FEDERAL RESERVE press release

For Use at 4:30 p.m. November 18, 1983

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on October 4, 1983.

Such records for each meeting of the Committee are made available a few days after the next regularly scheduled meeting and are published in the Federal Reserve Bulletin and the Board's Annual Report. The summary descriptions of economic and financial conditions they contain are based solely on the information that was available to the Committee at the time of the meeting.

Attachment

RECORD OF POLICY ACTIONS OF THE
FEDERAL OPEN MARKET COMMITTEE

Meeting Held on October 4, 1983

Domestic policy directive

The information reviewed at this meeting suggested that real GNP had continued to grow rapidly in the third quarter, although the pace of expansion had moderated from the exceptionally strong annual rate of about 9-3/4 percent in the second quarter. A major factor in the third-quarter expansion was a sharp swing in business inventories from liquidation to accumulation.

The index of industrial production rose 0.9 percent in August, following sizable advances in previous months. As in other recent months, gains were widespread across industry groupings and were particularly strong for consumer durable goods. By August the index had risen about 11-1/2 percent from its trough in November 1982 to a level 2-1/4 percent below the previous peak in July 1981.

Nonfarm payroll employment, adjusted for strike activity, rose about 300,000 in August, continuing the strong upward trend that has been evident since March. With growth in the civilian labor force roughly matching the rise in employment, the unemployment rate, which had declined 0.5 percentage point to 9.5 percent in July, was unchanged in August.

After rising sharply in the spring, consumer spending had moderated substantially in recent months. The nominal value of retail sales edged down in July and fell appreciably further in August as sales of durable goods, particularly in the automotive sector, declined. Sales of new domestic automobiles fell in August to an annual rate just above 6-1/2 million units, compared with an average rate of 7-1/4 million units in the preceding two months. The slowdown in auto sales, which continued into early September, apparently reflected the elimination of interest subsidies and other incentives to buyers as well as the limited availability of some popular models. Auto sales picked up in mid-September with the introduction of 1984 models and the associated increase in dealer inventories. Although the growth in consumer spending had moderated recently, consumer financial positions appeared to be quite strong and surveys indicated a continuing high level of consumer confidence.

Total private housing starts rose to an annual rate of more than 1.9 million units in August, nearly 10 percent above the average rate over the previous three months. However, other indicators suggested some weakening in housing activity: newly issued permits for residential construction declined in August, and sales of both new and existing homes fell for the second month in a row.

Data on new orders and shipments generally continued to indicate strength in the demand for business equipment. Investment in nonresidential structures had stabilized in recent months, after declines earlier in the year. The Department of Commerce survey of business spending plans conducted in late July and August suggested that plant and equipment expenditures in 1983 as a whole would be about 3 percent lower, in nominal terms, than in 1982. Given the reduced level of spending reported for the first half of 1983, the survey results implied a substantial increase in investment outlays in the second half of the year.

The producer price index for finished goods and the consumer price index both rose 0.4 percent in August, somewhat more than the average increase in the previous few months. The summer drought appeared to have had little immediate impact on prices of foods at the wholesale and consumer levels, but at the farm level the producer price index for crude foods jumped nearly 4 percent in August after three months of decline. Over the first eight months of the year, the producer price index had shown virtually no change, while the consumer price index had increased at an annual rate a little over 3 percent. Along with the moderation in price pressures, nominal wage increases had generally been quite modest, with the index of average hourly earnings of production workers rising only about 3 percent at an annual rate since the beginning of the year.

The debt of domestic nonfinancial sectors expanded somewhat less rapidly in August and apparently in September than in July, as growth in funds raised by private sectors slowed. Governmental credit demands remained unusually strong, with U.S. government borrowings accounting for roughly half of the total funds raised in credit markets by domestic nonfinancial borrowers. Credit at U.S. commercial banks expanded at an annual rate of about 11-1/4 percent in August, somewhat above the average pace of other recent months, but data for early September suggested a slowing in the growth of bank credit, in part reflecting reduced demand for business loans. Issuance of commercial paper by nonfinancial businesses was maintained in September at about the relatively rapid pace recorded in August, while bond offerings remained at a reduced pace.

