FEDERAL RESERVE press release

For Use at 4:10 p.m. April 3, 1981

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 February 2-3, 1981. This record also includes policy actions taken during the period between the meeting on February 2-3, 1981, and the next regularly scheduled meeting held on March 31, 1981.

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 February 2-3, 1981

Domestic policy directive

The information reviewed at this meeting indicated that real gross national product expanded at a 5 percent annual rate in the fourth quarter. Average prices, as measured by the fixed-weight price index for gross domestic business product, increased at an annual rate of about 9-1/2 percent. Over the year ending in the fourth quarter of 1980, real GNP was unchanged and nominal GNP rose about 9-3/4 percent.

The index of industrial production rose an estimated 1 percent in December, following substantial gains in each of the four preceding months. By December, the index had regained much of the ground lost earlier in the year. Capacity utilization in manufacturing increased further in December to 79.8 percent, 4.9 percentage points above its July trough but well below earlier peaks.

Nonfarm payroll employment expanded substantially in December for the fifth consecutive month, and the unemployment rate was essentially unchanged at about 7-1/2 percent. Growth in manufacturing employment slowed in December, but the average workweek lengthened 0.3 hour to 40.2 hours.

The dollar value of retail sales declined in December, according to the advance report, after a sizable gain over the preceding six months. Sales of new automobiles were at an annual rate of 9 million units in December, virtually unchanged from the rate in the preceding five months.

The Department of Commerce survey of business spending plans taken in November and December suggested that expenditures for plant and equipment would rise about 10-3/4 percent in 1981, following an expansion of about 8-3/4 percent in 1980. After allowance for respondents' expectations for price increases, however, the survey results implied no increase in real outlays for 1981.

In December private housing starts remained at the annual rate of about 1-1/2 million units recorded in the previous three months. Newly issued permits for residential construction declined, and sales of both new and existing houses fell somewhat.

Producer prices of finished goods continued to rise at a rapid pace in December, but the rate of increase over the fourth quarter was considerably below the exceptional pace in the third quarter. Consumer prices also rose at a rapid pace in December, reflecting not only continued sharp advances in food prices and a renewed upsurge in energy prices, but sizable increases in most other categories as well. Over the year ending in December 1980, producer prices of finished goods and consumer prices rose about 11-3/4 and 12-1/2 percent respectively, compared with increases of about 12-1/2 and 13-1/4 percent over the preceding year.

Over the last few months of 1980, the rise in the index of average hourly earnings was at about the rapid pace recorded earlier in the year. Over the year 1980 the index was up 9-1/2 percent compared with a rise of about 8 percent over 1979.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had risen about 3-1/2 percent over the interval since the Committee's meeting in December. There were divergent changes against individual currencies: the dollar appreciated substantially against the German mark and other continental European currencies, and depreciated somewhat against the pound sterling, the Japanese yen, and the Canadian dollar. The U.S. trade deficit in the fourth quarter of 1980 widened from the exceptionally low rate in the third quarter but remained substantially less than the rate in the first half. The value of exports rose slightly in the fourth quarter, but the value of imports increased by a larger amount, mainly as a result of higher oil imports.

At its meeting on December 18-19, the Committee had decided that open market operations in the period until this meeting should be directed toward expansion of reserve aggregates associated with growth of M-1A, M-1B, and M-2 over the first quarter along a path consistent with the ranges for growth in 1981 contemplated in July 1980, abstracting from the effects of shifts into NOW accounts; the midpoints of those ranges were 4-1/4 percent, 4-3/4 percent, and 7 percent respectively. 1/

1/ M-1A comprises demand deposits at commercial banks plus currency in circulation. M-1B comprises M-1A plus negotiable order of withdrawal (NOW) and automatic transfer service (ATS) accounts at banks and thrift institutions, credit union share draft accounts, and demand deposits at mutual savings banks. M-2 contains M-1B and savings and small-denomination time deposits at all depository institutions, overnight repurchase agreements (RPs) at commercial banks, overnight Eurodollars held at Caribbean branches of member banks by U.S. residents other than banks, and money market mutual fund shares.

