FEDERAL RESERVE press release

For Use at 4:10 p.m. February 6, 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 December 18-19, 1980. This record also includes policy actions taken during the period between the meeting on December 18-19, 1980, and the next regularly scheduled meeting held on February 2-3, 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 December 18-19, 1980

1. Domestic policy directive

The information reviewed at this meeting suggested that real GNP expanded more in the fourth quarter than in the third. Average prices as measured by the fixed-weight price index for gross domestic business product were continuing to rise at a rapid pace, close to the average annual rate of about 10-1/2 percent recorded in the first three quarters of the year.

The dollar value of retail sales rose substantially further in November, according to the advance report, after a large increase over the five preceding months. Sales of new automobiles were at an annual rate of 9.1 million units in November, marginally above the October rate. A brisk selling pace of foreign cars sustained total unit sales as sales of domestic autos edged down.

The index of industrial production rose an estimated 1.4 percent in November, following substantial gains in each of the three preceding months. Capacity utilization in manufacturing increased about 1 percentage point further in November to 78.8 percent, 3.9 percentage points above its July trough but well below earlier peaks.

Nonfarm payroll employment expanded substantially in November for the fourth consecutive month, and the unemployment rate was essentially unchanged at 7-1/2 percent. Employment gains were widespread, and the average workweek in manufacturing lengthened slightly.

In November private housing starts remained at the annual rate of about 1-1/2 million units recorded in September and October. Sales of new homes edged off slightly further in October, and sales of existing houses declined for the first time since May.

Producer prices of finished goods rose appreciably in October and November, but the rate of increase over the two months was considerably below the exceptional pace in the third quarter. In October consumer prices continued to rise rapidly; average prices of energy items fell, but mortgage interest rates rose sharply after having declined over the preceding three months. The rise in the index of average hourly earnings of private nonfarm production workers accelerated sharply in October and November; over the first eleven months of the year the index rose at an annual rate of about 9-1/2 percent, compared with an increase of about 8-1/4 percent during 1979.

In foreign exchange markets the trade-weighted value of the dollar against major foreign currencies had risen about 2-1/2 percent over the interval since the Committee's meeting in mid-November. The U.S. foreign trade deficit in October was essentially unchanged from the August-September level, which was well below the rate in the first half of the year. The volume and value of oil imports were up somewhat in October from the sharply reduced levels of the third quarter, while the value of non-oil imports was little changed. Total exports in October also were close to the third-quarter level.

At its meeting on November 18, the Committee had decided that open market operations in the period until this meeting should be directed toward expansion of reserve aggregates consistent with growth of M-1A, M-1B, and M-2 over the period from September to December at annual rates of about 2-1/2 percent, 5 percent, and 7-3/4 percent respectively, or somewhat less, provided that in the period before the next regular meeting the weekly average federal funds rate remained within a range of 13 to 17 percent. Shortly after the November 18 meeting, incoming data indicated that the monetary aggregates were growing considerably faster than the rates consistent with the Committee's objectives for the September-to-December period. Required reserves and member bank demands for reserves expanded substantially in relation to the constrained supply of reserves being made available through open market operations. These developments were associated with additional upward pressures on the federal funds rate and other short-term interest rates; in the first statement week after the meeting, the funds rate was at about or somewhat above the upper limit of the range of 13 to 17 percent specified by the Committee, compared with an average of 14-1/2 percent in mid-November. In a telephone conference on November 26, the Committee raised the upper limit of the intermeeting range for the funds rate to 18 percent.

On December 4 the Board of Governors announced an increase from 12 to 13 percent in basic discount rates at Federal Reserve Banks and an increase from 2 to 3 percentage points in the surcharge on frequent borrowings of large institutions, effective December 5. This action exerted additional upward pressure on the federal funds rate; in trading during the morning of December 5, the rate generally was well above 18 percent. At the same time, incoming data suggested that M-1A and M-1B currently might be growing a little less rapidly than projected a week earlier, which would imply some reduction in member bank demands for reserves in relation to the supply being made available through open market operations.

In light of uncertainties about the duration and extent of upward pressure on the federal funds rate while markets were adjusting to the discount rate action, the Committee decided in the afternoon of December 5 to provide the Manager for Domestic Operations leeway to pursue the short-run objectives for the reserve aggregates without operations being precisely constrained in the current statement week by the 18 percent upper limit of the intermeeting range for the federal funds rate. On December 12 the Committee decided to extend this leeway for operations through the period before the meeting. In the statement weeks of December 10 and 17 the funds rate averaged 18.8 percent and 19.8 percent. Member bank borrowings receded to an average of about $1.6 billion in the two statement weeks ending December 17 from an average of about $2.2 billion in the preceding two statement weeks.