The foreign exchange value of the dollar, as measured by its trade-weighted average against major foreign currencies, had fluctuated within a relatively narrow range since mid-August. Fluctuations in the exchange rate over the period generally paralleled changes in the spread between U.S. interest rates and foreign rates. The U.S. foreign trade deficit rose substantially in July-August from the rate in the second quarter, as imports increased further in association with the pick-up in U.S. economic activity.

At its meeting on August 23, 1983, the Committee had decided that open market operations in the period until this meeting should be directed at maintaining about the existing degree of reserve restraint. That action was expected to be associated with growth of M2 and M3 at annual rates of around 8 percent from June to September, consistent with the targets established for those aggregates for the year. The Committee had also agreed that, depending on evidence about the strength of the economic recovery and other factors bearing on the business and inflation outlook, lesser restraint would be acceptable in the context of a significant shortfall in growth of the aggregates from current expectations, while somewhat greater restraint would be acceptable should the aggregates expand more rapidly than expected. The Committee had anticipated that a reduction in growth of M1 to an annual rate of around 7 percent from June to September would be consistent with its third-quarter objectives for the broader aggregates and that expansion in total domestic nonfinancal debt would remain within its range for the year. The intermeeting range for the federal funds rate was retained at 6 to 10 percent.

In the latter part of the summer, growth in M2 remained at, or below, its reduced pace in July, and over the June-to-September period its growth was estimated to have been well below the annual rate of around 8 percent expected by the Committee. Growth in M3 strengthened somewhat in late summer and in the third quarter that aggregate expanded at a pace close to the expected rate. Meanwhile, expansion in M1 fell to an annual rate a little below 3 percent in August, and growth remained relatively low in September. By September all three monetary aggregates appeared to be within the longer-run ranges specified by the Committee, with M2 in the lower portion of its range, M3 in the upper portion of its range, and M1 somewhat above the midpoint of its monitoring range. Growth in total domestic nonfinancial debt also appeared to be well within its range for the year.

Consistent with the policy directive adopted at the August FOMC meeting, a slightly lesser degree of reserve restraint than that prevailing at the time of the meeting was sought as the intermeeting period progressed, in light of slower than anticipated money growth in the context of evidence of a moderation in the rate of economic expansion and continued restraint on inflationary pressures. Nonborrowed reserves of depository institutions, after declining in July and August, rose somewhat in September as institutions employed the increased availability of reserves in part to repay borrowings from the Federal Reserve. Adjustment plus seasonal borrowing, which had averaged somewhat over $1 billion in August, fell off in September. However, the average level for September was inflated in part by complications in reserve management related to the redistribution of reserves around the banking system in connection with a huge build-up in U.S. Treasury cash balances at depository institutions and also at Federal Reserve Banks following the mid-September tax date.

Borrowings (excluding extended credit) surged to nearly $1.6 billion during the statement week ending September 21, but were in a range of about $650 million to $750 million during other weeks in September.

Interest rates in general fluctuated around a modest downward trend over the intermeeting interval, as the market responded to incoming data on the economy and the monetary aggregates, to some weakening in credit demands, and to varying expectations about implications for the stance of monetary policy. Short-term interest rates in general declined about 1/4 to 1/2 percentage point on balance over the intermeeting interval. The federal funds rate averaged close to 9-1/2 percent through most of the intermeeting period, down slightly from its average in the first half of August. The rate dropped to about 9 percent in the last full statement week of September, apparently in part because of reserve distribution effects stemming from the large build-up in Treasury deposits. However, the funds rate rose substantially in the days just before this meeting, reflecting usual pressures around the end-of-quarter statement date. Most long-term rates fell about 10 to 20 basis points over the period, and the average rate on new commitments for fixed-rate conventional mortgage loans at savings and loan associations declined about 1/4 percentage point.