The members agreed that some shortfall in growth would be acceptable in the near term if it developed in the context of reduced pressures in the money market. If it appeared during the period before the next regular meeting that fluctuations in the federal funds rate, taken over a period of time, within a range of 15 to 20 percent were likely to be inconsistent with the monetary and related reserve paths, the Manager for Domestic Operations was promptly to notify the Chairman, who would then decide whether the situation called for supplementary instructions from the Committee.

During the course of the intermeeting period, incoming data for the latter part of December and subsequent weeks indicated that a shortfall in growth of the monetary aggregates, after adjustment for the estimated effects of shifts into NOW accounts, had developed from the short-run objectives set forth by the Committee. Required reserves contracted in relation to the supply of reserves being made available through open market operations. After the turn of the year, member bank borrowings declined; they averaged about $1.2 billion in the two weeks ending January 14, compared with about $1.6 billion in the preceding four weeks. Nevertheless, the federal funds rate remained in a range of 19 to 20 percent, perhaps in part because of unusually strong demands for excess reserves and an inclination of some banks to increase their overnight borrowings in the funds market in expectation of near-term declines in interest rates. Borrowings moved up to an average of $1.8 billion in the statement week ending January 28, while the funds rate declined to a range of 17 to 18 percent in the days preceding this meeting.

M-1A and M-1B declined in December at annual rates of about 11 percent and 9 percent respectively. Growth in these aggregates in January was affected greatly by the introduction of NOW accounts on a nationwide basis as of December 31, 1980. It had been anticipated that shifts into NOW accounts would significantly retard the growth of M-1A and enhance the growth of M-1B during 1981. Such shifts during the first few weeks of the year were much larger than generally had been expected, and available data suggested a very sharp decline in M-1A in January and a substantial rise in M-1B. However, after adjustment for shifts into NOW accounts based on surveys of commercial banks and other data, both M-1A and M-1B were estimated to have risen moderately in January.

Growth in M-2 slowed markedly in December to an annual rate of about 2-3/4 percent. Growth apparently accelerated to a relatively rapid rate in January, however, as money market mutual fund shares posted a sizable increase and growth in small- and large-denomination time deposits remained substantial.

Growth in total credit outstanding at U.S. commercial banks slowed somewhat in December from the rapid pace of other recent months. The slowing reflected a deceleration in the pace of investment acquisitions and in expansion of loans, including business loans. However, the moderation in the growth of business loans at commercial banks was accompanied by stepped-up issuance of commercial paper and longer-run debt instruments by nonfinancial businesses. For the period from the fourth quarter of 1979 to the fourth quarter of 1980 total commercial bank credit grew at an annual rate of 7.9 percent, well within the 6 to 9 percent range adopted by the Committee for the year.

Market interest rates fluctuated considerably over the intermeeting period but declined on balance from their mid-December highs. At the time of this meeting, short-term rates were down about 2-1/4 to 4-1/2 percentage points and long-term rates about 1/2 to 1 percentage point from their December peaks. During the intermeeting interval, the prime rate charged by commercial banks on short-term business loans was raised to a record 21-1/2 percent and subsequently reduced to 20 percent. In home mortgage markets, average rates on new commitments for fixed-rate loans at savings and loan associations reached 14.95 percent in the latter part of December and edged off slightly in subsequent weeks.

The staff projections presented at this meeting suggested that the buoyancy of economic activity in the final quarter of 1980 would extend into the first quarter of the new year but that over the four quarters of 1981 real GNP would change little for the second consecutive year. Such a sluggish performance of the economy would be associated with an increase in the rate of unemployment during 1981. The rise in the fixed-weight price index for gross domestic business product was projected to remain rapid, although not quite so rapid in the second half of the year as in the first half.

