

# FEDERAL RESERVE press release



For Use at 4:10 p.m.

November 20, 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 October 5-6, 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 October 5-6, 1981

Domestic policy directive

The information reviewed at this meeting suggested that real GNP declined slightly further in the third quarter, following a decline at an annual rate of about 1-1/2 percent in the second quarter indicated by revised estimates of the Commerce Department. Average prices, as measured by the fixed-weight price index for gross domestic business product, were estimated to have continued rising at the somewhat lower rate that emerged in the second quarter.

In July and August the nominal value of total retail sales was essentially unchanged from the level in June. Substantial credit and price concessions offered during August and early September temporarily boosted unit sales of new domestic automobiles. Sales dropped off in the latter part of September, however, and for the month as a whole were down considerably from August. Growth in consumer spending on goods other than autos had remained sluggish in August; the nominal value of nonauto retail sales in August was only slightly above its March level.

The index of industrial production fell 0.4 percent in August. Most of the decline reflected a sharp reduction in output of consumer durable goods, particularly in the motor vehicle industry. Production of

business equipment and space and defense products continued to expand, while output of home goods, construction supplies, and materials fell. Incoming information for September, including reports of declines in output in steel, electricity, and coal, and data on hours and employment, suggested a further appreciable decline in industrial production. Capacity utilization in manufacturing declined 0.6 percentage point in August to 79.2 percent, its lowest level since October 1980 and 8 percentage points below its recent peak in early 1979.

Total nonagricultural employment changed little in August and September, according to the establishment data. In manufacturing, employment changes in the two months were small and offsetting, and the average factory workweek dropped 0.9 hours in September, although the decline was apparently overstated because the survey week included Labor Day. Over the August-September period, employment in service industries continued to expand, while employment by state and local governments declined appreciably. In contrast to the establishment data, the survey of households showed a substantial decline in employment in September, and the unemployment rate rose to 7.5 percent, about equal to its average in the first half of 1981.

The Department of Commerce survey of business spending plans taken in late July and August suggested that current-dollar expenditures for plant and equipment would be 8.8 percent greater in 1981 than in 1980, compared with the 8.4 percent indicated by the survey taken in late April and May. The latest survey implied little, if any, change in real expenditures for the year.

Private housing starts fell in August to an annual rate below 1 million units, down from the already depressed rate of just over a million

units in June and July. Starts of single-family homes, at an annual rate of less than 600,000 units in August, were down two-fifths from their level of a year earlier. Newly issued permits for residential construction also declined, and sales of new and existing homes dropped considerably. Outlays for residential construction had declined sharply in real terms over the spring and summer months, but expenditures for nonresidential construction had changed little on balance during that period.

The producer price index for finished goods rose 0.3 percent in August, compared with 0.4 percent in July. The rate of increase in the two months was moderately lower than the rate during the second quarter and sharply lower than that during the first quarter. The consumer price index rose considerably more in July and August than in the immediately preceding months. Much of the acceleration reflected a substantial rise in the homeownership component of the index; food prices rose considerably, but energy costs increased little. Over the first nine months of the year, the rise in the index of average hourly earnings was somewhat less rapid than it was during 1980.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had declined by nearly 10 percent through mid-September from its peak in early August and on balance had changed little after that. The depreciation through mid-September was associated with a decline in U.S. short-term interest rates and with market sentiment that the U.S. current account might move more sharply into deficit than had been thought earlier. In August the U.S. foreign trade deficit rose substantially from the low rate in July; for July and August combined, the rate was considerably

higher than that in the second quarter, as the value of nonpetroleum imports increased and the value of exports, agricultural and nonagricultural, declined markedly.

At its meeting on August 18, the Committee had decided to reaffirm the policy objectives for the third quarter that had been adopted at its meeting on July 6-7. Specifically, the Committee agreed that open market operations in the period until this meeting should be directed toward behavior of reserve aggregates associated with growth of M1-B from June to September at an annual rate of 7 percent after allowance for flows into NOW accounts (resulting in growth at an annual rate of about 2 percent from the average in the second quarter to the average in the third quarter), provided that growth of M2 remained around the upper end of, or moved within, its range for the year. If it appeared to the Manager for Domestic Operations that pursuit of the monetary objectives and related reserve paths during the period before this meeting was likely to be associated with a federal funds rate persistently outside a range of 15 to 21 percent, the Chairman might call for a Committee consultation.