The staff projections presented at this meeting indicated that growth of real GNP would proceed at a less rapid pace in the fourth quarter and in 1984, partly reflecting lessened stimulus from inventory rebuilding and from expenditures on residential structures. Growth in consumer spending was projected to recover somewhat over the balance of the year from a reduced rate in the third quarter but to moderate again during 1984. A decline in the unemployment rate was anticipated over the projection period, and upward pressures on prices were expected to remain moderate.

In the Committee's discussion of the economic situation, the members were generally optimistic about the prospects for continued recovery in economic activity and containment of inflationary pressures. They agreed that the staff projection of moderate economic growth seemed to be the most likely outcome for the year ahead, and in this connection some members commented that a more moderate rate of economic growth than that experienced recently would be more consistent over time with sustaining the expansion and containing inflation. The view was expressed, however, that the rate of inflation could turn out to be somewhat higher than projected and the rate of expansion somewhat slower. Several members also emphasized that financial markets and the economy could be adversely affected by unpredictable developments, including possible disturbances originating abroad such as a major interruption in oil shipments due to hostilities in the Middle East or a debt-servicing crisis that led to a disruption of international credit flows. Concern was also expressed about the continued lag in demand in traditional heavy capital equipment industries and also about the restraint that would be exerted over time on capital investment and housing by the current high level of long-term interest rates.

In the latter context, the members again expressed a great deal of concern about the prospects for massive federal deficits. It was observed that the Treasury's large borrowing needs were already exerting upward pressure on interest rates, and that greater pressure could be expected if relatively large Treasury credit demands continued and were augmented by growing business demands for a substantial amount of external funds to finance their investments. To date, a relatively good rebound in corporate cash flow had combined with moderate investment demands to limit the net external financing needs of the business sector. Moreover, large net inflows of capital from abroad had been helping to finance the federal deficit, and the sustainability of such inflows was open to question, with possible implications for the exchange value of the dollar and for domestic interest rates.

The members commented at some length on the related rise in the foreign trade and current account deficits to historic and disturbing levels. A substantial decline in the foreign exchange value of the dollar, which many forecasters anticipated, would help to reduce the deficit over time, but it would probably also foster some inflationary pressures in the domestic economy. On balance, though, foreign trade developments were viewed as having a disproportionately adverse impact on some domestic industries and, more generally, appeared to be retarding the economic recovery.

Members referred to the substantial progress that had been made in curbing the rise of prices and wages and to the concessions that were still being made in some wage settlements. However, it was noted that a number of recent settlements, primarily in industries not subject to strong competitive or financial pressures, had called for wage increases substantially higher than the rate of inflation. There also appeared to be a "catch up" demand for higher wages from workers in previously troubled firms. Concern was expressed that, with continuing expansion in economic activity, an increasing number of firms would become less willing to resist inflationary wage demands and that progress in containing wage costs might be halted or reversed.

In the Committee's discussion of monetary policy for the weeks ahead, a consensus was expressed in favor of making no further adjustment in the degree of reserve restraint at this time beyond the slight easing that had been sought in recent weeks on the basis of the directive issued at the August meeting. A staff analysis suggested that such reserve restraint was likely to be associated with some increase in monetary growth from the reduced third-quarter pace, reflecting in part an abatement of the restraining effects of the rise in interest rates in late spring and summer. Growth of all the monetary aggregates was likely to remain within the Committee's longer-run ranges, however, given a projection of moderate expansion in nominal GNP in the fourth quarter. According to the staff analysis, the removal of most remaining controls on time deposits by the Depository Institutions Deregulation Committee, effective October 1, would under prevailing circumstances probably have only a minor, and possibly undetectable, near-term effect on the monetary aggregates--in the direction of restraining growth of M1 and increasing that of the broader aggregates.

The Committee members recognized that the behavior of the monetary aggregates remained subject to a great deal of uncertainty, and they focused on the issue of how promptly and to what extent open market operations should respond to any deviations in monetary expansion from expected growth rates. The members agreed on the desirability of continuing to take account of emerging economic and financial developments, including the international financial situation, in policy implementation. In this connection, some members felt that the Committee should be prepared to respond a little more promptly and aggressively in an easing direction than in a tightening direction, should developments seem to warrant a change in the degree of reserve restraint. These members underscored the sensitivity of key sectors of the economy to interest rate developments and the impact of U.S. interest rates on the strained international debt situation. On the other hand, others called attention to the need for caution in light of the inflationary risks of being too accommodative in the provision of reserves, with even more adverse consequences over time both domestically and internationally.

