FEDERAL RESERVE press release

For Use at 4:30 p.m. November 9, 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 October 2, 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 October 2, 1984

Domestic policy directive

The information reviewed at this meeting indicated that growth in real GNP had slowed appreciably in the third quarter from the annual rate of about 8-1/2 percent recorded in the first half of the year. The slowing was most marked in final sales, which seemed to grow little during the quarter, while the rate of inventory accumulation appeared to have accelerated. Thus far in 1984, the rise in various measures of prices and wages appeared to be close to, or slightly below, the pace in 1983.

Industrial production edged up 0.2 percent in August, after climbing 0.9 percent in both June and July. Output of consumer durable goods fell markedly in August, largely reflecting fewer assemblies of automobiles and light trucks, and production of nondurable consumer goods also declined. In contrast, production of equipment for business and defense continued to advance briskly, and output of construction supplies edged up. With production gains moderating in August, capacity utilization in manufacturing was unchanged, after a sizable increase in July. At 82.8 percent, the utilization rate was slightly higher than the 1967-82 average and 14 percentage points above the postwar low registered in late 1982.

Gains in employment slowed in recent months. As measured by the establishment survey, nonfarm payroll employment (adjusted for strikes) rose a little over 200,000 per month in July and August, about two-thirds the average monthly increase during the first half of 1984. As measured by the survey of households, employment fell sharply in both July and August, partly reversing exceptionally large increases in the two preceding months. In August, the drop was about equal to the decline in the civilian labor force--a decline accounted for by youths under 25, apparently related to their leaving jobs and returning to school--and the civilian unemployment rate was unchanged at 7.5 percent.

Consumer spending, after rapid growth earlier, was notably weaker during the summer. The advance report on retail sales in August suggested a decline of about 3/4 percent; moreover, the decline in sales in July, originally reported to be about 1 percent, was revised substantially to 2 percent. Sales of new domestic automobiles, hindered by a shortage of popular models, dropped to an annual rate of 7.6 million units in August. However, a rebound to an 8.5 million unit pace was reported for the first 20 days of September, reflecting in part the early introduction of 1985 models by some major producers.

Housing starts fell appreciably in August to 1.5 million units. Starts of single-family units, declining for the fourth consecutive month, were more than 20 percent below their average in the second quarter. Multi-family starts, which had changed little on balance over the spring and early summer, fell to a level about 17 percent below their second-quarter pace. Newly issued building permits for both types of structures moved down for the second straight month.

Information on outlays and spending plans suggested that the expansion in business fixed investment in the third quarter had been slower than the exceptionally rapid pace over the preceding year. In August, orders placed at U.S. manufacturers for nondefense capital goods fell for the third consecutive month, and shipments edged off further after an appreciable decline in July; in contrast, purchases of equipment from abroad continued to climb. Backlogs of unfilled orders, which were still relatively large, continued good levels of corporate profits, and reported increases in business spending plans in the latest Department of Commerce survey suggested further growth in capital expenditures.

Incoming information on prices and wages generally indicated a continuation of recent favorable trends. The producer price index for finished goods edged down 0.1 percent in August; the index had risen 0.3 percent in July but had shown no change in the three preceding months. The consumer price index rose 0.5 percent in August after an increase of 0.3 percent in July. Thus far in 1984, producer and consumer prices had risen at annual rates of about 2-1/2 and 4-3/4 percent respectively, and the index of average hourly earnings had increased at an annual rate of about 2-3/4 percent.

The foreign exchange value of the dollar fluctuated widely in often volatile market conditions but rose sharply on balance over the intermeeting period. By September 20 the dollar had risen 7 percent to a new high; since then, it had declined somewhat to a level about 5 percent above its value at the time of the August FOMC meeting. In this environment, monetary authorities intervened, some on a substantial scale, in exchange markets. The U.S. foreign trade deficit increased to a record high rate in the July-August period, as a further surge in non-oil imports overwhelmed a moderate increase in exports.

At its meeting on August 21, 1984, the Committee had adopted a directive specifying no change in the degree of pressure on reserve positions in the period immediately ahead, but calling for a response to any significant deviation in the aggregates from expectations, viewed against the background of economic and financial developments. The members had anticipated that this approach to policy implementation would be consistent with growth of M1, M2, and M3 over the period from June to September at annual rates of around 5 percent or slightly less, 7-1/2 percent, and 9 percent respectively. The intermeeting range for the federal funds rate was left unchanged at 8 to 12 percent.

