

FEDERAL RESERVE press release



For Use at 4:10 p.m.

July 2, 1982

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 18, 1982.

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 18, 1982

The information reviewed at this meeting suggested that real GNP would change little in the current quarter after declining at annual rates of about 4 percent in the first quarter, according to preliminary estimates of the Commerce Department, and 4-1/2 percent in the fourth quarter of 1981. In the current quarter, business inventory liquidation appeared to be moderating from the first quarter's extraordinary rate. The rise in average prices, as measured by the fixed-weight price index for gross domestic business product, appeared to be slowing somewhat further from the annual rate of about 5-1/2 percent in the first quarter indicated by the preliminary estimates.

The nominal value of retail sales increased appreciably in April, according to the advance report, following little change on average over the first quarter. The advance report indicated especially strong sales gains in the automotive group, at stores selling building materials and related items, and at furniture and appliance stores. Unit sales of new domestic automobiles were at an annual rate of 5.5 million units compared with a rate of nearly 6 million in March and in the first quarter as a whole; unit sales picked up appreciably in early May, buoyed by new purchase-incentive programs.

The index of industrial production fell 0.6 percent in April, following a decline of 0.8 percent in March. In both months output of business equipment, construction supplies, and durable goods materials declined substantially, while production of consumer durable goods rose

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markedly. In April, industrial output was 8-1/2 percent below its pre-recession peak in July 1981.

Nonfarm payroll employment declined in March and April, reflecting continued sizable job losses in manufacturing and construction and smaller losses in other major sectors. The unemployment rate rose an additional 0.4 percentage point in April to 9.4 percent.

Private housing starts edged up in March for the fifth consecutive month, but at an annual rate still below 1 million units, they remained depressed. Sales of new homes declined further, while sales of existing homes picked up slightly.

The producer price index for finished goods changed little in March and April. Prices of energy-related items declined substantially in March and fell even more sharply in April. Prices of other nonfood consumer goods and of capital equipment rose in both months, and prices of foods and food materials rose sharply in April following little change in March. The consumer price index declined 0.3 percent in March, largely because of substantial reductions in costs of gasoline and homeownership, but declines in food prices also had a moderating influence. Thus far in 1982, both the producer price index for finished goods and the consumer price index have risen at annual rates of 1 percent or less on balance, and the advance in the index of average hourly earnings has remained at a reduced pace.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies rose somewhat further in early April but then fell about 3-1/4 percent over the following month, reflecting

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in part a decline in U.S. interest rates relative to foreign rates and market expectations of further declines. The U.S. foreign trade deficit was about one-third less in the first quarter than in the preceding quarter, as imports fell more sharply than exports.

At its meeting on March 29-30, the Committee had decided that open market operations in the period until this meeting should be directed toward behavior of reserve aggregates consistent with growth of M1 and M2 from March to June at annual rates of about 3 percent and 8 percent respectively. It was understood that most, if not all, of the expansion in M1 over the period might well occur in April, and within limits, an April bulge in M1 alone should not be strongly resisted. In any event, it was agreed that deviations from those targets should be evaluated in light of the probability that over the period M2 would be less affected than M1 by deposit shifts related to the mid-April tax date and by changes in the relative importance of NOW accounts as a savings vehicle. Some shortfall in growth of M1, consistent with progress toward the upper part of the range for the year as a whole, would be acceptable in the context of appreciably reduced pressures in the money market and the relative strength of other aggregates. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 12 to 16 percent.

Growth of M1 accelerated to an annual rate of 11-3/4 percent in April from 2-1/2 percent in March. But the expansion was concentrated in the first half of the month and was largely retraced by month-end. As in

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other recent months, checkable deposits other than demand deposits (OCDs) posted a sizable increase. Growth of M2 moderated to an annual rate of about 9-1/2 percent in April from 11-1/4 percent in March, reflecting a slackening in the expansion of its nontransaction component.

Total credit outstanding at U.S. commercial banks grew at an annual rate of 7-3/4 percent in April, about the same as in March. Banks added substantially to their holdings of Treasury securities, but expansion in their total loans, including business loans, moderated somewhat further. Business borrowing from other sources also moderated, as issuance of commercial paper by nonfinancial businesses slowed substantially and offerings of corporate securities declined.

