

# FEDERAL RESERVE press release



For Use at 4:30 p.m.

December 20, 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 November 4-5, 1985. This record also includes policy actions taken during the period between the meeting on November 4-5, 1985, and the next regularly scheduled meeting held on December 16-17, 1985.

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 November 4-5, 1985

1. Domestic policy directive

The information reviewed at this meeting indicated that growth in real GNP, which had picked up in the third quarter from the relatively slow pace in the first half, appeared to be continuing at a relatively modest rate. Broad measures of prices and wages appeared to be rising at rates close to or somewhat below those recorded earlier in the year.

Total retail sales increased considerably further in September, after a strong rise in August. But the gains in both months were attributable primarily to a surge in auto sales occasioned by financing incentive programs during the period. As expected, the surge proved temporary, and sales of domestic automobiles dropped to an annual rate of 6-1/4 million units in October from 11-1/4 million in the preceding month. Outlays for discretionary purchases other than autos were generally lackluster in recent months; spending at general merchandise and apparel stores and at furniture and appliance outlets, for example, changed little on balance in the third quarter. But with overall spending boosted by the transitory spurt in auto sales, the personal saving rate dropped to less than 3 percent in the third quarter -- an extraordinarily low rate historically.

Total nonfarm payroll employment rose about 415,000 in October, substantially above the average monthly increase of 225,000 posted over preceding months of the year. To some extent, however, the October gain balanced out a weaker-than-usual advance in September; the average increase over the two

months was 275,000. Service industries and finance and trade establishments continued to record job gains during the 2-month period, while manufacturing employment edged down further. In October, the length of the factory workweek remained relatively high at 40.7 hours, and factory overtime rose slightly. The civilian unemployment rate was unchanged at 7.1 percent.

The index of industrial production edged down in September and increased at an annual rate of only 1.1 percent during the third quarter. Nearly two-thirds of that rise was attributable to production of motor vehicles. Output of defense and space equipment and of construction supplies remained strong while production of durable goods materials and energy materials declined over the period. The capacity utilization rate for total industry fell 0.3 percentage point in September, reversing the August increase. At 80.2 percent, the rate was about 1-1/2 percentage points below its year-earlier level and its average for the 1967-84 period.

Total private housing starts fell in September and in the third quarter as a whole, with declines registered in both the multifamily and single-family sectors. But sales of new homes were higher during the quarter and sales of existing homes were up more than 10 percent on average. Moreover, newly issued permits for residential construction rose for the fourth consecutive quarter and a recent survey of consumer sentiment showed that favorable attitudes toward homebuying reached their highest level on record.

Incoming information generally suggested a leveling of business capital spending. Shipments of nondefense capital goods fell in September and were essentially flat for the third quarter as a whole. However, business spending for motor vehicles advanced sharply in the quarter and, on balance,

has accounted for virtually all of the rise in business equipment expenditures this year. New orders for nondefense capital goods, excluding the volatile components of aircraft and parts, rose about 1-3/4 percent in the quarter but on balance have shown little change thus far in 1985.

Over the first three quarters of 1985, most aggregate measures of inflation have evidenced some slowing from the rates posted in 1984, mainly reflecting downward pressures on prices of food and energy items. In September, the producer price index for finished goods fell 0.6 percent, leaving the index about unchanged on balance since the beginning of the year. The consumer price index rose 0.2 percent in September for the fifth consecutive month, down somewhat from the average monthly increase earlier this year and during 1984. On the wage side, the index of average hourly earnings rose at an annual rate of only 1 percent in the third quarter and 2-1/2 percent over the first nine months of the year, compared with an increase of about 3 percent in 1984. However, the employment cost index, which takes account of non-wage benefits and salaries of white-collar workers as well as hourly wage earners, has risen at an annual rate of about 4-3/4 percent thus far this year, a little above last year's rate.