As the intermeeting period progressed, incoming information pointed to continuing substantial shortfalls in growth of the monetary aggregates relative to the Committee's expectations for the third quarter. Growth of M1 in August turned out to be quite small, and while there appeared to be a moderate acceleration in September, expansion over the three-month period from June to September was running well below the Committee's expectations Growth of M2 and M3 also appeared to have picked up in September after expanding at relatively sluggish rates over the previous two months, but growth in these broader aggregates over the summer was also lower than expected.

Expansion of total domestic nonfinancial debt was estimated to have been at an average annual rate of around 13-1/4 percent in July and August, keeping growth thus far in 1984 at a pace well above the Committee's monitoring range of 8 to 11 percent for the year. Expansion of private debt was estimated to have eased a bit from the rapid rates recorded earlier in the year, as the growth of mortgage and consumer borrowing slowed somewhat and merger financing abated. Expansion in business borrowing remained at a relatively rapid pace, however, and growth of federal debt surged.

Against the background of monetary growth that was weaker than anticipated, evidence of a slowing pace of economic advance, and a rapidly rising dollar in foreign exchange markets, open market operations were conducted, as the intermeeting period progressed, so as to lessen pressures on bank reserve positions. In the two complete reserve maintenance periods ending in September, adjustment plus seasonal borrowing averaged about $750 million, down from an average of about $1 billion over the previous intermeeting period. The easing in bank reserve positions was reflected in a decline in the federal funds rate from the area of 11-1/2 to 11-3/4 percent at the time of the August FOMC meeting to a range around 11 percent recently, though day-to-day trading levels fluctuated widely. In short-term markets, yields on Treasury securities fell about 1/4 percentage point over the intermeeting interval, and those on private instruments declined about 1/2 percentage point. Most long-term interest rates declined about 5 to 30 basis points, while yields on municipal bonds increased under heavy supply pressure. Most major banks reduced their "prime" lending rate from 13 to 12-3/4 percent.

The staff projections presented at this meeting suggested that real GNP would expand at a moderate pace over the remainder of the year and in 1985. The unemployment rate was projected to decline somewhat further over the period, and the rate of price increase was expected to pick up a little from its recent pace, as the economy continued to move toward fuller utilization of its productive resources.

The Committee's discussion of the economic situation and outlook focused on the implications of recent ~~indications of appreciably slower growth~~ in the context of an economic outlook that was already complicated by unusually large, sustained federal deficits, a strengthening dollar on exchange markets, and sensitive domestic and international financial markets. Many members commented that the economy appeared to be adjusting to a reduced, but potentially more sustainable, rate of expansion and that the moderation was likely in turn to be associated with relatively subdued rates of wage and price inflation. It was noted that many past expansions had been interrupted by a "pause" in the rate of economic growth. Although no one could say with certainty whether this most recent experience represented a "pause" and, if so, how long it would last, a number of members believed that a modest rebound was a likely prospect for the next quarter or two followed by some moderation in the rate of expansion later. Other members gave more weight to elements of slowing in the current economic situation, and they saw a greater likelihood of sluggish growth in the period ahead.

While acknowledging a greater potential for adverse developments, a number of members stressed various factors that seemed conducive to continued satisfactory expansion in economic activity. Among these were the direct economic stimulus provided by fiscal policy; a high level of consumer confidence sustained by continued growth in disposable incomes and relatively strong financial positions; and a favorable climate for business investment fostered by generally good profit levels, substantial tax incentives, and reduced margins of unused capacity. Other members, who were somewhat more concerned about the prospects for economic activity, placed more emphasis on the retarding influences of lower housing expenditures, the competition of imports, and the vulnerability of some depository institutions, businesses, and farmers to financial strains. Reference was also made to the related possibility that consumers might tend to curtail their spending if uncertainties about economic and financial conditions should intensify. In that event growth in business spending might also be scaled back, with inventories especially likely to become a less expansive factor.