Nonborrowed reserves, adjusted to include special borrowing and other extended credit from Federal Reserve Banks, changed little in April. Virtually all of the increase in total reserves associated with the expansion of M1 was provided through the discount window. Borrowing from Federal Reserve Banks for purposes of adjusting reserve positions (including seasonal borrowing) rose to an average of \$1.5 billion in the two statement weeks ending April 28 from a weekly average of about \$1.2 billion in March and the first half of April. Such borrowing subsequently fell back to an average of about \$1.1 billion in the two weeks ending May 12.

The federal funds rate, which had been about 15 percent at the time of the March meeting, generally fluctuated in a narrow range of about 14-3/4 to 15-1/2 percent during the subsequent intermeeting period. Most other short-term interest rates fell 1/2 to 1 percentage point on balance over the intermeeting interval, and long-term yields registered

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similar declines. The prime rate charged by commercial banks on short-term business loans remained at the 16-1/2 percent rate that has prevailed since early February. Average rates on new commitments for fixed-rate mortgage loans at savings and loan associations declined slightly, to about 16-3/4 percent.

During the meeting the Committee was apprised of developments in the market for U.S. government securities stemming from the failure of a securities firm to make sizable interest payments that were due on borrowed Treasury obligations. System officials were monitoring the situation closely and it was understood that they would continue to do so.

Staff projections at this meeting suggested that real GNP would expand moderately over the balance of 1982. Inflation, as measured by the fixed-weight price index for gross domestic business product, was projected to remain moderate while the unemployment rate was expected to remain near its April level.

Views of Committee members concerning prospects for economic activity and the behavior of prices generally differed little from the staff projections. However, several members commented that the risks of a deviation from the projections were on the downside; they noted reports of gloomy sentiment prevailing among businessmen and consumers and of financial strains being experienced by many business firms, financial institutions, farmers, and consumers. Reduced economic activity and high interest rates were adversely affecting profits and eroding financial positions; the impact on key sectors of the economy such as capital investment, housing, and spending on consumer durables could impede the recovery.

A few members gave more emphasis to elements of strength in the near-term outlook which, they believed, reduced the risks of prolonged recession and enhanced the prospects for a near-term recovery in economic activity. The favorable factors included the large tax cut at midyear and the concurrent increase in social security payments. In addition, liquidation of business inventories, which had been of unusual proportions in recent months, was likely to be reduced or reversed, thereby contributing to economic recovery. It was also suggested that spending in interest-sensitive sectors of the economy was likely to revive, perhaps more quickly than many anticipated, if inflation remained relatively moderate and interest rates declined.

It was emphasized during the discussion that a key element in the economic outlook would be developments affecting the federal budget and the size of future deficits. Significant progress in reducing prospective deficits would serve to improve business and consumer confidence and help to achieve and maintain the lower interest rates necessary to support a sustained economic recovery.

It was noted during the discussion that considerable progress had been made in the fight against inflation. Although the major price indexes overstated the extent of the recent improvement, the underlying rate of inflation was down substantially and cost pressures in general appeared to be continuing to ease. Inflationary expectations also appeared to have moderated somewhat further, but they remained sensitive to developments in the fiscal and monetary policy areas.

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At its meeting on February 1-2, 1982, the Committee had adopted the following ranges for growth of the monetary aggregates over the period from the fourth quarter of 1981 to the fourth quarter of 1982: M1, 2-1/2 to 5-1/2 percent; M2, 6 to 9 percent; and M3, 6-1/2 to 9-1/2 percent. The associated range for bank credit was 6 to 9 percent.

At this meeting the Committee reviewed the short-run objectives for monetary growth that it had established in late March calling for expansion at annual rates of about 3 percent for M1 and about 8 percent for M2 over the three months from March to June. The Committee took note of a staff analysis suggesting that, despite the bulge in April as a whole, growth of M1 was generally consistent with the objective for the three-month period, reflecting weakness in late April and early May. Thus the level of M1, although still above a path consistent with the Committee's range for growth from the fourth quarter of 1981 to the fourth quarter of 1982, had moved down toward that path somewhat more rapidly than had been anticipated earlier. Growth of M2 also appeared to be consistent with the Committee's objective for the March-to-June period, and the level of that aggregate remained close to the upper end of its range for 1982.

As at the previous meeting, staff analysis suggested that the demand for money, as defined by M1, might moderate significantly in the current quarter. In the first quarter, growth of M1 had been considerably greater on average than would have been expected on the basis of the actual behavior of nominal GNP and interest rates; as a result, the income velocity of M1 had shown an unusually large decline. The great bulk

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of the growth in M1 in the first quarter, and indeed in the period since October 1981, had occurred in its NOW account component. A variety of evidence suggested an increased preference on the part of individuals to accumulate highly liquid balances in an environment of considerable uncertainty about prospects for economic activity and interest rates. It was thought that in the course of the current quarter the strong savings or precautionary demands for liquid balances were likely to begin to moderate, and perhaps to unwind, if economic prospects appeared to be improving as projected and if uncertainties about financial conditions were reduced. While considerable uncertainties remained, the behavior of NOW accounts in late April and early May was consistent with that expectation.