Shortly after the meeting on August 18, data becoming available indicated some shortfall in growth of M1-B from the path consistent with the Committee's objective for growth over the three months from June to September; and later in the intermeeting period, the shortfall widened. However, growth of M2 remained relatively strong, especially after allowance for shifts from time accounts into retail repurchase agreements (not included in M2) in anticipation of the October 1 introduction of all savers certificates. Reflecting the shortfall in growth of M1-B, required reserves

and the demand for reserves contracted in relation to the supply being made available through open market operations. Consequently, borrowings from Federal Reserve Banks for purposes of adjusting reserve positions declined considerably from late August to late September. The federal funds rate fell from around 18-1/4 percent in mid-August to 15 percent in the statement week ending September 30. The funds rate moved back up to about 16-1/2 percent in the days just before this meeting, apparently reflecting cautious bank reserve management associated with the introduction of same-day settlement for most international transactions cleared through New York.

M1-B, adjusted for the estimated effects of shifts into NOW accounts, increased at an annual rate of about 1-3/4 percent over the period from June to September, while M2 grew at an annual rate of about 9 percent. In September the level of shift-adjusted M1-B was well below the lower end of the Committee's range for growth over the year from the fourth quarter of 1980 to the fourth quarter of 1981, while the level of M2 was at the upper end of its range for the year. Growth of M2 during the third quarter was reduced, perhaps by 1 or 2 percentage points at an annual rate, by the diversion of M2-type assets into retail repurchase agreements issued by depository institutions in anticipation of the scheduled introduction of all savers certificates on October 1.

Total credit outstanding at U.S. commercial banks grew at an annual rate of about 10-1/4 percent in August, following expansion at annual rates of about 5-3/4 percent in June and July. Growth in business loans picked up somewhat further from the brisk pace in June and July, while security loans contracted sharply. Bank holdings of Treasury securities declined in August,

but acquisitions of other securities increased appreciably. Net issues of commercial paper by nonfinancial corporations expanded at an exceptionally rapid pace, following moderate growth in July.

In frequently volatile markets, short-term interest rates declined on balance over the intermeeting period, while long-term rates rose further. At the time of this meeting, most short-term rates were down about 1 to 3 percentage points and long-term rates were up about 1/2 to 1 percentage point from their levels in mid-August. The rise in long-term rates apparently reflected concerns of market participants about the prospective size of federal deficits. During the intermeeting interval, the prime rate charged by commercial banks on short-term business loans was reduced by 1-1/2 percentage points to 19 percent. On September 21, in view of the decline in short-term market rates, the Board of Governors announced a reduction, from 4 to 3 percentage points, in the surcharge on frequent borrowings of large depository institutions at the discount window. In home mortgage markets, average rates on new commitments for fixed-rate level-payment conventional loans at sampled savings and loan associations rose to 18-1/4 percent from 17-1/4 percent at the time of the August meeting.

The staff projections presented at this meeting suggested that real GNP was likely to decline further in the current quarter and that activity would remain sluggish over the first part of 1982. The rise in the fixed-weight price index for gross domestic business product was projected to moderate somewhat further over the year ahead.

In the Committee's discussion of the economic situation and outlook, the consensus was that real GNP was drifting downward more or less as portrayed by the staff projections. The members generally agreed that the evidence currently available did not portend a sharp cumulative contraction in activity in coming months, but a few nevertheless commented on the risks of a more significant decline. A number of members observed that businesses, especially the smaller ones, were exposed to growing financial strains because of the sluggishness of their sales, the high level of interest rates, and a tendency among their customers to defer payments of bills.

With respect to prospects for prices, the members in general accepted the staff projection of a further moderation of the rise over the next few quarters. The view was expressed that in the current environment, both business and labor were being subjected to pressures to restrain or to reduce costs for the sake of maintaining sales and, in some cases, avoiding plant closings.