The trade-weighted value of the dollar against major foreign currencies had declined about 1-1/2 percent further on balance since the Committee's meeting on October 1, bringing its net depreciation during the period after the G-5 announcement on September 22 to nearly 8 percent. Intervention sales of dollars by U.S. and foreign authorities were relatively large. With respect to individual currencies, the dollar's depreciation had been considerably greater against the Japanese yen than against major European

currencies. Preliminary data on U.S. merchandise trade for the third quarter, which need to be interpreted with an extra amount of caution in light of uncertainties in the statistical reports, suggested that imports rose somewhat more than had been estimated earlier and that the trade deficit may have widened slightly in the quarter.

At its meeting on October 1, 1985, the Committee had adopted a directive that called for maintaining the degree of pressure on reserve positions sought in the weeks before the meeting. That action was expected to be consistent with growth of both M2 and M3 at annual rates of around 6 to 7 percent for the period from September to December. Over the same period, growth in M1 was expected to slow markedly -- also to an annual rate of 6 to 7 percent -- and even slower growth would be acceptable in the context of satisfactory economic performance, given the very rapid expansion in M1 in other recent months. The members agreed that somewhat greater or lesser reserve restraint would be acceptable over the intermeeting period, depending on the behavior of the monetary aggregates and taking account of appraisals of the strength of the business expansion, the performance of the dollar in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. It was understood that policy might be implemented with somewhat more flexibility than usual over the relatively short intermeeting period, given the uncertainties associated with particularly sensitive conditions in the foreign exchange and other markets. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

M1 appeared to have changed little on balance in October and may have declined slightly after several months of rapid expansion; but it remained well above the range set by the Committee in July of 3 to 8 percent at an annual rate for the period from the second quarter to the fourth quarter of the year. M2 and M3 apparently grew sluggishly during the month, reflecting a moderation in their nontransactions components as well as the weakness in M1. As a result, by October M2 apparently had moved to a level a bit below the upper end of its annual range, while M3 was still near the middle of its long-run range. Expansion in total domestic nonfinancial debt had remained relatively rapid and continued to be somewhat above the upper end of its monitoring range for the year.

Growth of total reserves slowed in October to an annual rate of about 4-1/2 percent, in association with the marked deceleration in transactions accounts. Nonborrowed reserves rose somewhat more rapidly than total reserves, however, as borrowing from the discount window fell from a temporarily inflated level at the end of September that was related to disruptions from the hurricane on the East Coast and to end-of-quarter statement date pressures. Over the full reserve maintenance period ending October 23, the level of adjustment plus seasonal borrowing averaged \$470 million.

The weekly federal funds rate generally moved in a range of about 7-7/8 to 8-1/8 percent and averaged 8 percent for the five weeks preceding this meeting. Interest rates on short-term Treasury securities were up about 10 to 20 basis points over the period since the October 1 meeting of the Committee, while rates on private short-term market instruments were

little changed to down somewhat. Most long-term rates fell about 25 to 35 basis points. The average rate on new commitments for fixed-rate conventional home mortgage loans declined about 15 basis points to around 12 percent.

The staff projections presented at this meeting suggested that growth in real GNP would continue at a relatively modest pace for the remainder of this year and throughout 1986. The staff continued to expect the average unemployment rate to change little over the projection horizon, and the rate of increase in prices to remain close to that experienced in the past few years.

During the Committee's discussion of the economic situation and outlook, members commented that, on the whole, the latest information suggested a more sluggish economic performance than had been indicated earlier. Nonetheless, several members felt that further economic expansion broadly in line with the staff forecast remained a reasonable expectation for the year ahead. In general, the members did not anticipate that any major sector of the economy would provide a strong fillip to the expansion, but they thought further growth was likely to be sustained by at least modest gains in several key sectors of the economy. At the same time, a number of members gave considerable emphasis to possible harbingers of a very sluggish economy. One member referred to the risk that the expansion itself might falter if persisting problems and financial strains in some sectors of the economy were not contained. The members recognized that under current circumstances their forecasts were subject to a great deal of uncertainty, and particular reference was made to the outlook for legislation to reduce the federal budget deficit and to the behavior of the dollar in foreign exchange markets.

