditions. In his view the underlying strength of the economy together with the ongoing effects of earlier declines in interest rates provided the basis for a likely rebound in economic growth during 1985. He also believed that the Committee needed to take greater account of the broader monetary aggregates whose expansion appeared to be exceeding the Committee's expectations by a substantial margin in the fourth quarter. Under current circumstances he was concerned that significant further easing of reserve conditions would foster additional declines in interest rates that would have to be reversed later as economic growth picked up again.

On January 18, 1985, the Committee held a telephone conference to discuss recent foreign exchange market developments in the context of the announcement made by the G-5 Ministers of Finance and Central Bank Governors. Against the background of various measures that could contribute to greater exchange rate stability, that announcement reaffirmed, in light of recent developments, the commitment made at the Williamsburg Summit to undertake coordinated intervention in exchange markets as necessary. It was noted in the course of discussion that the Committee's authorizations for foreign currency operations provided adequate scope for any actions in exchange markets that might be undertaken by the System in this context.

2. <u>Authorization for Domestic Open Market Operations</u>

At this meeting the Committee voted to increase from $4 billion to $6 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 for the intermeeting period ending with the close of business on February 13, 1985.

> Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, Ms. Seger, and Mr. Wallich. Votes against this action: None.

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