At the conclusion of the discussion the members agreed that no change should be made at this time in the degree of pressure on reserve positions and that operations should be directed toward maintaining the slightly reduced reserve restraint that had been sought in recent weeks. The members anticipated that such a policy course would be associated with growth of both M2 and M3 at an annual rate of around 8-1/2 percent for the period from September to December; this growth rate allowed for a minor impact from the October 1 deregulation of time deposits on the growth of the broader aggregates in the fourth quarter. The members also agreed that the need for greater or lesser restraint on reserve conditions should be evaluated against the background of developments relating to the strength of the economic recovery, the outlook for inflation, and conditions in domestic and international financial markets. Depending upon such developments, lesser restraint would be acceptable in the event of a significant shortfall in the growth of the aggregates over the weeks ahead, while somewhat greater restraint would be acceptable in the context of more rapid growth in the aggregates. The Committee anticipated that its fourth-quarter objectives for the broader aggregates would be consistent with M1 growth at an annual rate of around 7 percent from September to December, and that expansion in total domestic nonfinancial debt would remain within the range of 8-1/2 to 11-1/2 percent established for the year. It was agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee, would remain at 6 to 10 percent.

At the conclusion of the discussion, the Committee issued the following domestic policy directive to the Federal Reserve Bank of New York:

> The information reviewed at this meeting suggests that real GNP continued to grow rapidly in the third quarter, although the rate of expansion moderated from that in the second quarter. Industrial production and employment increased appreciably further in August, following large gains in previous months, and the civilian unemployment rate remained at 9.5 percent. After rising sharply in the spring, growth in consumer spending has moderated substantially. Housing starts rose in August but permits turned down. Data on new orders and shipments generally continued to indicate strength in the demand for business equipment. Producer and consumer prices increased somewhat more in August than in other recent months, but over the first eight months of the year average prices and the index of average hourly earnings have risen more slowly than in 1982.
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> After slowing substantially in July, growth in M2 remained at a reduced pace over the August-September period, while expansion in M3 picked up. Through September M2 is estimated to be at a level in the lower portion of the Committee's range for 1983 and M3 in the upper portion of its range. Growth in M1 decelerated considerably further in August-September and moved within the Committee's monitoring range for the second half of the year. Interest rates have declined somewhat since mid-August.
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> The foreign exchange value of the dollar, as measured by its weighted average value against major foreign currencies, has fluctuated within a relatively narrow range since mid-August. The U.S. foreign trade deficit rose substantially in July-August from the second-quarter rate, reflecting a further increase in imports of a broad range of goods.
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> The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to a sustainable pattern of international transactions. At its meeting in July the Committee reconsidered the growth ranges for monetary and credit aggregates established earlier for 1983 in furtherance of these objectives and set

tentative ranges for 1984. The Committee recognized that the relationships between such ranges and ultimate economic goals have become less predictable; that the impact of new deposit accounts on growth of the monetary aggregates cannot be determined with a high degree of confidence; and that the availability of interest on large portions of transaction accounts may be reflected in some changes in the historical trends in velocity.

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

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

The Committee seeks in the short run to maintain the slightly lesser degree of reserve restraint sought in recent weeks. The action is expected to be associated with growth of M2 and M3 at annual rates of around 8-1/2 percent from September to December, consistent with the targets established for these aggregates for the year. Depending on evidence about the strength of economic recovery and other factors bearing on the business and inflation outlook, lesser restraint would be acceptable in the context of a significant shortfall in growth of the aggregates from current expectations, while somewhat greater restraint would be acceptable should the aggregates expand more rapidly. The Committee anticipates that M1 growth at an annual rate of around 7 percent from September to December will be consistent with its fourth-quarter objectives for the broader aggregates, and that expansion in total domestic nonfinancial debt would remain within the range established for the year. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 6 to 10 percent.

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