In the course of the Committee's discussion, a number of members observed that consumer spending was likely to continue to expand but that its growth would be constrained by prospectively limited increases in real disposable income, relatively high consumer debt burdens, and a possible rise in the saving rate from its abnormally low third-quarter level. Views on the outlook for housing differed to some extent, with some members emphasizing the reduced levels of mortgage rates and current activity in resale markets while others stressed the negative implications of generally tighter lending standards. Growth in business fixed investment had already slowed markedly and the possibility of further weakening was suggested by a number of current indicators, including recent surveys of business spending plans and reports of deteriorating business sentiment in some parts of the country. With a ready availability of financing, commercial construction remained strong in many areas and might continue to hold up for a time. However, at least some types of construction such as office buildings appeared to be vulnerable to excess capacity and to possible changes in tax laws relating to real estate investments. Though agricultural conditions varied in different parts of the country, members commented that there were few, if any, signs of general improvement, and growth of income in agriculture and associated industries was considered likely to be weak over the next few quarters.

The outlook for foreign trade was viewed as especially difficult to discern. A reduced value of the dollar could be expected to foster improvement in the trade balance over time, with favorable repercussions on domestic economic activity and lessened incentives to close domestic production facilities or to relocate them abroad. The extent of progress in lowering the



trade deficit over the year ahead was highly uncertain, however, and would depend not only on the performance of the dollar but importantly also on appropriate economic policies, including satisfactory progress in reducing federal budgetary deficits. Over time, stronger economic growth in other industrialized countries and more open markets abroad would also be needed.

While it was believed that the drop in the dollar since the G-5 meeting would tend to exert a positive effect on the economy by relieving pressures on export and on import-sensitive industries, it was also pointed out that an unduly large and rapid depreciation could have the potential for unsettling economic consequences under present circumstances. One member commented that rising prices were already being reported for a few imported materials, apparently as a consequence of earlier reductions in the value of the dollar. The members were also concerned that, at a time when the deficit in the U.S. current account continued to require large net inflows of funds from abroad, any considerable reduction in the willingness of investors to accumulate dollar assets could exert upward pressure on domestic interest rates as well, with damaging implications for interest-sensitive sectors of the domestic economy and for several developing countries burdened by international debt problems. Time was required to make, in an orderly way, the adjustments in domestic spending and production that would be needed if the balance of trade were to move toward a more sustainable level. Those adjustments would be greatly facilitated by a substantial reduction over time in the federal budget deficit and could be disruptive without it.

At its meeting in July the Committee had reviewed the basic policy objectives that it had established in February for growth of the monetary

and credit aggregates in 1985 and had set tentative objectives for expansion in 1986. For the period from the fourth quarter of 1984 to the fourth quarter of 1985, the Committee had reaffirmed the ranges for the broader aggregates set in February of 6 to 9 percent for M2 and 6 to 9-1/2 percent for M3. The associated range for total domestic nonfinancial debt was also reaffirmed at 9 to 12 percent for 1985. With respect to M1, the base was moved forward to the second quarter of 1985 and a range of 3 to 8 percent at an annual growth rate was established for the period to the fourth quarter of the year. For 1986 the Committee had agreed on tentative monetary growth objectives that included reductions of 1 percentage point in the upper end of the M1 range and 1/2 percentage point in the upper end of the M3 range. The provisional range for total domestic nonfinancial debt was reduced by 1 percentage point for 1986.

The Committee turned to a discussion of policy implementation for the forthcoming intermeeting period, and most of the members indicated that they were in favor of maintaining reserve conditions essentially unchanged, at least initially following today's meeting. The members took account, among other things, of an analysis which suggested that, given the prospect of modest expansion in economic activity during the fourth quarter, a steady degree of reserve pressure was likely to be associated with some pickup in growth of all the monetary aggregates over the remainder of the quarter from the reduced October pace. For the 3-month period as a whole, their rates of expansion would probably be close to, possibly a bit below, those anticipated at the time of the October meeting.

