FEDERAL RESERVE press release

For Use at 4:30 p.m. July 20, 1984

The Federal Reserve Board and the Federal Open Market Committee today released the attached record of policy actions taken by the Federal Open Market Committee at its meeting on May 21-22, 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 May 21-22, 1984

Domestic policy directive

The information reviewed at this meeting suggested that growth in real GNP, while moderating from the annual rate of 8-3/4 percent recorded for the first quarter, was continuing at a relatively rapid pace in the current quarter. Thus far in 1984, average prices, as measured by the fixed-weight index for gross domestic business product, appeared to be increasing at about the same rate as in 1983.

Industrial production rose nearly 1-1/2 percent in April, after slowing to an increase of 1/2 percent in March. Gains in April were widespread across most major product and material categories. Auto production declined, however, primarily reflecting reduced output at plants producing small cars and the less popular large-size models. Some plants producing fast-selling models were encountering capacity constraints. The rate of capacity utilization in manufacturing rose 1 percentage point further in April to 82.3 percent, somewhat above the 81.8 percent average for the 1967-82 period.

Nonfarm payroll employment surged by 400,000 in April. The rise was attributable in large part to a rebound in employment at construction sites after a weather-related decline in March and to substantial employment gains in service industries. In manufacturing, employment rose by 100,000, about the same as the average monthly increase over the previous twelve months, and the length of the average factory workweek reached 41.2 hours, its highest level in nearly two decades. Despite continued gains in employment, the civilian unemployment rate was unchanged at 7.8 percent in March and April, as the labor force increased appreciably.

Total retail sales climbed 2.9 percent in April, about offsetting declines in the preceding two months. Sales gains were reported at all major types of stores but were particularly strong at automotive outlets and at general merchandise, apparel, and furniture and appliance stores. Sales of new domestic automobiles, which had dipped in March, rebounded in April to an annual rate of 8-1/4 million units and then surged to a rate of about 8-3/4 million units in early May.

In April, private housing starts recovered from a sizable decline in March and, at an annual rate of nearly 2 million units, matched their advanced first-quarter pace. Building permits for residential construction were unchanged in April at an annual rate of slightly more than 1.7 million units, somewhat below the level earlier in the year. In the first quarter, sales of new houses continued at about the same pace as in the fourth quarter of 1983, while sales of existing homes rose appreciably.

Business investment spending moderated from the extraordinarily rapid rate of expansion in the second half of 1983, but remained brisk. In real terms, fixed investment spending rose at an annual rate of about 14-3/4 percent in the first quarter. Data on shipments and new orders of nondefense capital goods have moved erratically in recent months; both series declined sharply in April after exhibiting considerable strength in some earlier months of 1984. But other recent information, including survey reports that indicate upward revisions in business spending plans, generally suggests continuing strength in business fixed investment.

The producer price index for finished goods was unchanged in April, after increases of about 1/2 percent per month in the first quarter. A reversal of the sharp runup in food prices contributed to the favorable performance in April. The consumer price index rose 1/2 percent in April, slightly more than the average rate in the first quarter; large increases in prices of energy-related items and some commodities accounted for the April rise. Over the first four months of the year, the index of average hourly earnings increased at about the same pace as in 1983.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had increased about 5-1/4 percent since late March to a level close to its peak for the floating rate period, reached in the first part of January. Increases in U.S. interest rates relative to foreign rates, together with labor unrest in some European countries and conflict in the Persian Gulf area, apparently contributed to the dollar's appreciation. The merchandise trade deficit widened further in the first quarter, as a surge in non-oil imports exceeded a rise in exports.

At its meeting on March 26-27, 1984, the Federal Open Market Committee had decided to seek to maintain pressures on reserve positions that were deemed to be consistent with growth of M1, M2, and M3 from March to June at annual rates of around 6-1/2, 8, and 8-1/2 percent respectively; it was decided that initially those pressures should be close to those that had emerged in the days preceding the March meeting. The members had agreed that greater restraint on reserve conditions would be acceptable in the event of more substantial growth of the monetary aggregates, while somewhat lesser restraint might be acceptable if growth of the aggregates slowed significantly. It was also agreed that the need for greater or lesser restraint would be considered in the context of the continuing strength of the business expansion, inflationary pressures, and the rate of credit growth. The intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee, was set at 7-1/2 to 11-1/2 percent.

M1 changed little in April, but data available for early May suggested a considerable strengthening. Given the pickup in early May, it was estimated that growth of M1 since March was roughly in line with the 6-1/2 percent annual rate of expansion sought by the Committee for the March-to-June period. Expansion in M2 was at an annual rate of about 7-1/4 percent in April, close to the rate specified by the Committee for the three-month period, while growth in M3, at an annual rate of 10-3/4 percent in April, was well above its 8-1/2 percent March-to-June growth path. From the fourth quarter of 1983 through April, M1 grew at a rate a little below the midpoint of the Committee's range of 4 to 8 percent for 1984; M2 increased at a rate in the lower part of its 6 to 9 percent longer-run range; and M3 expanded at a rate a bit above the 9 percent upper limit of its range.