Growth in M-1A and M-1B moderated further in November to annual rates of about 7 percent and 9-1/4 percent respectively, but these growth rates were still well above those consistent with the Committee's objectives for the period from September to December. In early December growth in both measures of money slowed substantially further. Expansion in M-2 and M-3 continued to accelerate in November, reflecting a surge in both small- and large-denomination time deposits. From the fourth quarter of

1979 through November, growth of M-1A was in the upper part of the range set by the Committee for the year ending in the fourth quarter of 1980; M-1B and M-2 grew at rates somewhat above the upper limits of their ranges, while M-3 grew at a rate slightly above the upper limit of its range.

Total credit outstanding at U.S. commercial banks continued to expand in November at about the rapid pace of the previous three months. Growth in business loans remained especially vigorous, but expansion in other bank loans was also sizable and banks added further to their holdings of securities. Outstanding commercial paper of nonfinancial corporations continued to fall in November, extending the decline that had begun in August.

Pressures on bank reserve positions and strong business demands for credit, along with large Treasury financings, were associated with sharp further increases in short-term interest rates over the intermeeting period. Rate increases were especially pronounced for bank CDs and commercial paper, which rose 3 to 6 percentage points, while Treasury bill rates advanced 1 to 3 percentage points. Most long-term bond yields moved up about 1/2 to 1 percentage point over the interval. The prime rate charged by commercial banks on short-term business loans was raised from 16-1/4 percent to a new high of 21 percent. In home mortgage markets, average rates on new commitments for fixed-rate loans rose more than 1/2 percentage point further, and new commitment activity was reported to be quite limited at prevailing rates.

The staff projections presented at this meeting suggested that the accelerated growth of real GNP in the current quarter was likely to be followed by some decline in the first part of 1981 and by sluggish recovery later in the year. Accordingly, the unemployment rate was expected to increase during 1981. The rise in the fixed-weight price index for gross domestic business product was projected to remain rapid, although not quite so rapid in the second half of the year as in the first half.

In the Committee's discussion of the economic situation and its implications for policy, the members noted the clear possibility of a decline in activity in the early part of the new year and of a sluggish performance over 1981 as a whole, although some members expressed the view that underlying expansive forces were strong. It was observed that the statistical indicators of prospective activity had not been signaling a near-term contraction, but that the greater-than-anticipated expansion in GNP in the current quarter had itself contributed to developments, including the sharp rise in interest rates, that were likely to produce some decline in the early part of 1981. Later in the year, assuming monetary expansion to be consistent with the Committee's longer-run objectives, the recovery was likely to be limited unless progress was made in reducing inflation. The need to deal with the deep-seated problem of inflation was emphasized, as was the difficulty of doing so without accepting risks of unsatisfactory economic performance in the short run. It was generally recognized that the course of economic activity remained difficult to forecast because of the unpredictability of behavior based on inflationary expectations and because of uncertainties about the fiscal and other economic policies of the new administration to be inaugurated on January 20.

At its meeting in July 1980, the Committee had reaffirmed the following ranges for monetary growth from the fourth quarter of 1979 to the fourth quarter of 1980 that it had established in February: M-1A, 3-1/2 to 6 percent; M-1B, 4 to 6-1/2 percent; M-2, 6 to 9 percent; and M-3, 6-1/2 to 9-1/2 percent. The associated range for the rate of growth in commercial bank credit was 6 to 9 percent. For the period from the fourth quarter of 1980 to the fourth quarter of 1981, the Committee had looked toward a reduction in the ranges for growth of M-1A, M-1B, and M-2 on the order of 1/2 percentage point from the ranges adopted for 1980, abstracting from institutional influences affecting the behavior of the aggregates. During the course of 1980, an inconsistency had become apparent between the longer-run ranges for M-1A and M-1B as a result of faster-than-expected growth of ATS and NOW accounts, which had been at the expense partly of demand deposits and partly of savings deposits and other instruments not included in the narrowly defined aggregates. In that light, the specified range for growth of M-1B in 1980 should have been somewhat higher than that actually adopted, while the range for M-1A should have been somewhat lower, consistent with the intended economic result.