In the Committee's discussion of the economic situation and outlook, members continued to stress the difficulties of forecasting output and prices in the current environment of high inflation and volatile expectations, and they recognized also the uncertainties surrounding the implementation of the fiscal and other economic policies soon to be announced by the new administration inaugurated on January 20. In response to a request to set forth their views concerning the outlook, a number of members expressed the opinion that the most likely outcome for the period through the fourth quarter of 1981 was little change in real GNP with a significant increase in the unemployment rate, as projected by the staff. Other members anticipated a small rise in real GNP over the year, generally with somewhat less increase in unemployment, and two members projected a small decline in real GNP with a larger increase in unemployment. All of the members expected continuation of a high rate of inflation over the year, although the anticipated rates of increase differed.

At this meeting, the Committee completed the review, begun at the meeting in December 1980, of the ranges for growth of monetary aggregates over the period from the fourth quarter of 1980 to the fourth quarter of 1981 within the framework of the Full Employment and Balanced Growth Act of 1978. At its meeting in July 1980, the Committee had reaffirmed ranges for growth over the year ending in the fourth quarter of 1980 of 3-1/2 to 6 percent for M-1A, 4 to 6-1/2 percent for M-1B, 6 to 9 percent for M-2, and 6-1/2 to 9-1/2 percent for M-3,[1/] with an associated range of 6 to 9 percent for growth of commercial bank credit. For the year ending in the fourth quarter of 1981, the Committee had tentatively indicated reductions on the order of 1/2 percentage point in the ranges for growth of M-1A, M-1B, and M-2, abstracting from institutional influences affecting the behavior of the aggregates.

1/ M-3 is M-2 plus large-denomination time deposits at all depository institutions and term RPs at commercial banks and savings and loan associations.

In reviewing the ranges for monetary growth in 1981, the Committee noted that from the fourth quarter of 1979 to the fourth quarter of 1980, M-1A grew 5 percent; M-1B, 7-1/4 percent; M-2, 9-3/4 percent; and M-3, 10 percent. For M-1A and M-1B, however, actual growth in 1980 was not comparable to the Committee's ranges for the year. The ranges had been established on the assumption of virtually no further shifts into ATS/NOW accounts from demand and other accounts; but as the year progressed, and particularly after passage of the Monetary Control Act, further significant shifts became apparent. Taking account of the estimated effects of such shifts, which have no significance for monetary policy, the basic range for growth of M-1B in 1980 could be adjusted upward by about 1/2 percentage point and the range for M-1A could be adjusted downward by about 1-1/4 percentage points. Alternatively, measured growth of M-1A could be adjusted upward to 6-1/4 percent and that of M-1B adjusted downward to 6-3/4 percent. With either method of adjustment, growth of each aggregate marginally exceeded the upper bound of its range.

In contemplating ranges for 1981, the Committee continued to face unusual uncertainties concerning the forces affecting monetary growth, in part because of sizable variations evident in the demand for both narrowly and broadly defined money in relation to nominal GNP. In the current year, moreover, relationships among the measured rates of growth for the monetary aggregates were subject to large changes resulting from the introduction of NOW accounts on a nationwide basis as authorized by the Monetary Control Act of 1980. Specifically, shifts into NOW accounts from demand deposits were expected to retard growth of M-1A significantly while shifts from savings deposits and other interest-bearing assets would enhance growth of M-1B. However, estimates of the impact of such shifts on measured growth of the two aggregates could only be tentative, because of the overall size of the shift and uncertainty about the ultimate sources of the funds. In January, the first month after their nationwide authorization, NOW accounts expanded far more than had been anticipated. It was expected that the flow of funds into NOW accounts would subside in coming months, and also that the proportion of the funds representing shifts from demand deposits would be gradually reduced.

Shifts of funds into NOW accounts were not expected to affect growth of the broader monetary aggregates significantly, because virtually all of the funds likely to be shifted into such accounts are already included in M-2. It was anticipated, however, that growth of both M-2 and M-3 would be somewhat stronger in relation to growth of the narrower aggregates, adjusted for the flows into NOW accounts, than projected in July 1980, when ranges for 1981 were first considered. The public has shown an increased preference for holding savings in deposits included in the nontransaction component of M-2, as changes in regulatory ceilings on interest rates have made small time and savings deposits more attractive relative to market instruments and as money market mutual funds have become more popular.