If these expectations for the fourth quarter were realized, they would represent less monetary growth than had occurred in the third quarter -- substantially less in the case of M1. Even so, growth in M1 would remain well above the rebased range for the second half of 1985. The Committee had established that range at the July meeting on the presumption that the relationship between M1 and broad measures of economic activity would move toward a more normal pattern following the sizable and unusual decline in M1 velocity in the first and second quarters. But M1 velocity dropped even more in the third quarter. While the expansion of M1 was expected to slow considerably in the fourth quarter to a rate much closer to that of nominal GNP, even a substantial tightening of reserve conditions and a sharp rise in interest rates might not bring this aggregate within the Committee's range for the second half as a whole. As they had at previous meetings, the members agreed that the behavior of M1 needed to be judged in the context of the performance of the economy and the fact that the broader aggregates were growing at rates within their ranges. Under prevailing circumstances, and unless the dollar declined sharply further, the strength of M1 thus far did not appear to suggest strong inflationary consequences. Thus, aggressive efforts to reduce its growth beyond the slower pace that was already expected were deemed to be unwarranted, especially in light of the financial strains and other problems in some sectors of the economy and the attendant risks to the expansion itself. Accordingly, the members concluded that growth of M1 above its target range would be acceptable for the second half of the year. Growth of M2 and M3 within their long-run ranges continued to be appropriate.

In the Committee's discussion of possible intermeeting adjustments in the degree of reserve restraint, members could foresee conditions that would call for either some easing or some tightening. Most of the members felt that policy implementation should be particularly alert to opportunities for some easing in light of the relatively sluggish growth in domestic economic activity and the favorable price performance, subject to the constraint imposed by a desire to minimize the risk of inducing unacceptably faster growth in money and credit. It was also emphasized that account needed to be taken of the behavior of the dollar on foreign exchange markets in any policy adjustments. One member urged giving considerable weight to the behavior of M1 in relation to expectations, with no presumptions regarding the direction of any intermeeting adjustment in the degree of reserve restraint.

At the conclusion of the Committee's discussion, most of the members indicated their acceptance of a directive that called for maintaining about the current degree of reserve restraint. Given the sensitivity of economic and financial conditions and exchange market developments, it was understood that policy would be implemented with some added degree of day-to-day flexibility. The members expected such an approach to policy implementation to be consistent with growth of both M2 and M3 at an annual rate of about 6 percent for the period from September to December. Over the same period, M1 was also expected to expand at an annual rate of around 6 percent, but in light of its very rapid growth in the third quarter, slower growth in this aggregate would be acceptable. Somewhat greater reserve restraint might, and somewhat lesser restraint would, be acceptable depending on the behavior of the monetary aggregates over the intermeeting period and taking account

of appraisals of the strength of the business expansion, the performance of the dollar on foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The members 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 left unchanged at 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 suggests that economic activity is continuing to expand at a relatively modest pace. In September, total retail sales rose considerably further, but the gain was boosted by a temporary surge in auto sales that was reversed in October. Total nonfarm payroll employment increased considerably in October, following a much slower advance in September, and the civilian unemployment rate was unchanged at 7.1 percent. In recent months industrial production has increased only slightly on balance. Housing starts fell in September, but sales of new and existing homes remained at a relatively high level on average. Incoming information generally suggests a leveling of business capital spending. Merchandise trade data for the third quarter indicate that the deficit widened slightly, as imports continued to increase. Broad measures of prices and wages appear to be rising at rates close to or somewhat below those recorded earlier in the year.

