

BDARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM WASHINGTON. D.C. 2055

CONFIDENTIAL (FR) CLASS II - FOMC

TO: Federal Open Market Committee DATE: November 9, 1983 FROM: Normand Bernard

Enclosed are the greenbook and supplementary reports prepared at three Federal Reserve Banks.

Enclosures

I.1

FIRST DISTRICT - BOSTON

SPECIAL DISTRICT REPORT ACADEMIC PANEL

Professors Eckstein, Houthakker, Samuelson, and Solow were available for comment this month. All are reasonably optimistic about inflation next year because they believe that wage settlements will continue to be modest and productivity growth will be strong over the next few quarters. Solow, for example, said he would not be surprised to see productivity grow by 1.5 percent net of cyclical influences over the course of 1984. Samuelson is especially reassured by the recent leveling off of cyclically sensitive commodity prices. Of the four economists, he is least confident that management will continue to exact sizable wage concessions from labor next year.

Samuelson, Solow, and Eckstein are generally pleased with the Fed's recent performance. Because he believes that the fragility of the recovery is greatly exaggerated, Samuelson urged the Board "not to resist" if the monetary aggregates fall to the bottom of their target ranges. He would rather see the Board "err in the direction of tightness now and looseness later." By contrast, Solow urged the Board to prevent interest rates from "drifting visibly upward" over the next 3 to 6 months as long as the recovery continues to decelerate slowly and no extraordinary wage settlements raise the spector of a sharp jump in inflation. He hopes that the Board does not "get hung up" on targeting the aggregates. In his opinion, the nurturing of a strong and orderly recovery should be its paramount concern.

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Eckstein, although satisfied with the overall thrust of monetary policy, believes that interest rates are uncomfortably high and that it would be a mistake for the Board to raise them. He also criticized the Fed for creating "unnecessary volatility" in short-term rates by issuing ambiguous statements about its intentions. In his view, the Fed has led financial markets to believe that it has been easing credit conditions in recent weeks, when in fact it has not. While Houthakker agrees with Eckstein's criticism, Samuelson believes that the Fed should be vague in its public statements in order to preserve its options. In his opinion, the Fed should make special efforts to maintain its flexibility now, given uncertainty concerning just how strong the economy will be over the next 6 months. Authorized for public release by the FOMC Secretariat on 3/25/2022 November 1983

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SECOND DISTRICT--NEW YORK

This month we have comments from Henry Kaufman (Solomon Bros. Inc.), Leonard Santow (Griggs & Santow, Inc.), and Robert Stone (Irving Trust Co.):*

<u>Kaufman</u>: Prospects are exceedingly good for continued robust economic expansion over the near term. With strong final demand still in process, the magnitude of real economic growth in this quarter will hinge importantly on the extent to which inventories will be enlarged. In the financial markets, liquidity building is still in effect in such sectors as business corporations and commercial banks. In addition, the securitizing of the mortgage market is continuing to narrow the yield spreads between mortgages and other fixed-income markets. This, in turn, is supportive of a better than generally anticipated housing activity. Business corporations are not likely to return soon to the bond market as a source of funds in view of the improvement in corporate internal cash generation, the continued large volume of new share flotations and the likely willingness of corporations to accept a shorter maturity structure for their liabilities.

With prospects for continued good economic growth, somewhat stronger pressures on wages and prices in the year ahead, and the lack of progress in reducing the Federal budget deficit, it is likely that interest rates will continue to trend irregularly higher after intermittent brief rallies and occasional periods of brief stability.

*Their views of course are personal, not institutional.

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Santow: There is little reason for any change in policy from the October meeting as the fourth quarter real GNP should grow about 6 percent, the deflator should be about 4 percent and the position of domestic interest rates and the dollar seems quite stable. Two technical suggestions would be moving the base for the annual growth rates for M1, M2 and M3 to the same period, such as the second quarter of 1983, and from now on not publishing interim targets for M1.