At this meeting the Committee began a review of the ranges for 1981 in the expectation that at the meeting scheduled for early February it would complete the review and establish ranges for the year within the framework of the Full Employment and Balanced Growth Act of 1978 (the Humphrey-Hawkins Act). The Committee once again faced unusual uncertainties concerning the forces affecting monetary growth, in part because of some sizable variations evident in the demand for both narrowly and broadly defined money in relation to nominal GNP during 1980. For the year ahead, moreover, the institutional changes expected to result from the Monetary Control Act of 1980 would need to be evaluated and interpreted. Relationships among the monetary aggregates will be affected by the introduction of NOW accounts on a nationwide basis as of December 31, 1980, as authorized by the act. A staff analysis suggested that during 1981 shifts of funds from demand deposits into NOW accounts would be substantial and would significantly retard the growth of M-1A. At the same time, transfers from savings deposits and other interest-bearing assets into NOW accounts would enhance the growth of M-1B. However, estimates of such shifts varied within wide ranges. Shifts of funds into NOW accounts were not expected to affect growth of M-2 significantly because virtually all of the funds likely to be shifted into such accounts are included in M-2.

In the Committee's discussion of policy for the near term, the members considered rates of monetary growth over the first three months of 1981 against the background of the tentative ranges specified earlier for growth over the year as a whole, pending the completion of the review of those ranges scheduled for the meeting in early February. The midpoints of the tentative ranges for 1981, abstracting from the effects of the introduction of NOW accounts on a nationwide basis, were 4-1/4 percent for M-1A, 4-3/4 percent for M-1B, and 7 percent for M-2. It was considered likely that the substantial weakening of the demand for cash balances evident in recent weeks would persist for a time, in response to the sharp increase in interest rates over the past few months and to the slackening of economic activity projected for the months ahead; but growth of M-2 was expected to be greater in relation to growth of the narrrowly defined aggregates than suggested by the tentative ranges for 1981.

Most of the members favored specification of monetary growth rates for the first quarter that were consistent with the tentative ranges for growth over the full year ahead. In view of the excessively rapid monetary growth in recent months, they were willing to accept a shortfall from those rates for a time, provided that the shortfall developed concurrently with some abatement of pressures in the money market. However, one member favored specification of higher rates of monetary growth for the first quarter, and another member favored specification of lower rates.

A number of members continued to express concern about the economic and financial effects of the high degree of variability of interest rates in 1980. In the light of the current prospects for economic activity and for the demand for money, these members wished to set a policy course for the near term that would tend both to avoid additional pressures in the money market and to moderate the expected easing of pressures. While the Committee's general practice had been to relax the constraint implied by the intermeeting range for the federal funds rate when the constraint became binding, some members felt that a somewhat narrower range than specified for most recent intermeeting periods might be appropriate to provide an opportunity for review of the situation if market interest rates changed by a sizable amount. It was also suggested that the Committee hold a consultation before the next scheduled meeting if it appeared that the rate might decline quickly toward the lower end of the range. One member expressed the opinion that setting 18 percent as the upper end of the range, which would lead to a prompt easing in money market conditions consistent with a decline in the funds rate to or below that level, would contribute over time to a reduction in the volatility of both interest rates and monetary growth.

At the conclusion of the discussion, the Committee decided to seek behavior of reserve aggregates associated with growth of M-1A, M-1B, and M-2 over the first quarter along a path consistent with the ranges for growth in 1981 contemplated in July 1980, abstracting from the effects of deposit shifts connected with the introduction of NOW accounts on a nationwide basis. The members recognized that the spread of NOW accounts and ATS accounts nationally was likely to widen the differential between growth of M-1A and of M-1B to an unpredictable extent and that operational paths for reserves would have to be adjusted in the light of the developing differential. Some shortfall in growth would be acceptable in the near term if that developed in the context of reduced pressures in the money market. If it appeared during the period before the next regular meeting that fluctuations in the federal funds rate, taken over a period of time, within a range of 15 to 20 percent were likely to be inconsistent with the monetary and related reserve paths, the Manager for Domestic Operations was promptly to notify the Chairman, who would then decide whether the situation called for supplementary instructions from the Committee.

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 expanded more in the fourth quarter than in the third, and prices on the average continued to rise rapidly. In November retail sales, industrial production, and nonfarm payroll employment expanded substantially further, and the unemployment rate was essentially unchanged at 7-1/2 percent. Housing starts remained at their September-October level. The rise in the index of average hourly earnings has been somewhat more rapid this year than in 1979.

The weighted average value of the dollar in exchange markets has risen considerably further over the past month. The U.S. trade deficit was unchanged in October, remaining well below the rate in the first half.