At its meeting on July 6-7, 1981, the Committee reaffirmed the monetary growth ranges for the period from the fourth quarter of 1980 to the fourth quarter of 1981 that it had set at its meeting in early February. These ranges were 3 to 5-1/2 percent for M1-A and 3-1/2 to 6 percent for M1-B, abstracting from the impact of NOW accounts on a nationwide basis; 6 to 9 percent for M2; and 6-1/2 to 9-1/2 percent for M3. The associated range for bank credit was 6 to 9 percent. The Committee recognized that a shortfall in M1-B growth in the first half of the year partly reflected

a shift in public preferences toward other highly liquid assets and that growth in the broader aggregates had been running somewhat above the upper end of the ranges. In light of its desire to maintain moderate growth in money over the balance of the year, the Committee expected that growth in M1-B for the year would be near the lower end of its range. At the same time, growth in the broader monetary aggregates might be at the higher end of their ranges. For the period from the fourth quarter of 1981 to the fourth quarter of 1982, the Committee tentatively agreed that growth of M1, M2, and M3 within ranges of 2-1/2 to 5-1/2 percent, 6 to 9 percent, and 6-1/2 to 9-1/2 percent respectively would be appropriate.

The Committee considered policy for the period immediately ahead against the background of a widening divergence between the behavior of M1-B and the more broadly defined monetary aggregates. M1-B (shift-adjusted) had expanded little from June to September, and its annual rate of growth from the average in the fourth quarter of 1981 to the estimated level in September was about 1 percent, compared with the Committee's range of 3-1/2 to 6 percent for growth over the year from the fourth quarter of 1980 to the fourth quarter of 1981. From June to September, meanwhile, M2 had continued to grow at a rate consistent with the upper end of its range of 6 to 9 percent for the year, and M3 had grown at a rate somewhat above its range.

In interpreting recent experience and contemplating policy for the period immediately ahead, the Committee continued to face uncertainties with respect to the behavior of the monetary aggregates. Among these was an apparent decline in the public's desire to hold transaction balances in the

forms included in M1-B. Given income and interest rates, the increase in M1-B so far this year had been considerably smaller than would have been predicted from historical relationships embodied in conventional money demand equations. It also seemed clear, however, that the slow growth in M1-B recently had resulted in part from the weakening in economic activity. With respect to M2, the uncertainties included the impact of the liberalization of interest rate ceilings on small saver certificates, the growth of money market mutual funds, and the introduction of the all savers (tax-exempt) certificate on October 1, 1981. Reflecting various structural changes, assets that bear either a market interest rate or are subject to variable ceilings closely related to market rates had become a much larger share of the nontransaction component of M2 than they were just a year or two ago.

Committee members agreed on the desirability of continuing to seek more rapid growth in M1-B over the remaining three months of 1981, while taking account of the relative strength of the broader aggregates. The observation was made that a pickup in growth of M1-B now would reduce the risks of a cumulative contraction in activity, which could well be followed by an excessively rapid recovery and expansion.

At the same time, many members expressed the view that very rapid growth of M1-B over the few remaining months of the year would contribute to instability and would interfere with achievement of longer-term economic goals. Specifically, such growth most likely would dissipate the gains already made in moderating inflation, exacerbate inflationary expectations,

and induce a rebound in interest rates after no more than a temporary decline. Moreover, rapid growth in M1-B would significantly increase the risk that the broader monetary aggregates would exceed their ranges for growth over the year by sizable margins, which was a source of concern in light of the uncertainties about the interpretation of the various monetary aggregates in the current circumstances.

In weighing the risks of inadequate monetary growth versus excessive growth over the last three months of 1981, Committee members took account of the need to reduce the chances of large destabilizing swings in both monetary growth and interest rates, while at the same time achieving the targets for money growth tentatively established for 1982. Agreement was reached to seek behavior of reserve aggregates associated with growth of M1-B from September to December at an annual rate of 7 percent, after allowance for the impact of flows into NOW accounts, and growth of M2 at an annual rate of 10 percent or slightly higher; in specifying the rate for M2, the Committee recognized that the behavior of that aggregate would be affected by the recent regulatory and legislative changes, particularly the public's response to the availability of the all savers certificate. In developing related reserve paths, approximately equal weight would be given to the movements of M1-B and M2. It was understood that if these objectives were realized, growth of M1-B from the fourth quarter of 1980 to the fourth quarter of 1981 would remain below the Committee's range for the year, while growth of M2 would equal or slightly exceed the upper end of its range. The intermeeting range for the federal funds rate that provided a mechanism for initiating further consultation of the Committee was set at 12 to 17 percent.