In the Committee's discussion of its objectives for 1981, the members agreed that some further reduction in the ranges for monetary growth, abstracting from the effects of shifts into NOW accounts, was appropriate in line with the long-standing goal of contributing to a reduction in the rate of inflation and providing the basis for restoration of economic stability and sustainable growth in output of goods and services. The members differed somewhat in their views concerning the extent of the reductions that might be made and also about the particular aggregates for which longer-run ranges should be specified.

For M-1A and M-1B, most members favored specification of ranges, abstracting from the NOW account effect, that were 1/2 percentage point lower than the ranges for 1980. One member advocated a reduction of 1 percentage point, particularly because growth over 1980 had appreciably exceeded the midpoints of the adjusted ranges for that year. Another member preferred not to specify ranges for the narrower monetary aggregates at all, because he believed that the NOW account effects could not be reliably estimated. In the view of one other member, confusion could be lessened by focusing attention entirely on M-1B because it would be less subject than M-1A to the distorting effects of the flows into NOW accounts.

Members differed somewhat more in their views concerning the broader monetary aggregates, in part because of uncertainty about the potential effects of interest rate relationships on the behavior of the nontransaction component. Reflecting an expectation that growth of the broader aggregates would increase relative to that of the narrower aggregates adjusted for expansion of NOW accounts, a number of members favored specification of ranges slightly higher than those for 1980. However, most members believed that sufficient allowance for the possibility of relatively stronger growth of the broader aggregates would be made by reiterating the 1980 ranges for them in association with ranges for the narrower aggregates that were 1/2 percentage point lower than those for 1980. In this connection, it was stressed that specification of ranges rather than precise rates for growth over the year inherently provided for some change in relative rates of growth among the monetary aggregates, and that growth of both M-2 and M-3 might well be in the upper portions of their ranges. Even so, growth of the broader aggregates would be less than actual growth in 1980. One member preferred to focus exclusively on the narrower aggregates, not specifying ranges for the broader aggregates.

At the conclusion of the discussion, the Committee decided to specify ranges for growth of M-1A and M-1B, adjusted for the effects of flows into NOW accounts, that were 1/2 percentage point lower than those for 1980 and to retain the 1980 ranges for M-2 and M-3. Thus, the Committee adopted the following ranges for growth of the monetary aggregates over the period from the fourth quarter of 1980 to the fourth quarter of 1981: M-1A, 3 to 5-1/2 percent; M-1B, 3-1/2 to 6 percent; M-2, 6 to 9 percent; and M-3, 6-1/2 to 9-1/2 percent. The associated range for growth of commercial bank credit was 6 to 9 percent. It was emphasized that at an early date the Committee might wish to reconsider the longer-run ranges in the light of developing conditions and that in any case it would reconsider them in July within the framework of the Full Employment and Balanced Growth Act of 1978. It was understood, moreover, that the distorting effects of shifts into NOW accounts would change during the year and that other short-run factors might cause considerable variation in annual rates of growth from one month to the next and from one quarter to the next. The Committee planned that periodically the staff would provide estimates of the effects that shifts into ATS/NOW accounts were having on the reported data.

> The Committee adopted the following ranges for growth in monetary aggregates for the period from the fourth quarter of 1980 to the fourth quarter of 1981, abstracting from the impact of introduction of NOW accounts on a nationwide basis: M-1A, 3 to 5-1/2 percent; M-1B, 3-1/2 to 6 percent; M-2, 6 to 9 percent; and M-3, 6-1/2 to 9-1/2 percent. The associated range for bank credit is 6 to 9 percent.
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> > Votes for this action: Messrs. Volcker, Gramley, Guffey, Morris, Partee, Rice, Roos, Schultz, Solomon, Mrs. Teeters, and Mr. Winn. Vote against this action: Mr. Wallich.