Growth in M-1A and M-1B continued to moderate in November but was still relatively rapid; growth in M-2 continued to accelerate, reflecting a further pickup in expansion of its nontransaction component. In early December, growth of M-1A and M-1B slowed substantially further. From the fourth quarter of 1979 to November, growth of M-1A was in the upper part of the range set by the Committee for growth over the year ending in the fourth quarter of 1980; M-1B and M-2 grew at rates somewhat above the upper limits of their respective ranges. Expansion in commercial bank credit was about as rapid in November as on the average in the preceding three months. Short-term market interest rates have risen sharply further in recent weeks. Long-term market yields have also risen, although considerably less, and average rates on new home mortgage commitments have continued upward. On December 4 the Board of Governors announced an increase in Federal Reserve discount rates from 12 to 13 percent and an increase in the surcharge from 2 to 3 percentage points on frequent borrowing of large institutions.

The Federal Open Market Committee seeks to foster monetary and financial conditions that will help to reduce inflation, encourage economic recovery, and contribute to a sustainable pattern of international transactions. At its meeting in July, the Committee agreed that these objectives would be furthered by growth of M-1A, M-1B, M-2, and M-3 from the fourth quarter of 1979 to the fourth quarter of 1980 within ranges of 3-1/2 to 6 percent, 4 to 6-1/2 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. For the period from the fourth quarter of 1980 to the fourth quarter of 1981, the Committee looked toward a reduction in the ranges for growth of M-1A, M-1B, and M-2 on the order of 1/2 percentage point from the ranges adopted for 1980, abstracting from institutional influences affecting the behavior of the aggregates.

In the short-run the Committee seeks behavior of reserve aggregates associated with growth of M-1A, M-1B, and M-2 over the first quarter along a path consistent with the ranges for growth in 1981 contemplated earlier, which will be reviewed in February 1981. Those ranges, abstracting from the effects of deposit shifts connected with the introduction of NOW accounts on a nationwide basis, imply growth in these aggregates centered on 4-1/4 percent, 4-3/4 percent, and 7 percent respectively. It is recognized that the introduction of NOW and ATS accounts nationwide at the beginning of 1981 is likely to widen the discrepancy between growth in M-1A and M-1B to an extent that cannot now be accurately estimated, and operational reserve paths will be developed in the light of evaluation of those differences as they emerge. In the light of the rapid growth of monetary and credit aggregates in recent months, some shortfall in growth would be acceptable in the near term if that developed in the context of reduced pressures in the money market. If it appears during the period before the next meeting that fluctuations in the federal funds rate, taken over a period of time, within a range of 15 to 20 percent are likely to be inconsistent with the monetary and related reserve paths, the Manager for Domestic Operation is promptly to notify the Chairman, who will then decide whether the situation calls for supplementary instructions from the Committee.

Votes for this action: Messrs: Volcker, Gramley, Guffey, Morris, Partee, Rice, Roos, Schultz, Solomon, and Winn. Votes against this action: Mrs. Teeters and Mr. Wallich.

Mrs. Teeters dissented from this action because she believed that the objectives for monetary growth were unduly restrictive in terms of their eventual effects on output and employment without improving prospects for significantly tempering the rate of inflation. Pending completion of the Committee's review of its ranges for growth in 1981, she preferred specification of moderately higher rates for monetary growth over the first quarter.

Mr. Wallich dissented from this action because, given the excessive monetary expansion in recent months, he favored specification of lower monetary growth rates for the first quarter of 1981 than those adopted at this meeting along with a higher intermeeting range for the federal funds rate. In his view, such a policy stance was appropriate both to restrain monetary growth if economic activity remained strong and to moderate the probable decline in interest rates if economic activity weakened.

2. Authorization for domestic open market operations

On January 23, 1981, the Committee voted to increase from \$3 billion to \$4 billion the limit on changes between Committee meetings in System Account holdings of U.S. government and federal agency securities specified in paragraph 1(a) of the authorization for domestic open market operations, effective immediately, for the period ending with the close of business on February 3, 1981.

> Votes for this action: Messrs. Volcker, Gramley, Guffey, Morris, Partee, Rice, Roos, Schultz, Solomon, Mrs. Teeters, Messrs. Wallich, and Winn.

This action was taken on recommendation of the Manager for Domestic Operations. The Manager had advised that since the December meeting, substantial net sales of securities had been undertaken to absorb reserves in association with a seasonal reduction in currency and deposits. The leeway for further sales had been reduced to about \$1 billion, and additional sales in excess of that amount might be required over the rest of the intermeeting interval.