Several members referred to the progress that had been made in containing inflation, although some threats to future progress remained, and a few members commented that inflation was still the main economic problem for the longer run. In this connection, concern was expressed that too strong a resurgence in spending, though not viewed as a likely development, would intensify inflationary pressures and would set in motion forces which could threaten the sustainability of the expansion itself. Moreover, as the foreign exchange value of the dollar rose, the possibility increased that a subsequent decline in the exchange rate could be precipitous when it occurred, which would exert significant upward pressures on domestic prices. Prior experience suggested that those pressures would emerge after some lag, but one member commented that the lag might well be shorter than usual as many domestic producers attempted to restore profit margins that were held down by foreign competition. On the favorable side, it was noted that apparently diminished inflationary expectations, relatively restrained wage settlements, and a business climate favoring improvements in productivity had enhanced the prospects for containing inflation.

At its meeting in July, the Committee had reviewed and reaffirmed the basic policy objectives that it had established in January for growth of the monetary and credit aggregates in 1984 and had set tentative objectives for growth in 1985. For the period from the fourth quarter of 1983 to the fourth quarter of 1984, the policy objectives included growth of 4 to 8 percent for M1 and 6 to 9 percent for both M2 and M3. Through September, M1 apparently grew at a rate close to the midpoint of the range for the year, M2 at a rate somewhat below the midpoint of its range, and M3 at a rate near the upper limit of its range. For 1985 the Committee had established tentative ranges that included reductions from the upper limits of the 1984 ranges for M1 and M2 of 1 and 1/2 percentage point, respectively, and no change in the range for M3. For both years the associated range for growth in total domestic nonfinancial debt was set at 8 to 11 percent.

In the Committee's discussion of policy implementation for the weeks immediately ahead, most of the members favored directing open market operations, at least initially, toward maintaining the lesser degree of reserve restraint that had been sought in recent weeks. Such an approach to policy was expected to be associated with expansion in the monetary aggregates from September to December at rates that were somewhat above those experienced over the third quarter, especially in the case of M1. It was noted in this connection that the degree of reserve restraint had been eased appreciably in recent weeks and that any further easing should be contingent upon clear evidence of further weakness in the monetary aggregates and the economy. A number of members expressed particular concern that under current conditions appreciably lesser restraint might well induce a sharp decline in market interest rates, excessive money growth, and an unsustainably strong rebound in economic activity. These members noted the risk that such a decline in interest rates might have to be strongly reversed later with damaging conseqences for the financial system and the economy. Some members, however, favored a prompt further lessening of reserve restraint. They deemed such an approach to operations to be desirable for a number of reasons, including the recent behavior of the monetary aggregates, the progressive slowdown in the economic expansion since the first quarter, the relatively favorable outlook for inflation, and the strength of the dollar in foreign exchange markets.

In the course of discussing how operations should respond to incoming information, most of the members agreed that the Committee should be prepared to respond a little more promptly in an easing than in a tightening direction, should monetary developments deviate significantly from expectations. In this view policy implementation, given recent shortfalls in money growth, should be relatively tolerant, up to a point, of any tendency for expansion in the monetary aggregates to strengthen more than expected, especially if such growth were not accompanied by clear indications of a strengthening of inflationary pressures or economic activity and if the dollar remained under strong upward pressure in the foreign exchange markets. Others, while not disagreeing that there might be a need to reduce restraint over the coming intermeeting period, emphasized that policy implementation should also be alert to potential developments that might call for greater restraint and that any move in either direction should be carried out in a cautious and probing manner.

At the conclusion of the Committee's discussion, a majority of the members indicated that they favored or could accept a directive that called for maintaining the lesser degree of restraint on reserve positions that had been attained over recent weeks. The members expected that such an approach to policy implementation would be consistent with growth of M1, M2, and M3 at annual rates of about 6, 7-1/2, and 9 percent respectively for the period from September to December. Somewhat lesser restraint would be acceptable if growth of the monetary aggregates should fall significantly short of expectations, with any adjustment in operations to be evaluated in the context of the strength of the business expansion and inflationary pressures, conditions in domestic and international financial markets, and the rate of credit growth. Conversely, greater restraint might be acceptable in the event of substantially more rapid growth in the monetary aggregates than was currently expected, provided such growth was associated with evidence that economic activity and inflationary pressures were strengthening significantly. It was agreed that the intermeeting range for the federal funds rate, which provides a mechanism for initiating consultation of the Committee, should be left unchanged at 8 to 12 percent.