Mr. Wallich dissented from this action because he thought that the ranges adopted for growth of M-1A and M-1B were too high. He believed that somewhat lower ranges would provide for adequate monetary growth in 1981, because he expected a further downward shift in money demand and also because growth of the monetary aggregates over the past year generally had exceeded the specified ranges.

In reviewing its objectives for monetary growth from December 1980 to March 1981 in light of the ranges adopted for the year from the fourth quarter of 1980 to the fourth quarter of 1981, the Committee took note of the recent behavior of the monetary aggregates. Specifically, growth of the aggregates in both the third and fourth quarters of 1980 (quarterly average basis) had been strong, more than compensating for the weakness earlier in the year. From the fourth quarter to January 1981, however, the annual rates of growth of M-1A and M-1B had fallen below the lower ends of the ranges for 1981, reflecting the sharp declines in those aggregates in December and the only partial recovery in January.

In that light, the members in general agreed that operations in the period before the next regular meeting scheduled for March 31 should be directed toward a gradual restoration of growth of M-1A and M-1B (adjusted for NOW account effects) to rates consistent with their longer-run ranges. Almost all members were willing to accept continuation of relatively slow growth in relation to the ranges for 1981 at least through March in recognition that it would generally compensate for the rapid growth during the fourth quarter of 1980, which carried growth for the year slightly above the upper bounds of the ranges for the year. They differed somewhat over the acceptable amount of growth. One member preferred to direct operations toward raising growth of the aggregates to the midpoints of their 1981 ranges by March.

In accepting the gradual approach toward encouraging rates of monetary growth consistent with the ranges adopted for 1981, several members commented on the danger of potentially confusing interpretations of policy intentions and also of possible instability in financial markets. It was observed, for example, that efforts to raise monetary growth promptly toward the longer-run paths could have the undesirable consequences of encouraging first relatively rapid growth and then an abrupt deceleration. A few members also suggested that the gradual approach to making up the shortfall would be acceptable provided that it proved to be compatible with relative stability or some easing in money market pressures.

At the conclusion of the discussion, the Committee decided to seek behavior of reserve aggregates associated with growth of M-1A and M-1B over the period from December to March at annual rates of 5 to 6 percent and in M-2 of about 8 percent, abstracting from the impact of flows into NOW accounts. Those rates were associated with growth of M-1A, M-1B, and M-2 from the fourth quarter of 1980 to the first quarter of 1981 at annual rates of about 2 percent, 2-3/4 percent, and 7 percent respectively. The members recognized that shifts into NOW accounts would continue to distort measured growth in M-1A and M-1B to an unpredictable extent and that operational paths would have to be developed in the light of evaluation of those distortions. If it appeared during the period before the next regular meeting that fluctuations in the federal funds rate, taken over a period of time, within a range of 15 to 20 percent were likely to be inconsistent with the monetary and related reserve paths, the Manager for Domestic Operations was promptly to notify the Chairman, who would then decide whether the situation called for supplementary instructions from the Committee.

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

> The information reviewed at this meeting suggests that real GNP expanded substantially in the fourth quarter of 1980 and that prices on the average continued to rise rapidly. In December industrial production and nonfarm payroll employment expanded further, and the unemployment rate was essentially unchanged at about 7-1/2 percent. Retail sales declined, however, following a sizable gain over the preceding six months. Housing starts were about unchanged for the third month. Over the last few months of 1980, the rise in the index of average hourly earnings was at about the rapid pace recorded earlier in the year.

The weighted average value of the dollar in exchange markets has risen further over the past six weeks. The U.S. trade deficit in the final quarter of 1980 widened from the exceptionally low rate in the third quarter but remained substantially less than the rate in the first half.