M1 appears to have shown little net change in October following several months of rapid expansion. Largely reflecting the weakness in M1, growth in M2 and M3 apparently was quite moderate in October. Expansion in total domestic nonfinancial debt has remained relatively rapid. Most short-term market interest rates have changed little on balance since the October 1 meeting of the Committee, while long-term rates have declined somewhat. The trade-weighted value of the dollar against major foreign currencies has dropped slightly further on balance since October 1, following a substantial decline after the September 22 meeting of the Finance Ministers and Central Bank Governors of the G-5 countries.

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 at the July meeting reaffirmed ranges for the year of 6 to 9 percent for M2 and 6 to 9-1/2 percent for M3. The associated range for total domestic nonfinancial debt was reaffirmed at 9 to 12 percent. With respect to M1, the base was moved forward to the second quarter of 1985 and a range was established at an annual growth rate of 3 to 8 percent. The range takes account of expectations of a return of velocity growth toward more usual patterns, following the sharp decline in velocity during the first half of the year, while also recognizing a higher degree of uncertainty regarding that behavior. The appropriateness of the new range will continue to be reexamined in the light of evidence with respect to economic and financial developments including developments in foreign exchange markets. More generally, the Committee agreed that growth in the aggregates may be in the upper parts of their ranges, depending on continuing developments with respect to velocity and provided that inflationary pressures remain subdued.

For 1986 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1985 to the fourth quarter of 1986, of 4 to 7 percent for M1, 6 to 9 percent for M2, and 6 to 9 percent for M3. The associated range for growth in total domestic nonfinancial debt was provisionally set at 8 to 11 percent for 1986. With respect to M1 particularly, the Committee recognized that uncertainties surrounding recent behavior of velocity would require careful reappraisal of the target range at the beginning of 1986. Moreover, in establishing ranges for next year, the Committee also recognized that account would need to be taken of experience with institutional and depository behavior in response to the completion of deposit rate deregulation early in the year.

In the implementation of policy for the immediate future, the Committee seeks generally to maintain about the existing degree of pressure on reserve positions. This action is expected to be consistent

with growth in M2 and M3 over the period from September to December at annual rates of about 6 percent. M1 growth over the period at an annual rate of around 6 percent is also anticipated; slower growth for that aggregate would be acceptable in the context of satisfactory economic performance, given the very rapid growth in M1 over the summer. Somewhat greater reserve restraint might, and somewhat lesser reserve restraint would, be acceptable depending on behavior of the aggregates, taking account of appraisals of the strength of the business expansion, developments in foreign exchange markets, progress against inflation, and conditions in domestic and international credit markets. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that reserve conditions during the period before the next meeting are likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

Votes for this action: Messrs. Volcker, Corrigan, Balles, Black, Forrestal, Keehn, Partee, Martin, and Rice. Vote against this action: Ms. Seger. Absent and not voting: Mr. Wallich.

Ms. Seger dissented because she believed that some reduction in the degree of reserve restraint was needed to help relieve financial strains in the economy, and to promote a more acceptable rate of economic expansion closer to the faster growth expected by Committee members early this year.

## 2. Authorization for Domestic Open Market Operations

On December 9, 1985, the Committee approved a temporary increase of \$1 billion, to \$7 billion, in the limit between Committee meetings on changes 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 immediately for the intermeeting period ending with the close of business on December 17, 1985.

Votes for this action: Messrs. Volcker, Balles, Black, Forrestal, Keehn, Martin, Partee, Rice, Ms. Seger, and Mr. Timlen. Votes against this action: None. Absent and not voting: Messrs. Corrigan and Wallich. (Mr. Timlen voted as alternate for Mr. Corrigan.)

This action was taken on the recommendation of the Manager for Domestic Operations. On December 9, the Manager had advised that outright purchases of securities thus far in the intermeeting interval had reduced the leeway under the usual \$6 billion limit to slightly over \$1.2 billion. Additional purchases of securities in excess of that leeway were likely to be necessary over the remainder of the intermeeting period, largely to offset reserve drains associated with seasonal increases in currency in circulation.