Total domestic nonfinancial debt appeared to be growing at a pace above the Committee's monitoring range for the year. Credit growth accelerated in April because of a faster pace of borrowing by the federal government; business borrowing also remained brisk, with most borrowing still concentrated in the short-term area. Growth in business loans at domestic offices of U.S. commercial banks slowed from the vigorous pace of recent months, as banks booked a sizable volume of loans offshore and firms shifted more of their borrowing to the commercial paper market. In the household sector, consumer installment credit expanded at an annual rate of about 17 percent in the first quarter and appeared to have remained strong in April; mortgage borrowing also was continuing to grow at a rapid pace.

Total reserves showed little net change in April, as a decline in excess reserves offset further increases in required reserves. In the three complete reserve maintenance periods ending May 9, adjustment plus seasonal borrowing at the discount window averaged somewhat less than $1.2 billion compared with about $1.1 billion at the time of the previous meeting. In the current two-week statement period ending May 23, average borrowing was running considerably higher, in excess of $4 billion, because of advances to a large bank that was experiencing substantial outflows of funds caused by market uncertainties about the bank's underlying condition.

The federal funds rate rose from an average of around 10 percent in the period immediately preceding the March FOMC meeting to about 10-1/2 percent recently. Most other interest rates moved considerably higher over the intermeeting interval, generally rising about 1/2 to 1-1/4 percentage points in both short- and long-term markets. Commercial banks raised their "prime" rate twice during the period, by a total of 1 percentage point, to 12-1/2 percent. On April 6 the Federal Reserve announced an increase of 1/2 percentage point in the discount rate to 9 percent. The increases in market rates apparently reflected continuing strong credit demands as economic activity expanded, the absence of rapid progress in reducing the federal deficit, and related concerns about future inflationary pressures and a possible need for a more restrictive provision of reserves. Late in the intermeeting period, market conditions also reflected a heightened degree of anxiety and sensitivity to potential liquidity strains, and especially the persistent rumors that a major bank was in serious financial difficulty. There were also renewed concerns about the possible implications of continuing international debt problems, particularly in the light of increased interest rates.

The staff projections presented at this meeting continued to suggest that real GNP would grow at a much more moderate pace over the balance of the year and in 1985, in line with the slower pattern characteristic of maturing business expansions. The unemployment rate was projected to decline over the period and, while current evidence of growing cost and price pressures was limited, the rate of price increase was expected to pick up modestly from its recent pace.

In the Committee's discussion of the economic situation and outlook, the members noted that the expansion in economic activity did indeed appear to be moderating from an unsustainable pace in the first quarter, but the extent of the slowdown remained in question as did the prospective degree of upward price pressures as the expansion continued. In the course of the discussion, the members gave considerable emphasis to uncertainties inherent in the unusually sensitive conditions in financial markets and volatile market attitudes.

It was noted that growth in nominal GNP might moderate relatively little if business and consumer spending remained strongly buoyed by a highly stimulative fiscal policy. In that connection members commented that credit growth had shown no sign of slowing so far and there were, as yet, no significant indications of a stiffening in loan standards and credit availability; in fact, there were indications of aggressive lending practices in real estate and other areas. On the other hand, some members stressed the cyclical tendency for a maturing expansion to slow and they saw some evidence already pointing in that direction. It was also pointed out that there had been a sizable rise in interest rates over the past several weeks; current rate levels, particularly against the background of concerns about potential liquidity problems, could have a considerable effect, after some lag, in curbing expenditures in interest-sensitive sectors of the economy and, more broadly, in fostering more cautious consumer and investor attitudes. Developments in financial markets had already contributed to a more guarded investor climate in some respects, as reflected in some declines in stock prices and a tendency among investors to back away from the long-term debt markets. The problems of a major commercial bank had sensitized markets to other potential problem areas such as outstanding loans to less developed countries that were experiencing debt servicing difficulties. In general, it was difficult to evaluate how such uncertainties -- which were seen as likely to persist for some time even if the most immediately pressing problems were resolved -- would affect business and consumer spending.

Most of the members, as they had at previous meetings, expressed concern that growing capacity constraints, declining unemployment, and the prospect of reduced productivity growth might be conducive to greater inflationary pressures over time. Individual members also commented on the development of price and wage pressures in some industries and occupations. While indications of greater inflationary pressures were still limited, there was a danger that they might become more widespread later in the year. In that connection some members commented that the terms of the wage settlements in the automotive industry later in the year, should they prove to be higher than the generally restrained pattern to date, might have a pervasive effect on other settlements, while others thought the circumstances in that industry were unique.

A more optimistic view of the outlook for inflation emphasized the possibility of currently relatively favorable wage-cost developments continuing for some time. In particular, productivity growth might not diminish as much as some observers expected, given the prospect that many businesses would continue their efforts toward greater operating efficiencies. One member also observed that the relatively rapid growth in the labor force over the course of recent months, if it persisted, would have favorable wage-cost implications.