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 declined slightly further in the third quarter and that prices on the average continued to rise at the somewhat lower rate that emerged in the second quarter. In July and August the nominal value of total retail sales was essentially unchanged from the June level, and unit sales of domestic automobiles weakened in September. Industrial production declined slightly in August and apparently slackened further in September, while nonfarm payroll employment changed little in both months. The unemployment rate rose to 7.5 percent in September, about equal to its average in the first half of 1981. Housing starts fell in August to the lowest rate in several years. Over the first nine months of the year, the rise in the index of average hourly earnings was somewhat less rapid than during 1980.

The weighted average value of the dollar against major foreign currencies declined sharply through mid-September from its peak in early August and on balance has changed little since then. In August the U.S. foreign trade deficit widened substantially from the low rate in July; for July and August combined, the deficit was considerably larger than the second-quarter rate.

M1-B, adjusted for the estimated effects of shifts into NOW accounts, increased little over the period from June to September, while M2 grew at a relatively strong pace. The level of adjusted M1-B in September was well below the lower end of the Committee's range for growth over the year from the fourth quarter of 1980 to the fourth quarter of 1981; the level of M2 was at the upper end of its range for the year. In frequently volatile markets, short-term interest rates have declined on balance since mid-August while long-term rates have risen considerably further. On September 21 the Board of Governors announced a reduction in the surcharge from 4 to 3 percentage points on frequent borrowings of large depository institutions.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation, promote sustained economic growth, and contribute to a sustainable pattern of international transactions. At its meeting in early July, the Committee agreed that these objectives would be furthered by reaffirming the monetary growth ranges for the period from the fourth

quarter of 1980 to the fourth quarter of 1981 that it had set at the February meeting. These ranges included growth of 3-1/2 to 6 percent for M1-B, abstracting from the impact of flows into NOW accounts on a nationwide basis, and growth of 6 to 9 percent and 6-1/2 to 9-1/2 percent for M2 and M3, respectively. The Committee recognized that the shortfall in M1-B growth in the first half of the year partly reflected a shift in public preferences toward other highly liquid assets and that growth in the broader aggregates had been running at about or somewhat above the upper ends of their ranges. In light of its desire to maintain moderate growth in money over the balance of the year, the Committee expected that growth in M1-B for the year would be near the lower end of its range. At the same time, growth in the broader aggregates might be high in their ranges. The associated range for bank credit was 6 to 9 percent. The Committee also tentatively agreed that for the period from the fourth quarter of 1981 to the fourth quarter of 1982 growth of M1, M2, and M3 within ranges of 2-1/2 to 5-1/2 percent, 6 to 9 percent, and 6-1/2 to 9-1/2 percent would be appropriate. These ranges will be reconsidered as warranted to take account of developing experience with public preferences for NOW and similar accounts as well as changing economic and financial conditions.

In the short run the Committee seeks behavior of reserve aggregates consistent with growth of M1-B from September to December at an annual rate of 7 percent after allowance for the impact of flows into NOW accounts and with growth in M2 at an annual rate around 10 percent or slightly higher, recognizing that the behavior of M2 will be affected by recent regulatory and legislative changes, particularly the public's response to the availability of the all savers certificate. 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 12 to 17 percent.

Votes for this action: Messrs. Volcker,  
Solomon, Boehne, Boykin, Corrigan, Gramley,  
Keehn, Partee, Rice, Schultz, and Mrs. Teeters.  
Vote against this action: Mr. Wallich.

Mr. Wallich dissented from this action because he favored specification of somewhat lower rates for growth in the monetary aggregates over the last three months of 1981 than those adopted at this

meeting and was willing to accept a greater shortfall in growth of M1-B from the Committee's range for growth over the year. In his opinion, much of the shortfall was attributable to a decline in the public's desire to hold transaction balances of the types included in M1-B and to the growth of other asset forms, especially money market mutual funds, that to some extent serve as transaction balances. He was also concerned that the public might perceive fairly rapid monetary growth over the balance of the year as a relaxation of the System's policy of restraint, especially if such growth were to be accompanied by sizable decreases in interest rates.