At the conclusion of the meeting the following directive was issued to the Federal Reserve Bank of New York:

The information reviewed at this meeting suggests that the expansion in economic activity slowed appreciably in the third quarter from a strong pace earlier in the year. In August, industrial production rose only slightly and gains in nonfarm payroll employment moderated further; retail sales and housing starts declined for the second month in a row. The civilian unemployment rate was unchanged in August at 7.5 percent. Information on outlays and spending plans suggests slower expansion in business fixed investment, following exceptionally rapid growth in recent quarters. Since the beginning of the year, average prices and the index of average hourly earnings have risen more slowly than in 1983.

In August the monetary aggregates expanded at relatively slow rates, but data available for September suggested some strengthening. From the fourth quarter of 1983 through September, M1 apparently grew at a rate close to the midpoint of the Committee's range for 1984, M2 at a rate somewhat below the midpoint of its longer-run range, and M3 at a rate near the upper limit of its range. Growth in total domestic nonfinancial debt appears to be continuing at a pace above the Committee's monitoring range for the year, reflecting large government borrowing along with relatively strong private credit growth. Interest rates generally have fallen somewhat further since the August meeting of the Committee.

Over the past month, the foreign exchange value of the dollar against a trade-weighted average of major foreign currencies has fluctuated widely under often volatile market conditions, reaching a new high in the latter part of September; since then the dollar has declined somewhat. The merchandise trade deficit rose sharply to a record high rate in the July-August period.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation further, promote growth in output on a sustainable basis, and contribute to an improved pattern of international transactions. In furtherance of these objectives the Committee agreed at the July meeting to reaffirm the ranges for monetary growth that it had established in January: 4 to 8 percent for M1 and 6 to 9 percent for both M2 and M3 for the period from the fourth quarter of 1983 to the fourth quarter of 1984. The associated range for total domestic nonfinancial debt was also reaffirmed at 8 to 11 percent for the year 1984. It was anticipated that M3 and nonfinancial debt might increase at rates somewhat above the upper limits of their 1984 ranges, given developments in the first half of the year, but the Committee felt that higher target ranges would provide inappropriate benchmarks for evaluating longer-term trends in M3 and credit growth. For 1985 the Committee agreed on tentative ranges of monetary growth, measured from the fourth quarter of 1984 to the fourth quarter of 1985, of 4 to 7 percent for M1, 6 to 8-1/2 percent for M2, and 6 to 9 percent for M3. The associated range for nonfinancial debt was set at 8 to 11 percent.

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

In the implementation of policy in the short run, the Committee seeks to maintain the lesser degree of restraint on reserve positions sought in recent weeks. This action is expected to be consistent with growth in M1, M2, and M3 at annual rates of around 6, 7-1/2, and 9 percent, respectively, during the period from September to December. A somewhat further lessening of restraint on reserve positions would be acceptable in the event of significantly slower growth in the monetary aggregates, evaluated in relation to the strength of business expansion and inflationary pressures, domestic and international financial market conditions, and the rate of credit growth. Conversely, greater restraint might be acceptable in the event of substantially more rapid monetary growth and indications of significant strengthening of economic activity and inflationary pressures. The Chairman may call for Committee consultation if it appears to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before the next meeting is likely to be associated with a federal funds rate persistently outside a range of 8 to 12 percent.

Votes for this action: Messrs. Volcker, Solomon, Boehne, Boykin, Corrigan, Gramley, Mrs. Horn, Messrs. Partee, and Wallich. Votes against this action: Messrs. Martin, Rice, and Ms. Seger.

Messrs. Martin, Rice, and Ms. Seger dissented from this action because they preferred a directive calling for a somewhat lesser degree of reserve restraint and marginally faster monetary growth in the fourth quarter. In their view some additional easing of reserve positions would be appropriate given the reduction in monetary growth over the third quarter and indications of further slowing in the rate of economic expansion. Somewhat lesser restraint would not incur a significant risk of stimulating inflation and would also be desirable in light of current conditions in domestic and international financial markets. Mr. Martin in particular expressed concern about strains now being experienced by some financial institutions.