The staff analysis also suggested that continued pursuit of the second-quarter objectives for monetary growth set at the preceding meeting and the related provision of reserves through open market operations would be consistent with at least modest easing in bank reserve positions. Such easing in turn could be reflected in some decline in short-term interest rates. Rates appeared high, considering the recession in activity, the slower rise in prices and, more technically, the degree of pressure on bank reserve positions.

During the Committee's review of its second-quarter objectives, almost all the members agreed that growth rates consistent with those adopted at the previous meeting remained appropriate under current economic and financial conditions. Some sentiment was expressed for moderately faster monetary growth in the current quarter with the objective of improving

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liquidity and easing financial pressures, but no member favored substantially faster monetary expansion. Pursuit of the latter policy course, it was suggested, would probably exacerbate inflationary expectations, especially in light of the outlook for large deficits in the federal budget, and thereby exert upward pressure on interest rates.

Given the uncertainties relating to the public's demand for liquid balances, notably NOW accounts, most members continued to believe that the behavior of M1 should be evaluated partly in light of the behavior of M2 over the weeks ahead. Thus, for example, somewhat more rapid growth of M1 might be accepted if it appeared to be associated with a continuing desire by the public to build up liquid balances and with growth of M2 near its specified rate.

At the conclusion of the discussion the Committee agreed to reaffirm the objectives for monetary growth established at the previous meeting and to seek behavior of reserve aggregates associated with growth of M1 and M2 from March to June at annual rates of about 3 percent and 8 percent respectively. The Committee noted that deviations from these objectives should be evaluated in light of changes in the relative importance of NOW accounts as a savings vehicle. The intermeeting range for the federal funds rate, which provides a mechanism for initiating further consultation of the Committee, was set at 10 to 15 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 will change little in the current quarter after the appreciable further decline in the first quarter, as business inventory liquidation moderates from last quarter's extraordinary rate. In April the nominal value of retail sales expanded, while industrial production and nonfarm payroll employment continued to decline. The unemployment rate rose 0.4 percentage point to 9.4 percent. Although housing starts edged up in March for the fifth consecutive month, they remained at a depressed level. The rate of increase in prices on the average appears to be slowing somewhat further in the current quarter; so far this year both the consumer price index and the producer price index for finished goods have risen little on balance, and the advance in the index of average hourly earnings has remained at a reduced pace.

The weighted average value of the dollar against major foreign currencies, after rising somewhat further in early April, has fallen sharply over the past month, reflecting in part a decline in U.S. interest rates relative to foreign rates and market expectations of further declines. The U.S. foreign trade deficit in the first quarter was one-third less than in the preceding quarter.

M1 increased sharply in April, but the expansion was concentrated in the first half of the month and was largely retraced later. Growth of M2 moderated somewhat, owing to a slackening of the expansion in the nontransaction component. Short-term market interest rates and bond yields on balance have declined since the end of March, and mortgage interest rates have edged down further.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation, promote a resumption of growth in output on a sustainable basis, and contribute to a sustainable pattern of international transactions. At its meeting in early February, the Committee agreed that its objectives would be furthered by growth of M1, M2, and M3 from the fourth quarter of 1981 to the fourth quarter of 1982 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. The associated range for bank credit was 6 to 9 percent.

In the short run, the Committee seeks behavior of reserve aggregates consistent with growth of M1 and M2 from March to June at annual rates of about 3 percent and 8 percent respectively. The Committee also noted that deviations from these targets should be evaluated in light of changes in the relative importance of NOW accounts as a savings vehicle. 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 10 to 15 percent.

Votes for this action: Messrs. Volcker, Black, Balles, Ford, Gramley, Mrs. Horn, Messrs. Martin, Partee, Rice, Wallich and Timlen. Vote against this action: Mrs. Teeters. (Mr. Timlen voted as alternate for Mr. Solomon.)

Mrs. Teeters dissented from this action because she favored specification of somewhat higher rates of monetary growth from March to June with the objective of improving liquidity and easing financial pressures. In her opinion, the time had come to foster lower and less variable interest rates in order to enhance prospects for significant recovery in output and employment.