Stone: The economy is performing well. Inflation remains quiet. The aggregates are not misbehaving. The international debt situation is as difficult as ever, but not necessarily worse. The Federal deficit and prospective wage negotiations loom as potential problems.

Current monetary policy reflects the Fed's judgment as to how these factors ought to be balanced. That judgment seems highly accurate and in present circumstances there is no reason to alter the balance.

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FOURTH DISTRICT - CLEVELAND

Economists who attended the Fourth District Roundtable meeting at this Bank on October 28 scaled down slightly their forecasts of output from their June forecasts, but continue to expect sustained but moderated growth at least through the end of 1984. The median of 23 forecasts now shows a 4.6% annual rate of increase in real GNP this quarter, and rates of 4.3%, 4.1%, 4.0%, and 3.8%, respectively, in next year's four quarters. The median forecast of real GNP is 5.9% for 1983 (IVQ-IVQ) and 4.1% for 1984.

The median forecast has the unemployment rate falling steadily to 9.1% this quarter and 8.3% in 1984:IVQ.

The group believes the inflation rate bottomed in the second quarter. They expect the Implicit Price Deflator to rise at a 4.7% annual rate this quarter and accelerate to a 5.7% rate by 1984:IVQ. From 1983:IVQ to 1984:IVQ, the deflator is expected to increase 5.4%, compared with an expected 4.3% increase over the four quarters ending in 1983:IVQ. The consumer price index is expected to rise at a 4.8% annual rate this quarter and accelerate to a 5.8% rate in 1984:IIIQ before easing to a 5.3% rate in 1984:IVQ.

The group expects interest rates to show little change through the end of next year. The median forecast has the prime rate sliding from a 10.9% quarterly average this quarter to 10.7% in 1984:IIIQ before rising to 11.0% in 1984:IVQ. The rate for Moody's seasoned Aaa corporate bonds is forecast to slide from 12.2% this quarter to 11.8% in 1984:IIQ and then move to 12.0% in 1984:IIIQ and 1984:IVQ.

The group assumed a smaller budget deficit and slower growth of the money stock in 1984 compared to 1983. The median assumptions were for a

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federal deficit between \$171 billion and \$180 billion in FY 1984 and M-1 growth above 9% in 1983 and between 6% and 8% in 1984.

A few members expressed concern over the recent slow growth of M-1 and total reserves. A bank economist asserted that the lack of growth of reserves since last June suggests that the Fed is not operating on a reserve target, but on an interest rate target. His preference is for a 5% (a.r.) growth in M-1 this quarter. Another economist also suggested that growth of reserves should be restored promptly in order to avoid risking a slowdown or outright recession by next spring.

The group discussed developments in several industries that are important in the Fourth District. A representative of a major tire producer reports the tire industry's capacity rose 5% this year, the first increase in eight years. His firm is currently negotiating with the union to expand to seven-day operations and expects to reach its capacity limit in 1984. However, the firm is planning no new tire production capacity, preferring to invest in other rubber product facilities.

Automobile production is expected to increase in 1984. The median forecast of seven firms that manufacture automobiles or automobile parts is for total new car sales to rise from 9.12 million units in 1983 to 10.20 million in 1984. Domestic production by U.S. manufacturers will rise from 6.84 million units in 1983 to 7.65 million in 1984. Imports of overseas models are forecast to rise from 2.35 million to 2.59 million units.

The average forecast of three major steel producers is for U.S. raw steel production to rise from 85 million tons this year to 102 million tons in 1984 as domestic steel consumption rises, and steel inventories rise in 1984 after falling in 1983. Output of 102 million tons would not come close to the industry's raw steel capacity. A major steel producer estimates the

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industry's raw steel capability to be 143.5 million tons, after adjustment for mills closed or closing in 1983. Subtracting facilities now in some danger of being closed after 1983 would leave 127.8 million tons of raw steel capability.