M-1A and M-1B declined sharply in December; in January, after adjustment of the actual figures for the estimated effects of shifts into NOW accounts, these aggregates recovered in part. Growth in M-2 slowed markedly in December but accelerated in January. Some moderation of the expansion in commercial bank credit in December and early January was accompanied by stepped-up financing of nonfinancial businesses through issuance of commercial paper and longer-term debt instruments. Market interest rates have declined on balance from their highs of mid-December.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation, encourage economic recovery, and contribute to a sustainable pattern of international transactions. The Committee agreed that these objectives would be furthered by growth of M-1A, M-1B, M-2, and M-3 from the fourth quarter of 1980 to the fourth quarter of 1981 within ranges of 3 to 5-1/2 percent, 3-1/2 to 6 percent, 6 to 9 percent, and 6-1/2 to 9-1/2 percent respectively, abstracting from the impact of introduction of NOW accounts on a nationwide basis. The associated range for bank credit was 6 to 9 percent. These ranges will be reconsidered as conditions warrant.

In the short-run the Committee seeks behavior of reserve aggregates consistent with growth in M-1A and M-1B from December to March at annual rates of 5 to 6 percent and in M-2 at a rate of about 8 percent, abstracting from the impact of flows into NOW accounts. These rates are associated with growth of M-1A, M-1B, and M-2 from the fourth quarter of 1980 to the first quarter of 1981 at annual rates of about 2 percent, 2-3/4 percent, and 7 percent respectively. It is recognized that shifts into NOW accounts will continue to distort measured growth in M-1A and M-1B to an unpredictable extent, and operational reserve paths will be developed in the light of evaluation of those distortions. If it appears during the period before the next meeting that fluctuations in the federal funds rate, taken over a period of time, within a range of 15 to 20 percent are likely to be inconsistent with the monetary and related reserve paths, the Manager for Domestic Operations is promptly to notify the Chairman, who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs. Volcker, Gramley, Guffey, Morris, Partee, Rice, Roos, Schultz, Solomon, and Winn. Votes against this action: Mrs. Teeters and Mr. Wallich.

Mrs. Teeters dissented from this action because she believed that the specifications adopted for monetary growth over the first quarter were unduly restrictive. She preferred specification of higher rates for monetary growth over the first quarter, consistent with the ranges adopted for monetary growth over the whole year, in association with a lower intermeeting range for the federal funds rate.

Mr. Wallich dissented from this action because he preferred to set a higher range for the federal funds rate in order to help avoid a repetition of the sharp drop in interest rates that occurred in the second quarter of 1980.

In late February, incoming data indicated that M-1A and M-1B, after adjustment for the estimated effects of shifts into NOW accounts, were growing at rates well below those consistent with the Committee's objectives for the period from December to March. Consequently, member bank demands for reserves had eased in relation to the supply of reserves being made available through open market operations, and member bank borrowings had fallen appreciably. At the same time, growth of M-2 and M-3 appeared to be strong. These developments were associated with a decline in the federal funds rate to around 15 percent, the lower end of the range of 15 to 20 percent specified by the Committee, raising the question of whether the situation called for supplementary instructions from the Committee.

In a telephone conference on February 24, the Committee adopted the following modification of the domestic policy directive adopted on February 3:

> In light of the relatively strong growth of M-2 and M-3 and the substantial easing recently in money market conditions, as well as uncertainties about the interpretation of the behavior of M-1, the Committee on February 24 agreed to accept some shortfall in growth of M-1A and M-1B from the specified rates in the domestic policy directive adopted on February 3 as consistent with developments in the aggregates generally and the objectives for the year.
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> Votes for this action: Messrs. Volcker, Gramley, Guffey, Morris, Partee, Rice, Schultz, Mrs. Teeters, and Mr. Winn. Vote against this action: Mr. Roos. Absent: Messrs. Solomon and Wallich.

Mr. Roos dissented from this action because he believed that it would tend to prolong unduly the shortfall in growth of M-1A and M-1B from the Committee's ranges for the year. In the circumstances, he preferred to reduce the lower limit of the intermeeting range for the federal funds rate in order to encourage a more prompt pickup in growth of the narrowly defined monetary aggregates.