In the Committee's discussion of policy for the weeks ahead, most of the members supported a proposal to maintain the current degree of restraint, although some sentiment in favor of marginally greater restraint was also expressed. In the view of most members, no significant change in policy -- in either direction -- was desirable at this time in light of the performance of the economy, the behavior of the monetary aggregates, and conditions in financial markets. Under present circumstances, it was argued, any significant further restraint would produce added strains in interest-sensitive sectors of the economy such as housing and agriculture and would incur an undue risk of a pronounced effect on already somewhat unsettled financial markets, with adverse effects on economic activity. At the same time, the apparent strength of the ongoing expansion and inflationary concerns argued against any significant easing. An argument advanced in favor of slightly greater restraint was that such a policy would tend to improve the prospects of achieving a desirable moderation in the rate of business expansion and progress over time in containing inflation.

The members noted that, according to a staff analysis, implementation of approximately the current degree of reserve restraint was likely to continue to be consistent with attainment of the growth objectives for M1 and M2 that the Committee had previously established for the second quarter. Growth in M3 was expected to exceed the second-quarter objective because depository institutions were currently making more active use of managed liabilities than had been anticipated to finance their share of the large rise in total credit.

A few members favored raising the current intermeeting range for the federal funds rate by a small amount as a technical adjustment to bring the present trading level of the federal funds rate closer to the midpoint of the range. However, most of the members preferred to retain the current range which they believed was likely to encompass the probable trading range over the intermeeting period.

At the conclusion of the discussion, all but one member agreed that no change should be made at this time in the existing degree of pressure on reserve positions. The members anticipated that this policy would continue to be associated with growth of M1 and M2 at annual rates of around 6-1/2 and 8 percent for the period from March to June and with growth of M3 at an annual rate of about 10 percent, somewhat above the objective set in March for the second quarter. It was agreed that the intermeeting range for the federal funds rate would remain at 7-1/2 to 11-1/2 percent. It was also recognized that, within the context of this overall policy approach, operations might need to be modified if unusual financial strains appeared to be developing.

In keeping with the Committee's usual practice, the members contemplated that operations might be adjusted during the intermeeting period toward implementing somewhat greater or somewhat lesser restraint on reserves if monetary growth should prove to be significantly faster or slower than targeted for the current quarter. In the view of most members, the implementation of open market operations should be equally sensitive to the potential need for greater or lesser restraint over the weeks ahead. Any such adjustment should not be made automatically but should be undertaken only after an appraisal of the strength of economic activity and inflationary pressures, and evaluations of conditions in financial and banking markets and the rate of growth in total domestic nonfinancial debt.

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 growth in real GNP, while moderating from the unusually strong first-quarter pace, remains relatively rapid in the current quarter. In April, industrial production and nonfarm payroll employment rose substantially following decreased growth in March; the civilian unemployment rate was unchanged at 7.8 percent in March and April as the labor force increased appreciably. Retail sales grew rapidly in April after two months of decline, and housing starts recovered to a rate equaling their first-quarter average. Information on outlays and spending plans generally suggests continuing strength in business fixed investment. Since the beginning of the year, prices and wages have continued to rise at about the same pace as in 1983.

M1 changed little in April on average, but data available for early May suggest a considerable strengthening. In April M2 grew about in line with expectations while M3 expanded more rapidly than anticipated. From the fourth quarter of 1983 through April, M1 grew at a rate a little below the midpoint of the Committee's range for 1984; M2 increased at a rate in the lower part of its longer-run range, while M3 expanded at a rate a bit above the upper limit of its range. Total domestic nonfinancial debt apparently is growing at a pace above the Committee's monitoring range for the year, with borrowing by businesses continuing to be concentrated in the short-term markets. Interest rates have risen considerably further since late March. On April 6, the Federal Reserve announced an increase in the discount rate from 8-1/2 to 9 percent. Recently, day-to-day market conditions have reflected considerable sensitivity to potential liquidity strains, as highlighted by problems of one large bank, and to uncertainties about the financial and budgetary outlook generally.

The foreign exchange value of the dollar against a trade-weighted average of major foreign currencies has risen considerably further since late March to a level close to the peak in early January. The merchandise trade deficit widened further in the first quarter, as a sharp rise in non-oil imports offset a substantial rise in exports.

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

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

In the short run, the Committee seeks to maintain existing pressures on bank reserve positions. This is expected to be consistent with growth in M1, M2, and M3 at annual rates of around 6-1/2, 8, and 10 percent, respectively, during the period from March to June. Somewhat greater reserve restraint might be acceptable in the event of more substantial growth of the monetary aggregates, while somewhat lesser restraint might be acceptable if growth of the monetary aggregates slowed significantly. In either case, such a change would be considered only in the context of appraisals of the continuing strength of the business expansion, inflationary pressures, financial market conditions, and the rate of credit growth. The Chairman may call for

Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 7-1/2 to 11-1/2 percent.

Votes for this action: Messrs. Volcker, Solomon, Boehne, Corrigan, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, and Wallich. Vote against this action: Mr. Boykin. (Absent and not voting: Mrs. Teeters.)

Mr. Boykin dissented because he believed a directive calling for somewhat greater reserve restraint and marginally lower monetary growth would improve the prospects for curbing inflation and achieving sustainable expansion without incurring a material risk of unsettling financial markets.